HD **Moody's: Aurizon's half-yearly results are credit positive; Ratings unaffected**

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Strong coal haulage performance and cost reductions create buffer for downside risk

Moody's Investors Service said today that Aurizon Holding Limited's ("Aurizon") results for the half-year ended 31 December 2013 (H1FY14) are credit positive. However, as the results are broadly within expectations, Aurizon's Baa1 rating and stable outlook is unaffected.

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"Aurizon's credit metrics have benefited during 1HFY14 from increased operating margins - which reflects the group's inroads into executing business transformation initiatives - as well as growth in coal haulage marginally exceeding our base case expectations", says Arnon Musiker, a Moody's Vice President and Senior Credit Officer. "The increase in operating cash flows is important in creating headroom for Aurizon to absorb possible declines in coal haulage revenue resulting from coal market weakness, such as failure of a coal counterparty under our downside scenario, as well as short-tem disruptions from industrial action."

Aurizon's coal haulage guidance for FY14 has increased to 207 - 212 million tonnes per annum (mtpa), compared with Moody's expectation (and previous company guidance) of around 200mtpa.

"Whilst Aurizon is transitioning mining counterparties to new form coal haulage contracts, the likelihood of our downside scenario, being failure of a mining counterparty, increases in tandem with weakness in the coal market", adds Musiker.

Moody's believes that the near-term outlook for global coal demand will continue to be negatively affected by slowing growth in China and other developing economies as well as the potential for production disruption due to labor disputes and adverse weather.

Aurizon's business transformation initiatives includes improving asset efficiency and utilization, the company's organizational structure and employee productivity. Moody's believes however that labour-related issues could result in short term operational disruptions. This is because Aurizon and the unions have not resolved certain key issues in current enterprise agreement renegotiations, and NSW-based unions have resultantly commenced a protected industrial action process.

Moody's expects Aurizon's EBITDA margins to be above 30% over the next 12 to 24 months and financial leverage - as measured by debt to EBITDA - in the low 2x region, notwithstanding increases in drawn debt to fund capex. This leverage is within the tolerance set for the Baa1 rating.

"While Aurizon is also subject to downside risk on its forthcoming regulatory reset on its coal network - which currently contributes around 46 % of consolidated EBITDA - the rating already factors in a decline in returns of up to 300bps", adds Musiker. "We therefore consider the regulatory risk to be manageable within the Baa1 rating".

Aurizon Network is also subject to execution risk on a capital expansion programme, which Moody's regards as manageable at the rating in view of the programme remaining within time and budget.

Aurizon has a solid liquidity profile, with primary sources include a cash balance of AUD91 million and over AUD1 billion of undrawn committed banking facilities at 1HFY14, with no maturities until FY16. Moody's believes that these liquidity sources are more than adequate to fund expected capital expenditure over the next 12 months, although the presence of an MAC clause and covenants results in the facilities being a weaker source of liquidity than cash.

Over the medium term, the group faces material refinancing of around AUD1.5 **billion** in FY16 - however in view of the appetite shown by various funding markets for Australian infrastructure, Moody's believes that this risk is manageable.

That said, the rating is based on Aurizon continuing to arrange debt refinancing well in advance of maturity.

The principal methodology used in this rating was Global Surface Transportation and Logistics Companies published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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