



Mr Greg Ruthven  
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Dear Greg

#### **WACC Components of the MRCP**

The Independent Market Operator (IMO) has engaged PricewaterhouseCoopers to provide estimates of the following WACC parameters:

- nominal risk free rate of return;
- expected inflation;
- real risk free rate of return;
- debt risk premium;
- corporate tax rate.

Estimates are to be provided at two dates, the first of which is at the end of September 2011.

This letter provides values of the WACC parameters at 30 September 2011. Values have been estimated applying the methods set out in our report to the IMO “Maximum reserve Capacity Price – WACC methodology” dated 28 February 2011. In particular:

- the nominal risk free rate is estimated as the average over the 20 trading days to 30 September of the interpolated yield on Commonwealth Government Securities with 10 years to maturity;
- the expected inflation rate is estimated as the geometric mean of inflation forecasts published by the Reserve Bank of Australia, or a value of 2.5 per cent per annum where no forecast is published;
- the real risk free rate of return is calculated from the nominal risk free rate of return and inflation rate applying the Fisher equation;

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- the debt risk premium is calculated by extrapolation from the Bloomberg fair value yield curve for 7 year BBB rated corporate bonds; and
- the corporate tax rate is taken as the current statutory rate of corporate income tax.

The estimates of WACC parameter thus derived are:

Nominal risk free rate	4.25%
Inflation rate	2.67%
Real risk free rate	1.53%
Debt risk premium	4.26%
Corporate tax rate	30%

A spreadsheet is attached showing the calculation of these estimates.

If you wish to discuss any of the detail of derivation of these estimates, please give me a call.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R Challen', with a large, stylized initial 'R'.

Ray Challen  
Principal  
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