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## Traffic Trouble for RiverCity

Australia's newest tollroad opened on 16 March. The Clem Jones Tunnel, named after Brisbane's longest serving Lord Mayor, looks like it's going to be another infrastructure disaster for investors.

The tunnel, owned by ASX-listed RiverCity Motorway (ASX code RCY), runs 6.8km north to south and bypasses some of Brisbane's most congested traffic areas. There's no doubt it's going to be a useful piece of infrastructure. But it's not going to go anywhere near justifying the \$1 per security initial investors stumped up to get the tunnel built.

The tunnel is toll-free for the first three weeks. In the opening six days, an average of 67,000 vehicles used the tunnel. That's not bad for a city of Brisbane's size. But it's not enough to pay the interest on RiverCity's \$1.336bn\* of debt. Based on my rough calculations, they're going to need an average of 80,000 paying vehicles per day to meet the interest bill, and more to deliver a return to securityholders.

Of course, it's only early days and traffic numbers typically grow between 40% and 60% in the first 18-24 months (known as the ramp-up period). Drivers take time to change their habits and get used to the idea of handing over \$4 per day. But if only 67,000 vehicles are using the tunnel when it's free, they're not going to get anywhere near the prospectus forecasts once they start charging full tolls.

Toll free periods are a relatively new initiative but we do have a couple of recent case studies. Melbourne's Eastlink (owned by ConnectEast) and Sydney's M7 (50% owned by Transurban) were both, like the Clem Jones Tunnel, finished early, enabling the owners to offer a toll free period without upsetting the banks. In both cases, traffic halved once tolling resumed. The M7 opened in December 2005 and an average of 156,439 vehicles used it during the first six toll-free days. In the first week of tolling, traffic dropped to an average of 79,033 per day, a decline of 49%. Even four years later, the average daily traffic was less than it was during the toll free period (an average of 128,669 vehicles per day used the road in the December 2009 quarter). EastLink's average daily traffic was 270,868 vehicles in July 2008, the toll-free month after it was opened. As soon as tolls were charged, however, traffic numbers fell 50% to 135,555. Today, more than 18 months later, an average of 176,497 vehicles use the road per day, still some 35% below the toll-free traffic numbers.

As an aside, while I indicated above that the 'ramp-up' period can result in an increase of between 40% and 60% in traffic, it is interesting to note that Eastlink's ramp-up has only been 30% in the first 18 months. This seems to be a direct result of offering a toll-free period – people become aware of the road and accustomed to using it earlier than they would have without a toll-free period. It's a great initiative, but it doesn't auger well for RiverCity.

Let's assume the same trends play out (I'm astonished at how similar the drop off was on the M7 and EastLink). The 67,000 vehicles that used the road in the toll-free period will drop to

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33,500 once tolls are charged (the road will be toll free until 5 April, and then a 30% discount will apply for the next five weeks). Then we'll optimistically assume that this number grows 50% over the next 18 months, meaning that in November 2011, an average of 50,250 vehicles will be using the road daily. Using the initial weighted average toll of \$4.43 (ex GST), annualised revenue would be \$81.2m. Subtract the operating expenses of \$31m (the assumption used in the prospectus) and the owners will be left with about \$50m of cash with which to service the interest on \$1.366bn of debt. Assuming an average interest rate of 7.1% (70% of the debt is hedged at an interest rate of approximately 7.5%, the unhedged portion would currently be a bit cheaper), the interest bill alone will be more than \$90m, \$40m more than the operating cashflow.

I'll keep a close eye on the traffic numbers and update these figures as the numbers come out. But the chances of securityholders ending up with another cent out of RiverCity are slim. In fact, the banks look like they're in for a haircut.

*\*The original post stated \$1.366bn, \$1.336bn is the correct number. Change the blue assumptions below to see the impact on RiverCity's cashflow*