

Mixed Ownership Model Descriptive Information

15 December 2011

Background

1. On 27 January 2011, the Government requested Treasury's advice on the merits and viability of extending the Mixed Ownership Model (MOM) to Genesis, Meridian, Mighty River Power, and Solid Energy, and further reducing the Crown's shareholding in Air New Zealand. Treasury subsequently advised that extending the Mixed Ownership Model has significant merit because of the potential to reinforce efficiency, fiscal, and capital market development policy goals, and to provide moderate economic gains.

2. Accordingly, the Government agreed to extend the MOM to Genesis, Meridian, Mighty River Power, and Solid Energy, and to further reduce the Crown's shareholding in Air New Zealand, over a 3-5 year programme beginning in 2012, subject to the Government receiving a mandate in the 2011 general election, market conditions and detailed scoping studies. [CAB Min (11) 18/6 refers]

3. The Government has indicated that there are five tests that need to be met for the MOM programme to proceed, namely:

- i. The Government would have to maintain a majority controlling shareholding by owning more than 51 per cent of the company.
- ii. New Zealand investors would have to be at the front of the queue for shareholdings, and we would have to be confident of widespread and substantial New Zealand share ownership.
- iii. The companies involved would have to present good opportunities for investors.
- iv. The capital freed up would have to be used on behalf of taxpayers to fund new public assets and thereby reduce the pressure on the Government to borrow.
- v. The Government would have to be satisfied that industry-specific regulations adequately protected New Zealand consumers.

4. A significant amount of preparatory work has now been completed. Comprehensive scoping study reports have been drafted for the four MOM SOEs and a sales programme report has been completed by the Crown Advisor (Deutsche Bank and Craigs Investment Partners). During the production of these reports, Treasury and the Crown Advisor have not identified any major impediments to meeting the five tests.

Outline of Proposed Sales Programme

5. The proposed sales programme has the following broad features:

- Initial Public Offerings (IPOs) would be held for Mighty River Power, Meridian, Genesis, and Solid Energy. The Crown's holding in Air New Zealand could be reduced via a share placement or a public offer.




- The Government would retain a minimum holding of 51% in all cases and no other shareholder would be allowed to own more than 10%. These requirements will be prescribed by legislation.
- The first IPO would be scheduled to take place in 2012. Transactions would typically be separated by six to twelve months to match likely domestic demand. Timing would, however, be subject to market conditions and particular company circumstances.
- The Government retains the ability to allocate shares in the IPOs primarily to New Zealand investors, to provide incentives to New Zealand investors if necessary, and to place ongoing restrictions on foreign investment. These decisions are recommended to be taken as part of designing individual IPOs.

Company Information

6. Of the four unlisted MOM Companies, three (Genesis, Meridian and Mighty River Power) are electricity companies with large retail customer bases and substantial generation portfolios. Solid Energy is New Zealand's largest coal mining company with interests in renewable energy and non-traditional coal commercialisation.

7. Key operational and financial metrics for the electricity companies are summarised in the table below.

MOM Gentailers – key metrics

		 genesis ENERGY	 meridian	 MIGHTY RIVER POWER
Generation ^(b)	Generation capacity (MW)	2,142	2,623	1,602
	Generation capacity market share (%)	22%	27%	16%
	Renewables (%) ^(c)	32%	100%	90%
	Generation output (GWh)	6,526	13,652 ^(a)	6,833
	Generation market share (%)	16%	33%	16%
Retail ^(b)	Electricity customers	549,300	272,776	392,000
	Customer market share (%)	27%	14%	21%
	Customer demand (GWh) ^(d)	5,705	7,870	4,776
	Customer demand market share (%)	15%	20%	12%
Financial ^(b) (\$m)	Revenue	1,834	2,053	1,164
	EBITDAF	293	660	443
	Underlying earnings	63	219	162

(a) As reported, includes Tekapo A&B power stations sold to Genesis on 1 June 2011. Combined output of 1,015GWh.

(b) For the 2011 financial year

(c) Renewables as a percentage of total capacity


(d) 7.5% line losses assumed

Source: Scoping Studies, MED, Electricity Authority, Annual Reports

8. Solid Energy is New Zealand's largest coal mining company with additional businesses focussing on renewables (biodiesel and biomass/wood pellets) and new developments (lignite conversion to fertiliser/diesel/briquettes, coal seam gas and underground coal gasification). The Stockton opencast mine on the West Coast of the South Island is the largest mining operation in New Zealand and produces predominantly metallurgical coal for export markets. Solid Energy mines thermal coal in the North Island supplying domestic customers, primarily Genesis and New Zealand Steel.

9. Key operational and financial metrics for Solid Energy are summarised in the table below for the 2011 financial year:

Solid Energy – key metrics



Production	Coking	c.2.2 Mtpa		Sales (\$m)	Export	60%
	Thermal	c.1.8 Mtpa			Domestic	40%
Reserves and resources (Mt)	Coking	Resources	174	Financials (\$m)	Revenue	829
		Reserves	26		EBIT	137
	Thermal	Resources	341		NPAT	87
		Reserves	15			
	Lignite	Resources	1,520			
		Reserves	10			

Note: Financial year 2011
Source: Public information

10. The Government has decided that Mighty River Power Limited will be the first MOM company for an IPO. Mighty River Power is a leading renewable energy company with a diverse portfolio of generation assets throughout the North Island. It owns nine power stations along the Waikato River, geothermal plants within the Taupo and Bay of Plenty regions, and the Southdown gas-fired station. The company's geothermal portfolio and geothermal expertise provide it with a point of difference and are a main source of the company's domestic and offshore growth opportunities. Further information on Mighty River Power can be obtained at www.mightyriverpower.co.nz.

Sales Proceeds

11. Sales proceeds will depend on market conditions, company performance, sales costs and fees, and any retail or domestic incentives that the government may choose to provide. The scoping studies and the sales programme report have included company valuations and estimated sales proceeds based on an indicative sequencing of IPOs over the course of the programme. Advisers are confident that the Government's goal of \$5b to \$7b in sales proceeds will be met.

Demand

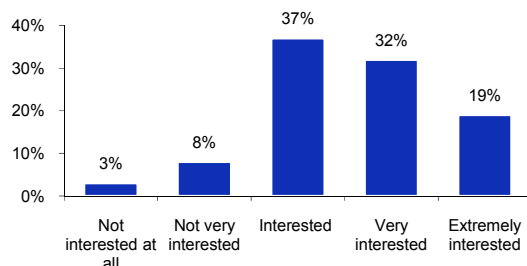
12. Scoping studies have estimated likely levels of demand for each of the offerings and the Crown Advisor has estimated likely demand for the programme as a whole. Advisors are confident that there will be sufficient demand to meet the Government's fiscal objective and to ensure widespread New Zealand ownership.

13. These estimates are supported by other data that has been gathered around domestic investors' current savings allocations and investors' intentions towards the MOM programme. Reserve Bank data indicates that retail investors have a significant amount invested in cash deposits both in absolute terms and relative to the amount invested in equities. As at December 2010, equities were on average 22% of a household's holdings in cash balances, compared to the average since 1990 of 34%.

14. The Crown Advisor has undertaken initial research to gauge the likely level of demand from New Zealand retail investors with respect to the MOM programme. The survey indicated that experienced retail investors are very positive about the investment opportunity presented by the MOM programme.

15. The survey was undertaken in May 2011 and involved Deutsche Bank and CIP's New Zealand retail client base. The survey returned 4,951 respondents with 60% of the respondents outside the main centres of Auckland, Wellington and Christchurch. Nearly 90% of the respondents are interested in investing in one of the assets when they come to market, with over 50% claiming to be either very or extremely interested. Only 3% claimed to have no interest in investing at all.

How interested would you be in investing in one (or more) of the Government's SOEs if the Mixed Ownership Model does eventuate and there is partial listing(s) on the NZX?



Maori Consultation

16. The Government intends to consult with Maori on the Mixed Ownership Model policy prior to the introduction of legislation. Consultation on the policy will be led by a minister, and will take place in February 2012. A series of meetings will be held with iwi across the country.

Legislative Implications

17. Legislation will be required to implement the MOM programme. The Government's general intent is that the companies should operate under legal and governance arrangements as similar as possible to other listed entities. Features of the legislation are likely to include:

- Removal of the SOE MOM companies from schedules 1 and 2 of the State Owned Enterprises Act.
- A requirement on the Government to maintain a minimum shareholding of 51%.
- A maximum permitted shareholding for all non-Crown individual equity holders of 10%.
- Various technical or consequential amendments.

Next Steps

18. Treasury will be undertaking competitive tender processes to appoint the required sales advisors and logistics and communications providers to implement the MOM programme. The Government anticipates being able to announce planned transactions and the detailed nature of these transactions towards the end of the first quarter of 2012.