

# **The Treasury**

## **Mighty River Power Share Buyback Information Release**

**October 2013**

### **Release Document**

**[www.comu.govt.nz/publications/information-releases/mixed-ownership-model](http://www.comu.govt.nz/publications/information-releases/mixed-ownership-model)**

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [2] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information, or who is the subject of the information
- [3] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [4] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [5] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [6] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [7] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied
- [8] 9(2)(h) - to maintain professional legal privilege
- [9] Not relevant

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [3] appearing where information has been withheld in a release document refers to section 9(2)(f)(iv).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

## **Treasury Report: Mighty River Power: Share Buyback**

|              |                 |                   |            |
|--------------|-----------------|-------------------|------------|
| <b>Date:</b> | 11 October 2013 | <b>Report No:</b> | T2013/2602 |
|--------------|-----------------|-------------------|------------|

### **Action Sought**

|  | <b>Action Sought</b>  | <b>Deadline</b> |
|--|---|-----------------|
| Minister of Finance<br>(Hon Bill English)                | <b>Agree</b> that the Crown will not participate in the MRP share buyback | 15 October 2013 |
| Associate Minister of Finance<br>(Hon Steven Joyce)      | <b>Agree</b> that the Crown will not participate in the MRP share buyback | 15 October 2013 |
| Minister for State Owned Enterprises<br>(Hon Tony Ryall) | <b>Agree</b> that the Crown will not participate in the MRP share buyback | 15 October 2013 |

### **Contact for Telephone Discussion (if required)**

| <b>Name</b>     | <b>Position</b>                               | <b>Telephone</b> |     | <b>1st Contact</b> |
|-----------------|---|------------------|-----|--------------------|
| Juston Anderson | Senior Analyst, Commercial Transactions Group | 04 890 7211      | [1] | ✓                  |
| Chris White     | Director, Government Share Offers Programme   | 04 890 7256      | [1] |                    |

### **Actions for the Minister's Office Staff (if required)**

|                                       |
|---------------------------------------|
| Return the signed report to Treasury. |
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**Enclosure:** No

## **Treasury Report: Mighty River Power: Share Buyback**

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### **Executive summary**

On Thursday 10 October, before the sharemarket opened, Mighty River Power (MRP) announced that it is proceeding with an on-market buyback of up to 25 million of its shares, which is around 1.8% of its ordinary shares on issue. At the share price of \$2.20 before the buyback was announced, the buyback could be worth up to \$55 million, although MRP has also said it intends to spend up to \$50 million. The buyback will take place over the next year, ending on 14 October 2014.

A buyback of \$50 million is less than two weeks worth of trading in MRP shares on the NZX. In the five months since the IPO more than \$1.4 billion worth of MRP shares have been traded on the NZX and ASX.

[4]

[4], [5]

When Air NZ initiated its buyback, its share price was around \$0.93, which the Air NZ board believed was significantly below fair value. Some market analysts supported the board's view at the time, but not all of them. Air NZ's share price is now \$1.47 – a 58% increase –

[4], [5]

Our advice is that the Crown should not participate in the share buyback by MRP. [4],[5]

[4], [5]

The buyback is an on-market transaction, so the Crown is in the same position as all other MRP shareholders. It is free to participate or not, as it chooses, subject only to maintaining the minimum 51% ownership of MRP, and holding the loyalty bonus shares that must be transferred to retail investors. Current Crown ownership is 51.76%, but this includes the loyalty bonus shares – excluding these, the Crown holds around 51.07% of MRP. This means the Crown could sell a maximum of 954,994 shares to MRP as part of the buyback.

There is no requirement for the Crown to announce what it will do. However, Ministers will be asked whether the Crown is participating in the buyback. We recommend that you state the Crown is not participating, but without going any further, i.e. we recommend against commenting on the desirability or otherwise of MRP as an investment, or implicitly or explicitly advising other shareholders what they should do. We do not think a press release announcing the Crown's non-participation in the buyback is necessary.

You may wish to inform the Chair of MRP, Joan Withers, of the Crown's decision regarding participation in the buyback.

## Recommended Action

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We recommend that you **agree** that the Crown will not participate in the MRP share buyback.

*Agree/disagree*  
Minister of Finance

*Agree/disagree*  
Associate Minister of Finance

*Agree/disagree*  
Minister for State-Owned Enterprises

Chris White  
**Director, Government Share Offers Programme**

Hon Bill English  
**Minister of Finance**

Hon Steven Joyce  
**Associate Minister of Finance**

Hon Tony Ryall  
**Minister for State Owned Enterprises**

## Treasury Report: Mighty River Power: Share Buyback

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### MRP's motivation for the proposal

1. MRP announced the buyback by stating that "the Board's view is that a purchase of our shares, at this time and at current market prices, provides a return above the Company's cost of capital and will be value-enhancing for our shareholders. It is also preferable at this point in time to the other tools we have available to us such as a special dividend or a change in dividend policy."
2. Buybacks are often used as a capital management tool. If management of a company considers it has excess cash that cannot be reinvested to produce acceptable returns relative to buying back shares in the company, a buyback is an efficient way to distribute cash to shareholders who choose to participate.
3. Buybacks are often undertaken when management has a view that the share price is undervalued. A buyback theoretically extracts value from selling shareholders in favour of non-selling shareholders, given the (assumed) value adding nature of removing shares from the market using excess cash from the balance sheet.
4. MRP recently announced that it had reduced its forecast capital expenditure in 2013/14, due to it adopting a "patient" approach to overseas development. MRP also outperformed its PFI forecasts in 2012/13 in both operating and capital expenditure. This provides the excess \$50 million of cash that MRP plans to apply to the share buyback.
5. As previously advised (T2013/2275 refers) we see this "patient" approach to capital investment as positive, and a direct result of the sharper incentives placed on MRP by being a listed company.

### The current situation

6. Following the IPO the Crown directly owns 51.76% of the shares on issue in MRP. The various Crown Financial Institutions own shares in MRP in addition to the direct Crown holding. The direct Crown holding includes around 9.7 million loyalty bonus shares that the Crown must retain to transfer to retail investors in 13 months. Excluding these, the Crown owns around 51.07% of MRP. This means the Crown could sell a maximum of around 0.07% of the company (specifically, 954,994 shares) to MRP as part of the buyback.
7. As of close of trading on 9 October, MRP's share price was \$2.20, and based on this price the company had a market capitalisation of \$3,080 million. In morning trading on 10 October, following the buyback announcement, MRP's share price increased to \$2.26, but by early afternoon it had fallen back to \$2.22.

### Impact of the buyback on the Crown

8. If MRP undertakes a share buyback without Crown participation, MRP would pay out cash in return for shares held by the minority shareholders. As a result, from the point of view of the Crown accounts:
  - MRP's assets (and the Crown's assets) would reduce (less cash held by the company)
  - the minority interest in the company would reduce by the same amount (fewer MRP shares will be owned by minority shareholders)
  - the Crown would own a slightly larger percentage of a slightly smaller company, with the net impact of these two effects exactly cancelling out, and so

- there would be no impact on Crown net worth or any of the other fiscal indicators at the time of the transaction.
9. If MRP undertakes a share buyback with Crown participation, MRP would pay out cash in return for shares held by all shareholders, including the Crown. Assuming the Crown participates in the buyback on a pro-rata basis, from the point of view of the Crown accounts:
- MRP's assets would reduce (less cash held by the company) to the extent MRP pays cash to third parties, and this flows through to the Crown given that MRP is fully consolidated
  - the minority interest share of net assets in the company would also reduce, but by a smaller amount than the reduction in cash – reflecting the Crown participation
  - the Crown would own the same percentage of a slightly smaller company
  - the Crown would have received cash from MRP for the shares it sold; effectively the Crown would have converted some of the value of its shareholding in MRP into cash, and
  - as a result, there would be no impact on either Crown net worth or the operating balance and OBEGAL, but there would be a slight reduction in core Crown net debt (the cash proceeds from the sale).

#### **What will MRP do with the shares?**

10. MRP has announced that it will hold the shares repurchased as treasury stock. MRP's constitution allows it to hold its own shares.
11. MRP will be able to sell the treasury stock it holds to a third party at a later date. This would be no different to MRP issuing new shares, which it is free to do, providing that it does not dilute the Crown below 51%. Alternatively MRP could choose to cancel some or all of the shares.

#### **Our advice**

12. Our advice is that the Crown should not participate in a share buyback by MRP. This is consistent with the decision to not participate in Air New Zealand's share buyback.
13. [4],[5]
14. [4]