

Jeremy Harding

From: John Wilson
Sent: Thursday, 19 June 2003 17:24
To: ^MOF: Chris MacKenzie
Cc: Jeremy Harding; Len Starling; Ivan
Subject: Tranz Rail: The path forward.

Chris

We have just had a discussion with First NZ Capital about the path ahead on rail, and in particular on how to improve the chances of the Crown deal being accepted by shareholders. The following is a list of the things we believe that, taken together, will strengthen our case.

1 *Presentation to financial markets/institutional shareholders.* First NZ Capital and Treasury will present the Crown proposal to institutional shareholders/financial markets next week. We should do this separately from Tranz Rail/Macquarie presenting Tranz Rail's argument, both because we do not want to be associated with Tranz Rail management presenting the reasons for the latest profit downgrades and we want some freedom to talk about the Crown's objectives/plans for the company. In doing that we would want to say that one of the reasons for the Crown taking a 35% shareholding in the Operating Company is that we believe the company needs a cornerstone shareholder steering it in a new direction. We would want to say that the Crown intends to appoint practical experienced commercial people as its directors, and that we would expect those directors to be rigorous in restructuring the company. (our view is that strong potential candidates would be unlikely to accept directors' positions until such time as the future ownership of the company is clear.) It would also be very helpful if we can say that the Government wants to build a strong commercial link between Opco and an experienced rail operator; that we are open as to whether such an arrangement is a management contract or involves equity participation by the rail operator; and that if the rail operator takes equity we are open, provided we are comfortable about the long-term direction for Opco, to selling down our shareholding. **(Chris: Is MoF comfortable with that)**

2 *Message to Toll Holdings.* Paul Little was going to get back to us with some reactions to the HoA. Irrespective of whether he does, we should prepare a "For the avoidance of doubt" letter from the Michael Cullen which sets out that the concessional track access charge and government's commitment to spend \$100million to refurbish the network are both in the HOA and that the government has made that offer essentially on a "Take it or leave it" basis; that if the HoA is rejected by shareholders, government would conclude that shareholders see no need for such mechanisms, and no further discussion on government support for the track would be entered into.

3 *Capital Expenditure on the Track.* Tomorrow Tranz Rail will start to present to us on the track and on priorities for capital expenditure going forward. This information may provide a basis for a Ministerial statement along the lines that "Tranz Rail and the Govt have started discussion on track refurbishment in terms of the HoA. It's now clear that much more than \$100 million will be required. The govt will only commit to this in terms of the HoA"

4 *Inclusion of Access rights in asset base .* Tranz Rail have this morning suggested that rather than completely writing the track asset off in their accounts, they should leave \$61 million in the asset base to reflect the value of the access rights for their remaining term. They say KPMG are comfortable with that treatment. Under the model we've developed, increasing Tranz Rail's asset base increases the amount of profit that it should be allowed to earn, and thus reduces the access price that Trackco charges for the next 60+years. Tranz Rail say this increases the value of the company (post the Crown deal) from around \$1.20 a share to \$1.40. They argue that this would make the Crown deal clearly more attractive. Our view is that financial market doubt about the Crown deal is built as much around concerns about the consistent underperformance of Tranz Rail's Board and management, and their lack of credibility in making new promises, and doubts about whether the Crown is committed to wholesale commercial restructuring of Tranz Rail. (See 1 above) We are still weighing up the Tranz rail proposal on asset base , and will come back with a recc based on assessment of its cost and its likely contribution to a successful outcome.

4 *Rail America.* We are setting up another meeting on Monday with Rail America to explore what is and is not practicable. This should settle whether we have enough common ground to go ahead and draw up a HOA with Rail America. Likely questions will be round Rail America's financial capacity, and the extent to which Rail America's concerns can be met without giving away value.

5 *Ownership options.* Aside from outbidding Toll (or making a takeover bid for Toll itself!) (both of which fall foul of our no-bidding war ordinance) it would be possible for the Crown to signal its determination by buying say 10% of the company, in the expectation that the price would be above Toll's 95c offer.

John Wilson