

The Treasury

Project Korimako - Release of advice

December 2022

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- [33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment
- [36] 9(2)(h) - to maintain legal professional privilege
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

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Treasury Report: Approval of Major Transaction – New Zealand Post Limited

Date:	21 July 2022	Report No:	T2022/1433
		File Number:	SE-2-12-1

Action sought

	Action sought	Deadline
Acting Minister for State Owned Enterprises (Hon Dr Megan Woods)	Agree recommendations Sign attached special resolution	28 July 2022
Acting Minister of Finance (Hon Dr David Clark)	Agree recommendations Sign attached special resolution	28 July 2022

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Alice Courtney	Senior Analyst, Commercial Performance	[39]	N/A (mob)
Andrew McLoughlin	Principal Advisor, Commercial and Institutional Performance	N/A (wk)	[35] ✓

Minister's Office actions (if required)

<p>Return the signed report and signed shareholder resolution to the Treasury.</p> <p>Note Ministers may sign separate copies of the shareholder resolution.</p>
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Note any feedback on the quality of the report

Enclosure: Yes (attached)
[Project Korimako NZP Special Resolution \(major transaction\) \(4676097v1\)](#)

Treasury Report: Approval of Major Transaction – New Zealand Post Limited

Executive Summary

This report provides shareholding Ministers with a special resolution to sign, approving New Zealand Post Limited's (NZ Post's) proposal to proceed with the sale of its 53% share in Kiwi Group Holdings Limited (KGH). The transaction is expected to constitute a "major transaction" under section 129 of the Companies Act 1993, requiring shareholder approval. The report also provides further details of commitments from the board regarding its capital structure and the proposed retention of funds from the KGH divestment.

The Crown is considering the transaction in two different capacities - on the buy-side (as purchaser), and on the sell-side (as shareholder of one of the vendors, i.e. NZ Post). As shareholding Ministers of NZ Post you are being asked to consider this transaction from the sell-side perspective.

The sale and purchase agreement is still being negotiated and finalised

Due to the targeted time for signing the Sale and Purchase Agreement (SPA) (the first week of August 2022), and the intention to announce the transaction publicly upon (or soon after) signing, NZ Post is seeking shareholder approval via special resolution to enter the transaction prior to signing the SPA. We highlight that the SPA is not yet final and the Crown and NZ Post have not yet finalised acceptable terms and conditions.

Negotiations are still progressing and a final SPA is expected in the last week of July or first week of August 2022. To approve the sale of shares in KGH, shareholders need to have consideration of the price at which those shares are being sold (and this is required for the shareholder resolution). While the enterprise value for KGH has been established between the parties and net debt and other adjustments are known, technical adjustments in the finalisation of the consideration for the shares means that the exact transfer price will be finalised in the coming weeks.

A "minimum" transfer price concept has therefore been used to determine the basis for assessing the proposed transaction, the impact on NZ Post and assessment of impact on value, and to allow for the effect of the shareholder resolution. Margin has been included so that the actual transfer is likely to occur at a slightly higher price after all adjustments are made (to the benefit of NZ Post).

We note the shareholder resolution permits NZ Post to enter the transaction (subject to a minimum price) but doesn't require NZ Post to enter the transaction. Whether to do so will be a decision for the Board to make following the finalisation of the SPA. If final negotiations and completion adjustments result in a share transfer price lower than the minimum included in this advice and resolution, then updated advice and an updated resolution will need to be provided at that time.

Key elements of the proposed transaction

The price for NZ Post's shares in KGH is expected to be at least \$1,080 million, \$8 million greater than the book value (as at 31 December 2021) of NZ Post's shares in KGH. NZ Post has had external legal advisors supporting it through the negotiations, which have been undertaken on an arms-length commercial basis, providing a degree of assurance on this.

Divesting its shareholding in KGH will better enable NZ Post to achieve its strategic ambitions, by allowing the company to direct management focus and capital towards its core

business of mail and parcels. [25], [26]

NZ Post proposes to retain [25], [26], [38] of the sale proceeds and distribute the balance via a special dividend, subject to board approval at that time consistent with the Companies Act 1993 (T2022/1078 refers). [25], [26]

The SPA is expected to be signed in the first week of August 2022 and Ministers will be provided with this final copy for their information. The transaction is expected to be publicly announced shortly after signing. Reserve Bank of New Zealand approval is a condition precedent of the SPA, and the transaction is expected to settle shortly following this approval (anticipated to be October 2022).

NZ Post will review its capital structure and demonstrate shareholder value

In its proposal to retain [25], [26], [38] of the proceeds of the sale of its share in KGH, the board committed to regularly reviewing its capital structure and returning any surplus capital, as well as demonstrating the shareholder value created through the retention (T2022/1078 refers).

NZ Post and the Treasury have agreed on a process for a six-monthly and annual review of NZ Post's capital structure, with the annual review to be undertaken by an independent third party. We have also agreed on a process for NZ Post to demonstrate to shareholding Ministers and the Treasury the shareholder value that is created by the retained funds and subsequent investments.

These agreed processes have been documented between NZ Post and the Treasury. The Treasury will update shareholding Ministers on these capital structure reviews, the demonstration of shareholder value, and the implications from a performance and monitoring perspective.

Recommended Action

We recommend that you:

- a **note** that before New Zealand Post Limited (NZ Post) signs the Sale and Purchase Agreement (SPA) for the sale of its 53% share of Kiwi Group Holdings Limited (KGH), shareholder approval is required under section 129 of the Companies Act 1993 as the sale of KGH is expected to constitute a “major transaction” under that Act
- b **note** that as negotiations are still progressing, the SPA is not yet final and the Crown and NZ Post have not yet finalised acceptable terms and conditions
- c **agree** to sign the attached special resolution of the shareholders which approves NZ Post’s participation in the proposed transaction, subject to a minimum price

Agree/disagree.

Acting Minister for State Owned Enterprises

Agree/disagree.

Acting Minister of Finance

- d **note** if the final purchase price is lower than the minimum price set out in the resolution we will provide a subsequent resolution and advice
- e **note** that NZ Post has signalled it intends to pay a special dividend in the amount of the sale price for its shares in KGH less [25], [26], [38]
- f **note** that NZ Post has committed to regular reviews of its capital structure and ensuring surplus capital is returned to the Crown. NZ Post and the Treasury have agreed on the terms and process for how these reviews will be undertaken.

Andrew McLoughlin

Principal Advisor, Commercial and Institutional Performance

Hon Dr Megan Woods

Acting Minister for State Owned Enterprises

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Hon Dr David Clark

Acting Minister of Finance

_____/_____/_____

Treasury Report: Approval of Major Transaction – New Zealand Post Limited

Purpose of Report

1. This report provides shareholding Ministers with a special resolution to sign, approving New Zealand Post Limited's (NZ Post) proposal to proceed with the sale of its 53% share in Kiwi Group Holdings Limited (KGH). The transaction constitutes a "major transaction" under section 129 of the Companies Act 1993 (the Companies Act) and therefore requires shareholder approval.¹
2. It also provides further details of commitments set out by the board in its capital structure proposal, as requested by shareholding Ministers in their letter to NZ Post dated 22 June 2022 regarding the proposed retention of funds from a KGH divestment.

Background

3. The Crown is moving to acquire KGH shares from those shareholders who intend to divest their interests in KGH and to put in place sustainable long-term ownership arrangements (Project Korimako). Cabinet has agreed the Crown can negotiate the purchase of shares (CAB-22-MIN-0250 refers).
4. NZ Post is seeking to divest its remaining interest in KGH and has provided shareholding Ministers with a shareholder resolution to enter into the transaction. We note that the Crown is considering the transaction and sale and purchase agreement (SPA) in two different capacities - on the buy-side (as purchaser), and on the sell-side (as shareholder of one of the vendors, i.e. NZ Post). As shareholding Ministers of NZ Post you are being asked to consider this transaction from the sell-side perspective.
5. Due to the targeted time for signing the SPA (the first week of August 2022), and the intention to announce the transaction publicly upon (or soon after) signing, NZ Post is seeking shareholder approval to enter the transaction prior to signing the SPA. We highlight that the SPA is not yet final and the Crown and NZ Post have not yet finalised acceptable terms and conditions. We note the shareholder resolution permits NZ Post to enter the transaction, but doesn't require NZ Post to enter the transaction, and this will be a decision for the Board to make following the finalisation of the SPA.
6. Advice was recently provided to shareholding Ministers on NZ Post's proposed special dividend from a divestment of its shares in KGH (T2022/1078 refers). In your letter to NZ Post sent 22 June 2022, shareholding Ministers set out expectations regarding next steps and clarity on the commitments NZ Post was making to review its capital structure. The Treasury has engaged with NZ Post on the review process which is outlined below.

Commitments on Review of Capital Structure

7. As previously set out in advice to shareholding Ministers (T2022/1078 refers), if the transaction proceeds NZ Post proposes paying a special dividend (imputed as far as is possible) to the Crown equal to the KGH transaction proceeds less [25], [26], [38]
Payment of the special dividend is subject to board approval. [25], [26]

¹ Section 129(2)(b) of the Act, defines a major transaction "the disposition of, or an agreement to dispose of, whether contingent or not, assets of the company the value of which is more than half the value of the company's assets before the disposition"

8. In its proposal, the NZ Post Board committed to continuing to work with the Treasury to assess its optimal capital structure, including through six-monthly reviews of NZ Post's capital needs with the intention of returning any surplus capital to the Crown. It also committed to demonstrating the shareholder value created through the retention.
9. Shareholding Ministers welcomed this commitment and set the expectation NZ Post would continue to work with Treasury officials to determine and document how these reviews will be undertaken. We have agreed with NZ Post the outcomes and process for the reviews. These are set out at a high level below and documented in more detail with NZ Post.

Outcomes Sought

10. Consistent with the commitments made by NZ Post in its proposal to retain funds from the KGH sale², the outcomes sought are to:

- a [25], [26]

Funds are returned to the Crown in the form of further special dividends as soon as they are considered surplus. Any dividend payment is subject to approval by NZ Post's Board.⁴

- b Ensure there are processes in place for NZ Post to clearly demonstrate to shareholding Ministers and the Treasury the shareholder value that is created by the retained funds and subsequent investments leading to sustained earnings growth.

Process and timing for reviews

Annual capital structure review

11. NZ Post will undertake a formal annual capital structure review and the Treasury will be included in agreeing on the terms of reference of the review. The review would be performed by a third party, expected to be sufficiently qualified and agreed by NZ Post and the Treasury. The Treasury may decide to engage a suitable third party to provide it with external assurance on the review.
12. The formal annual review would commence following the board sign-off of the final business plan budget (which is normally the end of May), and a view would be formed and provided by the third party within three months to both NZ Post and Treasury. The first annual capital structure review will begin in May 2023.
13. The Treasury will review the analysis and report to shareholding Ministers.

The half year review (i.e. in conjunction with the interim financial results to 31 December)

14. In conjunction with the interim financial results (i.e. end of December), NZ Post will perform an internal review of its capital structure and update the outputs of the annual review based on the most up to date information. This would include updating the Treasury as to variations from assumptions/forecasts signalled in the previous review. The Treasury would relay the outcome of this review and discussion to shareholding Ministers.

² Outlined in its letters to the Treasury dated 21 April 2022 (Project Korimako – Initial Engagement Period Discussions) and 2 June 2022.

³ Consistent with Owners Expectations, capital is returned by way of special dividend that is fully imputed (as far as is possible) to ensure that NZ Post/Crown is not subsidising the tax liabilities of other entities.

⁴ The board can only declare a dividend if it is satisfied on reasonable grounds that the company will, immediately after the distribution, satisfy the solvency test pursuant to the Companies Act 1993.

Demonstrating creation of shareholder value

15. [25], [26]

Continuation of performance monitoring

16. NZ Post will endeavour to perform in line with its business plan projections. Adverse variances or risks to the business plan should be documented and signalled to the Treasury in advance or as they are known as per current reporting/monitoring arrangements.⁵ As in its current monitoring role, the Treasury will periodically review NZ Post's performance against its business plan projections, as well as assess how projections are revised between plans.

Proposed Transaction and Shareholder Resolution

17. The execution of the SPA is expected to fall within the definition of a 'major transaction' as per section 129 of the Companies Act. We expect the sale price for NZ Post's 53% shareholding in KGH to be at least \$1,080 million, which is over half NZ Post's total assets of \$1,853 million in its half year report as at 31 December 2021 – its latest publicly available financial statements. To enter into a transaction to sell its 53% share in KGH, NZ Post requires a signed special resolution of the shareholders.
18. Due to the targeted time for signing the SPA (the first week of August 2022), and the intention to announce the transaction publicly upon (or soon after) signing, NZ Post is seeking shareholder approval to enter the transaction prior to signing the SPA. We highlight that the SPA is not yet final and the Crown and NZ Post have not yet finalised acceptable terms and conditions.
19. Negotiations are still progressing and a final SPA is expected in the last week of July or first week of August 2022. To approve the sale of shares in KGH, shareholders need to have consideration of the price at which those shares are being sold (and this is required for the shareholder resolution). While the enterprise value for KGH has been established between the parties and net debt and other adjustments are known, technical adjustments in the finalisation of the consideration for the shares means that the exact transfer price will be finalised in the coming weeks.
20. A "minimum" transfer price concept has therefore been used to determine the basis for assessing the proposed transaction, the impact on NZ Post and assessment of impact on value, and to allow for the effect of the shareholder resolution. Margin has been included so that the actual transfer is likely to occur at a slightly higher price after all adjustments are made (to the benefit of NZ Post).
21. If final negotiations and completion adjustments result in a share transfer price lower than the minimum included in this advice and resolution, then updated advice and an updated resolution will need to be provided at that time.

⁵ That is, monthly CE/CFO reports, quarterly reports, annual reports, and 'no surprises' commitments.
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Key commercial aspects of the SPA

22. The price for NZ Post's shares is expected to be at least \$1,080 million. [25], [33], [37]
- a [25], [33], [37]
 - b
 - c there won't be other material negative adjustments post due diligence and/or as a result of terms negotiations in the SPA.
23. While the final price is still subject to final completion adjustments, we have a high degree of confidence that the price will be at least \$1,080 million. As such, the resolution states \$1,080 million as the minimum price at which NZ Post can enter the transaction.
24. This price appears to be fair, based on the following:
- a The price is \$8 million greater than the book value of NZ Post's shares in KGH⁷;
 - b NZ Post has had external legal advisors supporting it through its negotiation, providing additional assurance that negotiations have been commercial and arms-length in nature; and,
 - c The transaction price offered to each shareholder is the same and has been reached through a commercial negotiation process between the Crown and each of NZ Post, and two Crown Financial Investment Institutions (Accident Compensation Corporation, and New Zealand Superannuation Fund), providing confidence that significant testing and scrutiny has been undertaken (including in relation to the transaction price).
25. Currently, the only condition precedent in the SPA is the regulatory approval by the Reserve Bank of New Zealand (RBNZ). This approval is anticipated to be completed by October 2022. The transaction is expected to settle shortly following this approval.

Impact of the transaction on the company's strategic direction

26. NZ Post has been signalling for some time that its ownership of KGH is no longer a good strategic fit for the company and the Treasury has supported this position. While initially synergies between the two businesses existed through retail networks and NZ Post's ownership has served KGH well to this point, the KGH and NZ Post business models are no longer aligned, nor do the core competencies within NZ Post (i.e. a mail and parcels business) provide the right support for a bank investment.
27. By divesting KGH NZ Post will be able to focus solely on its core business and the execution of its transformation strategy. [25], [26]

The divestment also frees up capital to invest in projects that the company considers important to support earnings growth and increasing shareholder value.

28. NZ Post is also unable to contribute the capital that KGH signals it will require to meet both RBNZ capital requirements and future growth requirements. KGH is therefore

⁶ [25], [33], [37]

⁷ NZ Post's Interim Statement of Financial Position as at 31 December 2021 reports its investment in KGH as \$1,072 million.
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constrained in its growth prospects with NZ Post as an owner. A sale to other owners will provide the possibility for KGH to realise its growth potential through sufficient capital for growth and a better alignment of strategic interests.

Impact of the transaction on company value and key metrics

29. The proceeds to NZ Post for its 53% shareholding are expected to be at least \$1,080 million. NZ Post has signalled that, subject to board approval, it will return the Crown a special dividend of the proceeds less [25], [26], [38]

⁸ [25], [26]

⁹ [25], [26]

30. Following the transaction and retention of [25], [26], [38] , [25], [26]

This impacts the value of NZ Post through changes in the weighted-average cost of capital.¹¹

31. [25], [26]

. NZ Post has committed to working with the Treasury to demonstrate the shareholder value created by retaining these funds and making these investments.

32. We have estimated impact of the transaction on some of NZ Post's key financial metrics and these are presented in the table below.¹²

[25], [26]

⁸ The board can only declare a dividend if it is satisfied on reasonable grounds that the company will, immediately after the distribution, satisfy the solvency test pursuant to the Companies Act.

⁹ Deloitte valuation of NZ Post Group, 30 June 2022.

¹⁰ [25], [26]

¹¹

¹² We note that some metrics may not align with those presented in NZ Post's business plan due to differences in the formulae used.

¹³ Metrics are calculated as follows:

- Return on equity: net profit after tax/average equity
- Return on invested capital: earnings before interest and tax (EBIT)/average capital employed (equity + debt)
- Net gearing: net debt/(net debt + equity)
- Interest cover: EBIT/net interest
- Leverage: Net debt/EBITDA
- Note: debt figures include lease debt, consistent with IFRS16

33. The key impacts are explained as follows:
- a Total assets and equity decrease as KGH is removed from the balance sheet and the proposed special dividend is paid. This is offset by the retained [25], [26], [38]
 - b Profitability metrics are negatively impacted due to the removal of KGH earnings and the impact of the proposed special dividend on equity. [25], [26]
 - c [25], [26]
34. NZ Post's rationale for its proposed [25], [26], [38] retention is [25], [26] . Based on modelling the Treasury has undertaken, a retention of [25], [26], [38] [25], [26]
35. We expect that NZ Post would consider updating its Statement of Corporate intent following the completion of the transaction, in light of the impact of the transaction on the company's value, scope of activities and key metrics. Shareholding Ministers raised this in their letter sent on 13 June 2022, inviting NZ Post to submit its final SCI.

Next Steps

36. The Treasury recommends that shareholding Ministers sign the attached special resolution which approves, subject to a minimum price, NZ Post signing the final SPA to sell its 53% shareholding in KGH. We note the shareholder resolution permits, but does not require, NZ Post to enter the transaction and this will be a decision for the Board to make following the finalisation of the SPA. The special resolution may be signed in counterpart (i.e. Ministers are allowed to sign separate copies).¹⁴
37. NZ Post is expected to sign the final SPA in the first week of August 2022 and shareholding Ministers will be provided a copy of this. The transaction is expected to be publicly announced shortly thereafter (target announcement date is 9 August 2022).
38. If the final purchase price is lower than the minimum price set out in the shareholder resolution, for example due to closing adjustments being greater than currently indicatively calculated, a subsequent resolution will need to be provided to shareholding Ministers at that time, along with advice from the Treasury.
39. The transaction is currently expected to be settled in October 2022, following the approval of the transaction by RBNZ. At that time, the board would approve a final special dividend considering the requirements of the Companies Act.
40. The Treasury will continue to work with NZ Post regarding expectations around the optimal capital structure review and commitments for demonstration of shareholder value. Following the public announcement of the sale of KGH we expect NZ Post will be engaging with key parties such as its rating agency, lenders, and auditors, as to the impact of the transaction on the company's balance sheet, risk profile and credit rating.
41. We also anticipate that NZ Post may update its SCI considering the impact of the transaction on the company's nature and scope of activities and on other elements of the SCI such as the commercial valuation and key metrics. If NZ Post does update its SCI, shareholding Ministers would have the opportunity to comment and the Treasury would provide a briefing to you at this time.

¹⁴ As per clause 14 of the NZ Post constitution.
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