Philip Barry

Taylor Duignan Barry Ltd

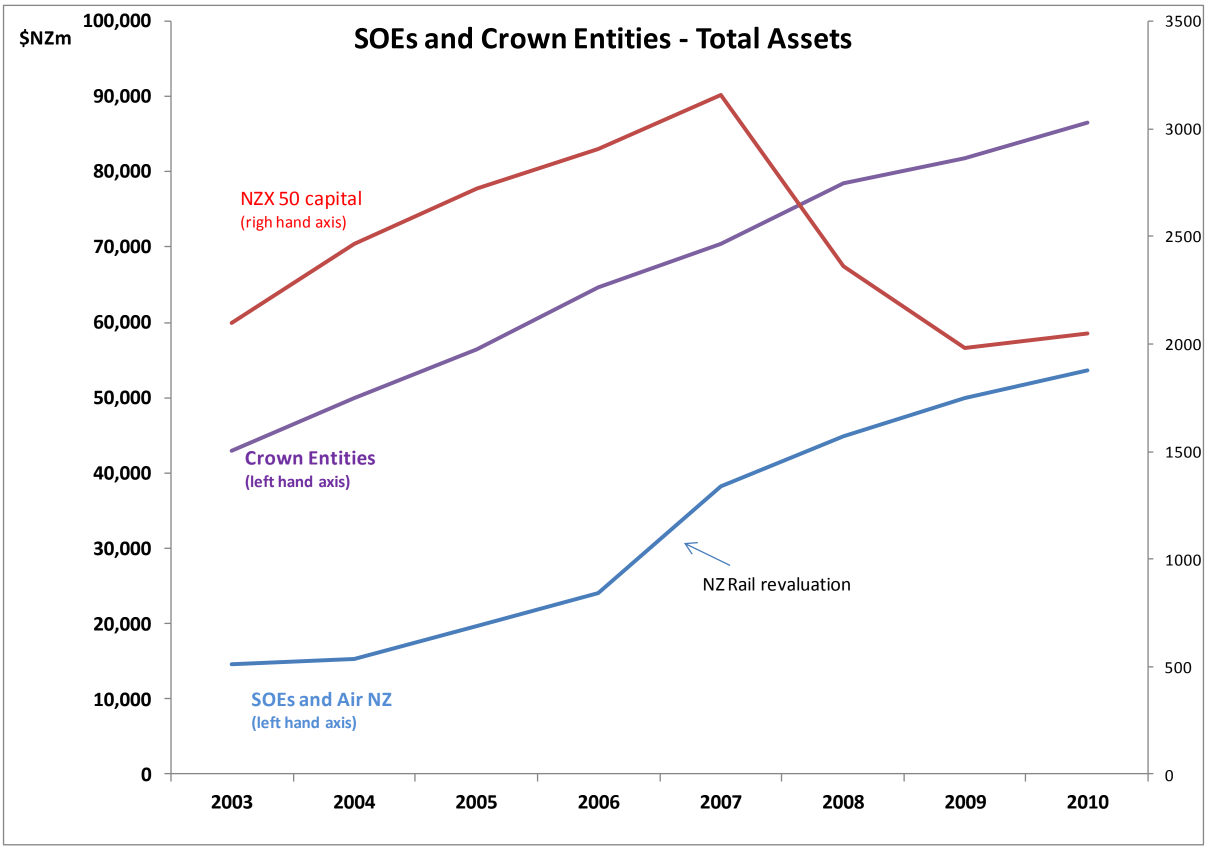
Partial privatization to kick-off in New Zealand[1]

After a 12 year long "cup of tea", privatization is back on the government's agenda in New Zealand. The National Party was re-elected for a second three year term in government in November 2011. A key part of National's election campaign was a commitment to sell-down the government's holdings in five major enterprises. With the election result the government now has a mandate to proceed.

New Zealand was seen as an early leader in privatizations, selling some 30 enterprises in the late 1980s and 1990s. However, over the 2000s, under the Labour-led government, privatization was halted. Instead, over the period 2002 to 2010, major growth in the government commercial sector occurred, with the assets of state owned enterprises and Crown entities increasing 2.5 times (refer Figure 1 below). The growth in commercial assets held by the government reflected a combination of renationalisations of Air New Zealand, of the country's rail network and the buyout by Auckland Regional Council of the minority shareholders in Ports of Auckland; the start up of new enterprises by the government, most notably of a state owned retail bank, Kiwibank; and growth in the balance sheets of the existing state enterprises.

[1] Published in Privatization Barometer Report, 2011. http://www.privatizationbarometer.net

Figure 1: SOE and Crown Entity Total Assets



Nb: Crown Entities are state enterprises with a mixture of commercial and non-commercial objectives.

The five state enterprises that are now to be sold down by the government are three electricity companies, a coal company and Air New Zealand. The government currently owns 100% of the four energy companies and 75% of Air New Zealand.

The electricity companies, Genesis Energy, Meridian Energy and Mighty River Power are vertically integrated generators and retailers of electricity. Together they have over 6,000MW of generating capacity and account for 65% of New Zealand’s generation market. The largest, Meridian, is 100% renewable (hydro and wind) based.

The coal company, Solid Energy, is New Zealand's largest coal mining company, accounting for around 85% of national production. Around 60% of the company’s revenue is from export sales, being sales of high-quality coking coal, largely to China, India and Japan. The company also mines thermal coal in the North Island, supplying domestic customers, primarily Genesis and New Zealand Steel.

Air New Zealand has already been privatised once before, in 1989. However the company ran into severe financial difficulties and was recapitalised by a government equity injection in 2002. The company is still listed on the New Zealand share market, with around 25% of its shares currently in private hands.

The government is to sell up to 49% of the four energy SOEs and is to commit by way of legislation to maintain a majority shareholding in all the five companies. The sales of the four energy companies will be by way of Initial Public Offerings (IPOs). The government's holding in Air New Zealand could be reduced via a share placement or a public offer.

Traditionally New Zealand governments have relied largely on trade sales when privatising state owned assets, with 100% of the government's shares sold to a single buyer or consortium of buyers (refer Table 1 below). Indeed, 27 of the 30 privatizations that occurred in New Zealand in the late 1980s and 1990s were by way of trade sale. These trade sales accounted for 83% of all sales proceeds from privatizations in New Zealand. In some of these cases, such as the largest transaction, that of Telecom Corporation of New Zealand Limited, the successful buying consortium was required to subsequently partially sell down its interest by way of a public share issue.

In contrast, the last three privatizations in New Zealand – those of Auckland International Airport Ltd, Contact Energy Ltd and Capital Property Services - in the late 1990s were all by way of sharemarket listings. The move towards public sharemarket listings in privatizations in New Zealand reflects a shift in political pressures, with the government wanting to ensure widespread domestic holdings for the privatized company, and a desire by the government to help develop the New Zealand sharemarket.

Table 1: New Zealand privatizations: 1988-1999

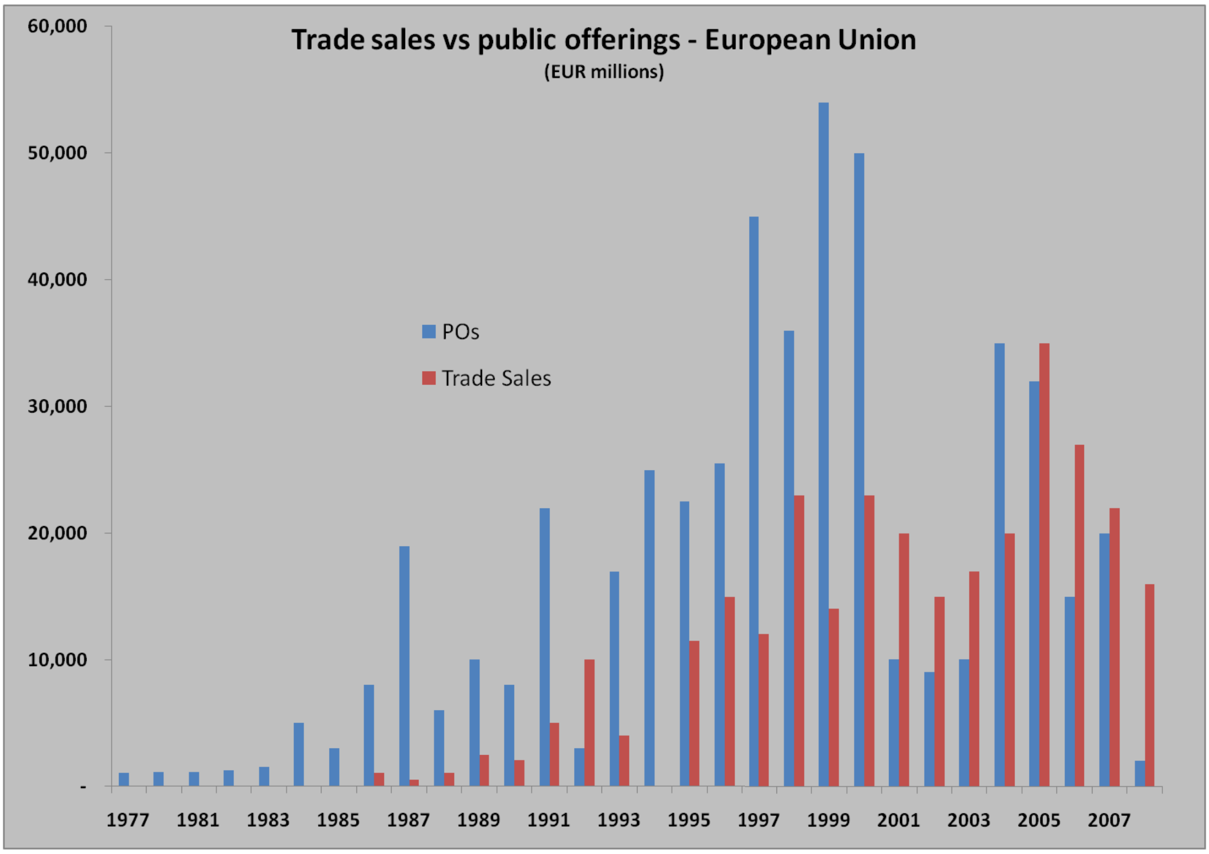
	Number	Value ($US)[1]
Privatizations	30	$9b
- trade sales	27	$7.2b

- public offerings	3	$1.8b

1. Converted at the average $NZ/$US exchange rate for 1988-1999 of 0.60.

The move away from trade sales and towards IPOs in New Zealand contrasts with the trend in Europe. As Figure 2 below illustrates, while public offerings were most common method of privatization in the European Union (EU) in the fourth quarter of the last century, trade sales have become the dominant means in the EU in more recent years.

Figure 2: Trade Sales vs Public Offerings – European Union



Source: Bortolotti & Megginson, 2008.

Scoping studies for the four New Zealand energy SOEs have been completed and a sales programme report has been completed by the Crown Advisor, Deutsche Bank. Mighty River Power has been identified by the government as the first sales candidate, with three investment banks, First NZ Capital/Credit Suisse, Goldman Sachs and Macquarie appointed as Joint Lead Managers for the sale.

Legislation has been passed for the sales to proceed to remove the four SOEs from the State Owned Enterprises Act so the companies can operate under legal and governance arrangements as similar as possible to other listed entities. However, the legislation includes a requirement on the Government to maintain a minimum shareholding of 51% and a maximum permitted shareholding for all non-Crown individual equity holders of 10%.

The total proceeds raised by the government from the sell-down of its interest in the five entities could be around US$5.6b, based on recent broker valuations of the enterprises and assuming the government retains 51% shareholding in each of the five businesses.

The first IPO is scheduled to take place in 2012, with the government announcing that the sale of Mighty River Power is likely to proceed in the third quarter of the year. Subsequent transactions are likely to occur at around six to twelve months intervals. The timing is, however, dependent on legal challenges, with some Maori groups challenging the sales process through the Waitangi Tribunal, and will be subject to market conditions and particular company circumstances.

There have not been many formal studies done of the effects of past privatizations in New Zealand. However, those that have been conducted (one of the sale of Telecom NZ and one of the sale of New Zealand Rail) show strong evidence of efficiency gains (Boles de Boer and Evans (1996) and New Zealand Institute for the Study of Competition and Regulation (1999)). Many of the public, however, remain deeply sceptical about privatisation, with concerns focusing especially around foreign control of the companies. The government has moved to allay these concerns by the policies noted above (selling only up to 49% of the companies and by the additional step of a 10% cap on individual shareholdings). In addition, the marketing of the shares will be targeted at domestic investors. Nevertheless, given the size of the transactions and the relatively thin domestic capital markets, foreign participation in the sales process will almost certainly be required if the government is not to forego too much value in the process.

The sales are likely to lead to greater transparency in the performance of the partially privatized SOEs and increased external monitoring of their performance. However, with the government retaining control of the enterprises, the efficiency gains arising from the asset sales may be limited. The incentives on private shareholders to monitor the performance of the enterprises will be weakened (compared with 100% privately owned companies) as the private shareholders can look to the deep pockets of the government to bale the companies out if they get into financial difficulties. It should be noted, however, that most bailouts by governments of private enterprises in recent years – both in NZ and in other countries - have inflicted substantial costs on shareholders, often to the full amount of the equity. Bondholders have been protected largely but not shareholders. So shareholders in the partially privatized enterprises may still have relatively strong incentives to monitor management despite ongoing government control. The absence of the threat of takeover is probably the more significant factor in reducing the pressures on the partially privatised enterprises to perform.

Questions must also be raised around the sale method chosen by the government. The government has listed no fewer than 10 objectives for the sales, including maximising sales proceeds, deepening domestic capital markets and widespread and substantial New Zealand share ownership (New Zealand Budget Paper (2011)). Inevitably there are tensions between and tradeoffs to be made amongst these multiple objectives.

Despite the caveats noted above, the planned privatizations are a positive feature of the new government's economic policy. The new government will be keen that the first sale in the new program scheduled for later this year goes off smoothly and is seen to be a commercial and political success.

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