TDB Digest, October 2018

Mixed ownership model – is it working?

Between 2011 and 2014, the government sold down its ownership in Meridian, Mercury and Genesis Energy and listed 49 percent of each company's shares under the "mixed-ownership model" (MoM). In a recent report, TDB reviewed the performance of these three MoM companies since their sharemarket listing. We found that since listing, the overall operating performance of these companies has improved, with EBITDAF increasing by 4 percent and return on assets increasing from 7.8 to 8.3 percent on average. Performance improved despite static total electricity demand and without average electricity prices rising. The government received $4.3b in sale proceeds, has kept control of the companies (through its 51 percent holdings) and is receiving more in ordinary dividends now than it did when it owned 100 percent of the companies. Read the full report or the related article published in the Herald below.

https://www.tdb.co.nz/wp-content/uploads/2018/10/TDB-Advisory-Mixed-Ownership-Review-2018.pdf

https://www.stuff.co.nz/business/106462506/crown-may-be-getting-more-in-dividends-now-than-before-electricity-company-sales?cid=app-iPhone

Fonterra: a long-run financial assessment

As part of its current review of the Dairy Industry Restructuring Act (DIRA) the government asked whether the intended benefits of the 2001 industry restructure have been realised. While major parts of the industry have flourished (eg, A2 Milk, Synlait and Open Country Dairy), Fonterra's financial performance has been well below the expectations for the company when it was established. The mega-merger that created Fonterra was expected to deliver $310 million per annum in synergy gains. TDB estimates that if Fonterra had delivered the benefits that were projected, Fonterra's share price should now be $7.60 to $8.80, compared with its current share price of below $5.00. Revenue has fallen well short of the targets set and the anticipated contributions to earnings from value-added products has not materialised. Overall, Fonterra's long-run financial performance has not been satisfactory and has been well below the level projected at the time of the mega-merger. Looking ahead, the question is: how can the situation be improved? First and foremost is shareholders recognising the limitations of the status quo. Read the full working paper or related article in the Herald below.

https://www.tdb.co.nz/wp-content/uploads/2018/09/TDB-Advisory-Fonterra-Long-Run-Financial-Assessment-Sept-18.pdf

https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=12132117

Are there too many electricity distributors?

A long-standing debate in the New Zealand electricity sector is whether the country has too many electricity distribution businesses (EDBs). In our recent report looking at the potential benefits from amalgamation of the current 29 EDBs, we found that amalgamation is no silver bullet for improving the efficiency of the lines companies. Our analysis found that customer density, not size, is the biggest driver of EDBs' asset operating costs and found only small gains attributable to increasing scale. This suggests that the gains from amalgamation would probably be quite limited. Read the full report below to find out the details.

https://www.tdb.co.nz/wp-content/uploads/2018/09/TDB-Advisory-EDB-Amalgamation-Efficiency-2018.pdf

The value of flying to and from Kāpiti

Those who enjoy flying from Kāpiti Coast to Auckland felt a shock to the system when Air New Zealand withdrew its services from Kāpiti in March 2018. This flight has since been replaced by Air Chathams, but could Air NZ's withdrawal have been a sign that demand for the airport isn't high enough to warrant its operation? TDB investigated the economic value of the airport to the local community in a report commissioned by the Kāpiti Coast District Council. Overall, we found that the net economic benefits of the airport to the district are around $4.3 million per year, largely made up of the value of time savings to Kāpiti residents, the recreation value of the Kāpiti Aero Club and some additional visitor expenditure. Find out the details in the report below.

https://www.tdb.co.nz/wp-content/uploads/2018/08/TDB-Advisory-Kapiti-Airport-Economic-Valuation-2018.pdf

Comcom price reviews

The Commerce Commission has recently accepted applications from Wellington Electricity and Powerco to go on customised price-quality paths (CPPs), allowing new revenue limits to be set for these electricity distribution businesses. After processing the two applications, the Commission published an open letter seeking feedback on the CPP decision-making process. TDB worked with the Electricity Retailers Association of NZ (ERANZ) to submit on the need for cost-benefit analysis (CBA) to be incorporated into future CPP applications. CBA is an internationally recognised means of assisting major investment decision making. CBA would permit the consumer benefits achieved through increased investment to be quantified and assessed against the counterfactual of no additional investment in a rigorous way. The Commission is already using CBA to assess significant Transpower projects and TDB believe it would be a valuable addition to the CPP-assessment process for EDBs. Read the full submission below.

https://www.tdb.co.nz/wp-content/uploads/2016/05/TDB-Advisory-Powerco-CPP-Application-Submission-to-ComCom-2017.pdf

TDB's quote of the day

"It's true hard work never killed anyone, but I figure, why take the chance?"

-Ronald Reagan