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SOE floats pose tricky problems

Duncan Bridgeman

Structuring state asset floats to cater for retail investors will be a thorny issue for the Crown and its advisers.

Past experience suggests mum and dad investors do not fare well in public floats compared to institutional investors due to their allocations being heavily scaled back.

Balancing the expectations of both institutions and small investors while ensuring a good price for the Crown will be crucial, says lawyer Frank Chan, who specialises in financial markets.

Meanwhile, the appointment of Australian firm Lazard as an independent adviser raises some important questions, including the amount of fees being paid.

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How to avoid sidelining retail investors in SOE floats

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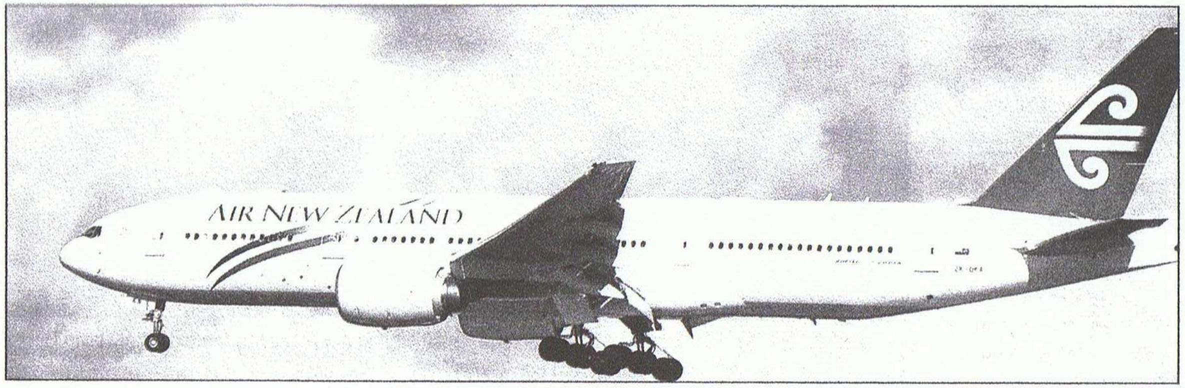

SELL DOWN: But will mums and dads' fortunes take off if the government cuts its holdings in SOEs like Air New Zealand?

Giving retail investors a fair crack at government floats is easier said than done.

Small investors have been promised shares in state-owned enterprises to be floated in the National-led government's mixed ownership share sell down.

National intends selling up to 49% of its stakes in Mighty River Power, Genesis Energy, Meridian Energy and Solid Energy. It is also proposing to sell down its 74% stake in Air New Zealand to no lower than 51%.

The government has said it expects 85-90% of shares in the companies to be owned by New Zealanders and during the election campaign Prime Minister John Key was explicit that so-called "mum and dad" investors would be offered entitlements.

Iwi leaders are also lobbying hard to get to the front of the queue and plan to set up a share-buying consortium in anticipation.

This creates a number of challenges for the Crown, not least ensuring it gets a good price, but also in structuring the floats to try to favour the smaller retail investors.

If past experience is anything to go by, heavy marketing of Crown issues has a tendency to create unrealistic expectations and lead to frustrated investors not being able to secure worthwhile holdings.

The floats of Contact Energy, Auckland International Airport and Capital Properties in the late 1990s were a classic example, with retail allocations scaled down after heavy bidding from institutions.

In the private sector the partial float of online auction site TradeMe is heading in the same direction, with the IPO three times oversubscribed.

There is plenty of evidence to suggest retail investors do not fare well in public floats compared to institutional investors.

Frank Chan, a lawyer specialising in financial markets, said there is a case for fixing a slice of the offers to meet demands of smaller investors.

"If the government decides it's a good thing for retail investors to have the ability to participate in the float, they can structure it in a way so they can have an allocation," he said.

"They could have a minimum amount set aside not affected by scaling. If you set aside say 20% for argument's sake, then as long as you get that level, if it is heavily oversubscribed by retail investors, then you are just competing against other retail investors."

Other carrots could include reducing brokerage fees for retail investors.

That would be a way around offering preferential treatment in the form of a discounted offering for locals.

Crown jewels

Meridian Energy
New Zealand's largest electricity generator owns and operates seven hydro stations, four wind farms within New Zealand, and one wind farm in Australia

Meridian also retails electricity to about 270,000 individual customers and to New Zealand's single largest electricity user, the Rio Tinto Alcan New Zealand aluminum smelter in Bluff.

Crown value: $6.3 billion

Genesis Energy
Supplies 19% of New Zealand's electricity from thermal and renewable power stations.

It is also a significant energy retailer supplying electricity, natural gas and LPG to more than 658,100 customers across the country. It has a 31% equity interest in the Kupe oil and gas project.

Crown value: $1.6 billion

Mighty River Power
Mighty River is an integrated energy generation, trading, retailing and metering business.

Its portfolio includes the Waikato Hydro System, with nine power stations along the Waikato River; geothermal plants within the Taupo and Bay of Plenty regions; the Southdown gas-fired station; and an active wind development programme.

Mighty River Power sells electricity and gas to more than 400,000 customers through retail businesses Mercury Energy, Bosco and Tiny Mighty River Power.

Crown Value: $3.7 billion

Solid Energy
The country's largest coal mining company's operations are located in the West Coast region and in the Waikato.

About half its coal is exported, with Asia a key market where it is used for power generation and coking for the manufacture of steels and other metals.

Major domestic users include the Huntly Power Station and New Zealand Steel.

Crown value: $1.7 billion

Air New Zealand – 74.2% government owned
Provides air passenger and cargo transport services within New Zealand, and to and from Australia, the South West Pacific, Asia, North America and the UK.

Business units also provide engineering and ground handling services.

Subsidiaries extend to booking systems, travel wholesaling and retailing services.

Market capitalisation $1.1 billion

The government could also open a pre-registration programme, as it did for the Contact float. In that case the government promised 25% more shares than the minimum allocation for being early.

Those pre-registering would be required to provide their Inland Revenue number to stop them handing allocations on.

That would also help the tax department monitor any "share flipping" after the IPO that could be subject to capital gains tax.

"It's a matter of balancing demand from institutions as opposed to the public float," Mr Chan said.

"These types of floats will be heavily oversubscribed so there is pressure in terms of pricing and they need to satisfy demand to ensure the float is successful."

Oversubscription is often the market's reaction to anticipated oversubscription – investors applying for more shares than they want due to expectation of an undersupply.

This seems to be the case with TradeMe with local brokers applying for as much stock as possible, knowing that Australian institutions had got in first.

Mr Chan said fixing the allocation would help address this issue.

Mr Key indicated this week that Mighty River Power or Genesis Energy was likely to be first on the block. The government expects the mixed ownership programme will raise between $5 billion and $7 billion, with the proceeds used to pay for new spending on infrastructure, schools and other public projects.

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