Public Excluded

Report PE00.14
26 January 2000
File: CFO/21/2/13

Report to the Policy and Finance Committee
from Greg Schollum, Chief Financial Officer

Sale of CentrePort to Port Investments Ltd

1. Purpose

To advise the Committee of the impact of the adjustment clause contained within the Sale and Purchase Agreement dated 28 October 1998 between Council and Port Investments Ltd (relating to CentrePort shares).

2. Public Excluded

Grounds for exclusion of the public under the Local Government Official Information and Meetings Act 1987 are:

> *So as not to unreasonably prejudice the commercial position of the person who supplied the information or who is the subject of the information.*

3. Background

On 22 September 1998 the Council approved the sale of its 76.9% interest in CentrePort (shares and convertible notes) to Port Investments Ltd (a 100% owned subsidiary company) at a price of $40.8 million. The sale, which was effected on 28 October 1998 when the Agreement became unconditional, was based on an independent valuation of CentrePort dated September 1998.

At the 22 September 1998 meeting the Council also approved the Sale and Purchase Agreement (refer **Attachment 1**) which included an adjustment clause.

The adjustment clause provided the Council as seller with the opportunity on the first anniversary after sale to increase the selling price for its interest in CentrePort.

At the time the adjustment clause was included in the agreement due to the unresolved Tranz Rail issue (associated with the future location of the ferry terminal at the Port) and the potential impact that this had on the valuation of CentrePort. The valuation was undertaken for the purposes of the sale and purchase transaction to ensure it could be demonstrated to have occurred on an arms length basis.

The adjustment clause was seen by the Council as necessary as the independent valuation report had been prepared on the conservative, but not unreasonable assumption (at the time) that the Tranz Rail revenue to CentrePort from the ferry terminal rental would be lost completely with effect from the year 2001.

The adjustment clause provided that in the event the Tranz Rail assumption was deemed to be incorrect (resulting in a net positive revenue stream for the Port Company beyond 2001) this would increase the value of the Port Company, and such an increase should be reflected in an adjusted sale price. The existence of the purchase price adjustment clause was seen as commercially sound in that, without it, Council (as seller) could be seen to be acting imprudently by selling at an inappropriate time (with the uncertainty over Tranz Rail having such a large potential impact on investment value) and consequently for an inappropriate amount.

By setting the adjustment clause at 50% of any value increment it effectively reflected a negotiated position between the seller (Council) and buyer (Port Investments Ltd).

4. What is the position 15 months later?

A number of things have occurred during the 15 months since October 1998 which affect the adjustment clause, namely:

- The Glasgow Wharf option for the ferry terminal has been rejected due to the significant 'gap' between parties' negotiated positions increasing the likelihood of Tranz Rail remaining at the existing ferry terminal site beyond 2001.
- The Directors of Port Investments Ltd have received an independent valuation of the Port Company dated August 1999 which confirmed that with the benefit of hindsight the position taken with the base case valuation at September 1998 was conservative (as we suspected which is why the adjustment clause was included within the Sale and Purchase Agreement).

- CentrePort converted all convertible notes into additional shares on 28 June 1999.
- CentrePort paid shareholders a special dividend equal to 75% of the value of the convertible notes.
- Port Investments Ltd topped up and passed "up the chain" the special dividend received of $5.8 million by paying a special dividend of $6.0 million to WRC Holdings Ltd, which was in turn, onpaid to the Council.

5. How was the sale price of Council's interest in CentrePort determined?

The sale price in October 1998 was calculated as follows:

Base case valuation of Port Company (Sept 98)	
- shares	$43 million
- convertible notes	$10 million
	$53 million
∴WRC's share	
$43 million @76.9%	$33.1 million
$10 million @ 76.9%	$ 7.7 million
	$40.8 million

Based on the above information, the Sale and Purchase Agreement settled at a sale price of $40,800,000.

6. What is the impact of the adjustment clause?

Comparing the September 1998 and August 1999 independent valuation reports the following values were attributed to revenue from the Tranz Rail ferry terminal:

September 1998	$4.6 million
August 1999	$12.8 million

(Refer **Attachment 2**)

The reason for the increased value in the latest valuation attributed to Tranz Rail relates to extension of the assumption of ferry terminal rental from 2001 to 2004 (a further three years' revenue).

The adjustment clause provides for the sale price to be adjusted by 50% of the difference between $12.8 million and $4.6 million, resulting in a price adjustment of $3.2 million ($12.8m - $4.6m x 50% x Council's shareholding @76.9%).

Adding the $3.2 million adjustment clause to the initial sale price of $40.8 million will mean a total sale price of $44 million.

Enforcement of the adjustment clause within the Sale and Purchase Agreement will mean that Port Investments Ltd will be required to pay an additional $3.2 million to the Council for its CentrePort Investment. The various impacts will be:

- Increased bank deposits of the Council ($3.2 million)
- Increased investments of, and borrowing by, Port Investments Ltd ($3.2 million)
- Increased bank borrowing by WRC Holdings Ltd and an increased intercompany advance to Port Investments Ltd ($3.2 million)

These cashflows will result in increased interest costs and therefore increased tax losses within Port Investments Ltd which will then be available to be on-sold to those companies within the Group with assessable income, primarily CentrePort Ltd.

From a Council perspective having more money on deposit will mean an increase in the return from its investments. The increased sale price also increases the tax losses generated by Port Investments Ltd and therefore increases the benefit of the 1998 ownership restructuring to the group.

7. Other Considerations

The August 1999 independent valuation of CentrePort also included an allowance for "Tranz Rail site opportunities" of $12-15 million. Credit Suisse First Boston noted in their valuation report that there remained considerable uncertainty over the future of the ferry terminal site beyond 2003. However, primarily on the basis of the representations made by CentrePort management, the August valuation report contains an additional item associated with Tranz Rail site opportunities (noted above).

This is based on the not unreasonable assumption that, in the event that Tranz Rail did vacate the current ferry terminal site in 2003 (and CentrePort lost the current terminal rental stream), CentrePort could utilise the site for other Port related activities and thereby generate additional revenue from alternate land use.

While this $12-15 million was incorporated into the latest CentrePort valuation it is only indirectly related to the Tranz Rail assumption, and therefore is not strictly covered by the wording of the adjustment clause.

However, in effect the Council has already received value for these additional opportunities anyway through receipt of the special dividend as follows:

Tranz Rail site opportunities	$15 million
x 50% (if adjustment clause applied)	$7.5 million
x 76.9%	$5.8 million

This equates to the amount of CentrePort
Special Dividend of $5.8 million

Had the Council sold its CentrePort investment externally (rather than to Port Investments Ltd), while the Council as seller could argue that it is entitled to a higher purchase price adjustment to reflect these additional revenue opportunities, in effect such compensation has already been received by Council through Port Investments Ltd passing up the chain the Special Dividend.

8. Communications

Not necessary.

9. Recommendations

(1) That the report be received and the contents noted.

(2) That the Committee recommend to Council that it:

(a) agree that the purchase price adjustment, pursuant to the agreement for the sale and purchase of shares in CentrePort Ltd, is $3.2 million.

(b) note that the sale price of Council's interest in CentrePort will increase from $40.8 million to $44 million.

(c) note that the receipt of an additional $3.2 million from Port Investments Ltd for the sale of the Council's 76.9% interest in CentrePort will be added to Council's existing deposit facility with the National Bank of New Zealand.

GREG SCHOLLUM
Chief Financial Officer

Attachment 1:	**Report PE98.446 – Holding company restructure (including sale and purchase agreement)**
Attachment 2:	**Credit Suisse First Boston fax dated 8/11/99 in relation to Tranz Rail valuation assumptions**