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HD **Australia aims to sell state assets**

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WC 2,799 words
PD 7 April 2014
SN Asiamoney
SC AMF
LA English

LP

The Australian federal and state governments are looking to divest a set of infrastructure and utility assets in an effort to raise funds for other project needs. Ben Power reports.

In mid-February, Australia's federal government reportedly hired a high-profile public relations **firm** to develop a communications strategy for the A$4bn ($3.58bn) privatisation of health insurer, Medibank Private.

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While the Medibank privatisation is almost guaranteed, the appointment of Newgate Communications was still big news: The Sydney Morning Herald splashed it across their front page. It signified the huge public interest in the **sale** of government-owned assets, particularly a well-known brand such as Medibank Private, with more than A$100bn of assets.

The news also highlighted that Australia's cash-strapped governments are set to conduct a string of privatisations in the next half decade. Another iconic brand, Australia Post, is also slated for **sale**, while a raft of electricity companies and ports are either being sold or considered for privatisation.

"All of the Australian governments at the state and federal level have some element of a budget emergency on hand," says Julie Novak, a senior fellow at the free-market think tank, The Institute of Public Affairs, which advocates more privatisations.

"There's not going to be a nice orderly, planned list of assets sold across Australia," adds Julian Vella, Asia-Pacific regional leader of global infrastructure at KPMG. "But I do think over the next five years or so there will be continued activity in that area."

The state asset sales are good news for investment banks, with the likes of JP Morgan, Rothschilds and Bank of America Merrill Lynch (BofA Merrill) appointed to look at selling government-owned assets. Further sales are likely to generate tens of **millions** in fee income for financial advisers.

Conducted shrewdly, such asset sales would not just help the governments balance their budgets, they could also make for better-run, cheaper utilities and services.

But the sales risk triggering a backlash in a country with a record of public distaste over state asset sales. Governments are treading carefully, especially over offloading controversial assets, such as universities.

The state disposals may be needed to help plug government balance-sheet holes. But they will test the ability of the federal and state governments to explain such privatisation to a sceptical public.

Squandering a boom

Australia hasn't had a recession for 23 years, but it now faces slowing economic growth, debt-laden governments and falling productivity.

The explosion of **China**'s economy over the past decade brought unprecedented demand for Australia's mineral resources. That led to once-in-a-lifetime boom conditions. But **China**'s growth is slowing, along with its appetite for Australian commodities. With the **mining** boom over, economists are wondering where the money went.

“We should be looking at pretty robust government surpluses, but we’ve got nasty government deficits,” says Stephen King, professor of economics at Melbourne’s Monash University.

He says Australians and their central and state governments mistakenly believed boom conditions were “the new normal”.

“Government spending has gone up,” he says. “We had 10 years of very good fiscal management under [former prime minister Paul] Keating and [former treasurer Peter] Costello. But then we went into a period where fiscal management lessened a lot – you could say it went out the window.”

According to King, the 2007-2009 premiership of Kevin Rudd marked the peak of state spending largesse. Rudd’s government became notorious for spending programmes such as the Home Insulation Programme, a global financial crisis stimulus programme in 2009 that spent A$2.5bn on subsidising ceiling insulation. It was cut after faulty insulation caused 200 fires and four deaths, triggering a Royal Commission.

The consequence has been a deteriorating fiscal position. Australia’s federal budget deficit is forecast to hit A$47bn this year, A$17bn higher than forecast in the last budget in August. Net debt is forecast to surge to A$280bn, or 15.7% of gross domestic product (GDP), by 2016-2017, and peak at 16.2% of GDP in 2018-2019. That’s not drastic by global standards, but the trend has many concerned.

The states are also struggling, and Queensland has been one of the worst. When the Liberal National Party government led by Campbell Newman was elected in 2012, he established a Commission of Audit to look at spending. It predicted Queensland’s debt would surge to A$100bn by 2018/2019. To recover its 2007/2008 position, the commission said the government needed to reduce debt by $25bn-$30bn, largely through asset sales.

It’s a picture only likely to worsen, courtesy of an unpalatable combination of falling productivity and a growing population. National labour productivity grew at an average annual rate of 3.3% from 1997 to 2007, but has slowed to just 1.9% in the year to March 2013.

Meanwhile Australia’s population looks set to double in 50 years. The country needs to increase infrastructure investment to cope. Engineers Australia and Infrastructure Partnerships Australia predict that Australia faces a A$700bn shortfall in infrastructure spending over the coming half century.

Privatisation path

Australia’s governments are increasingly looking to privatisations to repair their fiscal situations and fund needed infrastructure.

It’s not a new concept in Australia, which conducted its first privatisations in the 1980s and accelerated them in the 1990s, although they were done mostly in the spirit of reform rather than fiscal crisis.

The federal government offloaded its stakes in the Commonwealth Bank of Australia from 1991 and Telstra from 1997, while state governments such as Victoria and South Australia have also sold assets such as electricity and public transport networks.

The Victorian government’s **sale** of its electricity assets during Jeff Kennett’s premiership in the 1990s is widely lauded as one of the most successful.

“They were brilliant,” King says, adding that they provided net gains for the economy and sizeable funds for Victoria. There were also efficiency improvements with generators under private ownership, while the **sale** of the distribution network appears to have led to lower power prices than in states where networks remain government-owned.

But the privatisation wave stopped by the 2000s, as governments developed reform fatigue and the **mining** boom hit.

In today’s more cash-strapped times, the concept is understandably regaining appeal. Privatisations let governments quickly raise money while taking sometimes costly companies out of the public purse. Conducted well, they benefit economies too. Private companies constantly seek to cut costs and offer product benefits to boost profits and stay ahead of rivals. In contrast, publicly run institutions have little incentive to curb spending.

“In most cases, not all, privatised assets will be operated more effectively and efficiently,” asserts the Institute of Public Affairs’ Novak.

Even the national competition regulator, the Australian Competition and Consumer Commission (ACCC), has called for privatisation. ACCC chairman Rod Sims says privatisation is the most important way for Australia to boost productivity because it removes impediments to competition.

“Government ownership versus private ownership massively affects the incentives people have to drive productivity change,” Sims says.

The Productivity Commission released a report in early 2013 referring to the superior performance of electricity concerns in those states that privatised vis-a-vis those remaining under governmental ownership.

Both the state and federal governments are already acting. “To a varying degree, each of the state governments is thinking about and talking about privatising their assets,” KPMG’s Vella says. “Increasingly, they are starting to get into a dialogue and narrative about considering selling assets to recycle into new infrastructure because of the pressure to invest in new infrastructure.”

Pockets of opportunity

But the pressure to privatise is far from uniform. “It’s difficult to see any common or uniform move across Australia to privatise,” says Novak. “We’ll more likely see isolated, ad-hoc, baby-step movements over the next two to three years.”

Vella adds that privatisation is “largely left to the state governments”.

Queensland and New South Wales in particular have lagged on the privatisation front and are seeking to catch up. “They never really got going on their electricity privatisation,” King says.

In 2010, Queensland successfully sold off its rail freight business, QR National (now Aurizon). Then late last year it appointed advisers to look at selling its electricity transmission and distribution sector, which is entirely government-owned. Rothschild and BofA Merrill will look at Ergon, Energex and Powerlink; Lazard will look at CS **Energy** and Stanwell; and **Energy** Edge and ACIL Allen will look at **Energy** Markets Advisors, a generator/retail business.

An Infrastructure Partnerships Australia report says the **sale** of electricity assets across the country could reap between A$40bn and A$48bn. It valued the country’s retail arms at A$650m-A$1bn; the generation business at A$2.28bn-A$3.25bn; and the transmission assets at A$37.1bn-A$43.8bn.

The Queensland government is also looking to offload its ports. JP Morgan is looking at a **sale** of the Gladstone and Townsville ports (Victoria’s Port of Melbourne is also mooted as a possible privatisation candidate), which is expected to raise up to A$3bn. The government’s Commission of Audit has also recommended the **sale** of other assets such as funds manager Queensland Investments Corp. (QIC).

The privatisations are likely to prove lucrative for the investment banks involved, welcome news in an otherwise sluggish **M**&A market.

“In some regards it’s somewhat simpler than typical work,” says one investment banker of the appeal of tender work. “It’s a formal process whereby a wide range of parties get an opportunity to put forward their capabilities.”

He expects the privatisation trend to continue. “It’s probably a current thing that will go on for several years,” he says. “It’s not obvious that the drivers of why government would consider it are going to go away in the foreseeable future.”

New South Wales is also moving. Last year it sold the 99-year lease of Port Botany and Port Kembla for A$5bn to a consortium led by Industry Funds Management. And in mid-February it sold its wholesale electricity business, Macquarie Generation, to AGL **Energy** for A$1.5bn.

Federal fire-**sale**

The central government is expected to look to offload other major assets in addition to Medibank Private.

Australia Post is a high-profile target. “That one’s a no-brainer,” King says.

Australia Post has a unique role: it has a monopoly on delivering standard letters up to 250 grams. Its ‘universal service obligation’ ensures that letter delivery to Australia’s sprawling outback is affordable. But technology means mail volumes are falling.

King believes the NBN, which is the broadband network the government is rolling out, will replace Australia Post as the national connector. That would leave Australia Post as a package **company** competing with private players such as DHL and TNT.

“There is no point having a government-owned parcel **company**,” King says.

Malcolm Turnbull, the minister who decides whether or not Australia Post will be privatised, has ruled out a **sale**. But that doesn’t mean it won’t happen. King believes the current debate is a way of offering the publicly opposed government some political cover on the issue, and will pave the way for an inevitable privatisation.

If and when it is sold, King says Australia Post will attract interest from competitors and privatised post offices not yet operating in Australia.

Medibank Private is the other high-profile privatisation looming. Like Australia Post in packages, it competes against other privately owned health insurers. “There is no reason the government should own it,” King says.

The government has appointed Lazard to write a scoping study on disposing of its **stake** through a listing or trade **sale**. The study, due at the end of February, was expected to value the **company** at around A$4bn.

Still, King says it won’t be a simple **sale**. “[Health insurance] is not an easy way to make your money,” he says, adding that insurers need federal government approval for price rises and premiums. “It’s a volatile sector and depends on federal policy and health policy.”

Other targets

Other state assets are also likely to end up on the block. Infrastructure Australia has identified more than A$100bn of government-owned assets suitable for privatisation, in electricity generation, transmission, distribution and retailing; water; airports; ports; freight rail; and forestry.

One investment banker says water assets are another possibility, though he describes it as a “fairly sensitive area”.

“Most of the Western world’s water assets have been privatised without any adverse consequences,” he says. Possible candidates include New South Wales’ Sydney Water, SA Water in South Australia and WA Water in Western Australia, along with water companies in Victoria and Tasmania.

KPMG’s Vella says governments could also consider selling infrastructure assets under development after they have generated a track record. The A$30bn NBN broadband operation could be privatised if and when it becomes a solid business.

Higher education could also be ripe for privatisations. The sector is the nation’s third-biggest exporter, and remains almost entirely in government hands.

“Should Australia’s governments be controlling Australia’s third-largest export industry?” asks King, although he notes that “some of my colleagues would hit the roof” over a university privatisation.

Risking a backlash

The threat of public backlash hinders possible privatisations.

The Kennett government was dumped in 1999 in part because of its privatisations, which were seen as harsh, while the Bligh Labor government’s loss to Campbell Newman in Queensland in 2012 can be traced in part to the perception it had misled voters about possible asset sales.

Unions have campaigned strongly against government asset sales, and there is widespread public scepticism. It could prove difficult for state and federal governments to convince potential voters of their necessity.

“They’re going to have a very hard time convincing people who have some element of anti-market bias to sell government assets and to separate government from capital allocation,” Novak says. “This is a debate that needs to be had.”

Political sensitivity surrounding privatisations is affecting the way the governments are approaching the issue. They’re choosing to “do some work on it, think about it, and take it to the next election”, says Vella.

The Queensland government, for example, has ruled out any privatisations until after the next election in 2015.

Vella thinks it's the wrong approach. He believes governments should challenge the "slightly naïve view in the electorate that if a government has built an asset, it's the taxpayers' asset, and should not be sold to foreign investors".

"It's entirely valid for governments to raise capital and transfer risk by selling assets, within an appropriate regulatory environment, and to recycle that capital into new infrastructure," Vella adds. "This is also an effective way of harnessing the significant amount of global capital held by institutional investors, such as pension funds, which are attracted to investment in operating infrastructure assets."

One strategy governments are using is the 'recycling' of assets: selling government-owned assets and using the money to fund new infrastructure.

"Selling existing operating assets is a very valid way of raising capital to fund new infrastructure investment," Vella says. He says global capital in sovereign and pension funds is looking to buy stakes in infrastructure, which offers predictable revenue streams. They don't necessarily want to invest in new projects.

Asset recycling has been dubbed the 'NSW model' after the New South Wales government sold the 99-year lease of Port Botany and Port Kembla. The state government clearly earmarked the proceeds for urban transport infrastructure, including WestConnex, the A$11.5bn, 33-kilometre motorway planned to link Sydney's central business district, west, south-west, airport and port areas, which is due to commence construction in 2015.

Its follow-up **sale** of the Port of Newcastle is expected to be finalised in mid-2015 and fetch more than A$700m, with half slated for revitalising Newcastle's central business district.

Australia's drive to sell state assets may be based on indebtedness, but it offers the potential to improve competition and allow for new infrastructure investment, both of which are largely to blame for deteriorating government revenues.

But the country's state and central governments will only be able to pursue such plans if they can persuade the public that such sales are necessary and beneficial.

In their efforts to sell assets to balance Australia's public books, Prime minister Tony Abbott and his state counterparts face tricky times ahead.

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AN Document AMF0000020140630ea47000b8

