The bidding prospects for Australia's TransGrid

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24/07/2015

Australia's long-planned privatisation wave is starting to gain momentum.

The New South Wales (NSW) government issued an information memorandum today to bidders that had filed expressions of interest (EOIs) for the roughly A$9 billion ($6.7 billion) lease of TransGrid. The documents will offer bidders the first opportunity to look over the details of the most sought-after asset set to be sold in Australia as part of the so-called 'poles and wires' privatisation.

The buzz among investors looking at Australia was slightly muted earlier this year, after the defeat of the Liberal National coalition in the Queensland. The election had been seen as a referendum on the state's privatisation plans. Attention then turned to NSW. In spite of some resistance in the state Senate, the NSW government managed to push through legislation to facilitate the long-term lease of its electricity transmission and distribution network.

In spite of – or perhaps because of – the cancellation of Queensland's privatisation programme, competition for TransGrid has proven fierce even by Australia's standards. Assets leased in the last few years to private investors, including Newcastle port and the ports of Botany and Kembla, have attracted earnings before interest, tax, depreciation and amortisation (Ebitda) multiples of 25-27x.

First out the block

NSW Premier Mike Baird won this year's state election partly on a privatisation referendum.

In 2014 NSW appointed UBS and Deutsche Bank last year to study the feasibility of leasing 49% of the state's electricity transmission network assets to the private sector. The state government plans to recycle the capital gained from a sale, and from the Commonwealth government's asset recycling initiative, to fund new major infrastructure projects.

The 49% figure is slightly misleading. It represents the average level of government ownership across all four of the state's main electricity businesses. The NSW government has said that it will sell 100% of electricity transmission operator TransGrid to the private sector in the form of a 99-year lease. This is to be followed by the sale of 50.4% stakes in electricity distributors Ausgrid and Endeavour Energy, possibly via an initial public offering (IPO). NSW plans to maintain full ownership of Essential Energy.

TransGrid is the most attractive of these assets, and not just because of the intended 100% ownership of the lease. TransGrid will also benefit from the highest estimates for dividends and tax equivalent payments among the assets, per a decision in April 2015 by the Australian Energy Regulator (AER).

The AER's decision will allow TransGrid to recover A$2.19 billion over the 2015-18 regulatory control period, though roughly 25% less than what the operator had sought. The decision, however, will eat less into TransGrid's returns than for Ausgrid and Endeavour Energy. TransGrid's dividends and tax equivalent payments is projected to slide to A$149 million in FY2016-17 before recovering.

Fierce competition

NSW is expected to allow all seven EOIs to proceed to the indicative bid stage. Bidders include:

- A consortium of Hastings Funds Management, Spark Infrastructure, the Abu Dhabi Investment Authority, Caisse de Depot et Placement du Quebec, and Kuwait Investment Authority subsidiary Wren House
- A consortium of IFM Investors and Queensland Investment Corporation
- A consortium of AustralianSuper (Australia's largest superannuation fund), Canada Pension Plan Investment Board and Borealis Infrastructure
- A consortium of China Southern Power Grid and Global Infrastructure Partners
- Li Ka-shing's Cheung Kong Infrastructure Holdings

AusNet, which is also understood to be bidding, would be a natural contender given that it already operates three energy networks in Victoria. The AusNet bid has been called into question, however, after its largest shareholder – Singapore Power – voted against plans for an equity raising.

State Grid Corporation of China, AusNet's second largest shareholder, is instead bidding in a consortium with Macquarie Infrastructure and Real Assets. The state-owned utility is one of several Chinese investors bidding for TransGrid.

Chinese investors have bid for Australian assets before.

Hastings and China Merchants, for instance, won the tender for Newcastle port in early 2014. They have since formalised their arrangement through an investment partnership agreement.

But the number of Chinese bidders circling TransGrid is unusual. The interest in the asset may push Ebitda multiples beyond the 27x Ebitda that Hastings and China Merchants paid for Newcastle port.

One possible snag for Chinese investors could be the Foreign Investment Review Board (FIRB). But since both the federal and state governments favour privatisation, the FIRB probably won't prove a major hindrance, and it's likely that bidders would have already sounded it out. The Australian Competition and Consumer Commission (ACCC) is often stricter, although this will only apply to those participants in a bidding consortium with significant electricity operations in Australia.

Rising prices

In nearly all recent privatisations in Australia, the final sale prices have outstripped even the most optimistic estimates at the time that the assets were put out to tender.

At least three factors explain the buyer appetite: investor preference for stable, contracted infrastructure assets in safe regulatory jurisdictions; increasing Chinese outbound investment; and a small number of available quasi-monopolistic, operational assets.

Newcastle port was expected to fetch about A$1 billion, but Hastings and China Merchants paid A$1.75 billion (including transaction costs for the 98-year lease). Other recent M&A deals for brownfield assets, including APA Group's $4.6 billion acquisition of the QCLNG pipeline, also reflect this trend.

For the next wave of assets, the answers to some outstanding questions will probably determine the bid offers. These include: with whom responsibility lies for future capital expenditure, and – in the case of Ausgrid and Endeavour Energy – the relationship between the government and the private sector in an unincorporated joint venture.

Assuming these concerns are adequately dealt with, 'poles and wires' will be Australia's most competitive privatisation programme yet.