

---

## **WELLINGTON INTERNATIONAL AIRPORT LIMITED**

### **SHAREHOLDER PROPOSAL**

---

#### **PUBLIC EXCLUDED**

**Grounds:** Section s48(1)(a) - That the public conduct of this item would be likely to result in the disclosure of information for which good reason for withholding would exist under Section 7.

**Reasons:** Section 7(2)(b)(ii) - The withholding of the information is necessary to protect information where the making available of the information would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information.

Section 7(2)(h) - The withholding of the information is necessary to enable the local authority to carry out, without prejudice or disadvantage, commercial activities.

Section 7(2)(i) - The withholding of the information is necessary to enable the local authority to carry on, without prejudice or disadvantage, negotiations (including commercial and industrial negotiations).

---

#### **Purpose**

1. This report asks the Council to agree to participate in the provision of shareholder support to Wellington International Airport Limited (WIAL or the Company) through the underwriting of a potential equity issue.

#### **Summary**

2. WIAL is jointly owned by Infratil (66%) and Council (34%), hereinafter referred to as the Shareholders.
3. The Shareholders have been approached by WIAL to provide shareholder support due to the impact of Covid-19 on air travel and therefore the Company's operating revenues.
4. The Council investment in WIAL is \$198m based on 34% of the shareholder funds of the Company, this is a significant investment for Council. This proposal should be considered in the context of what is in the best interests of Council to protect the value of that investment.
5. The shareholder support is required to enable the Company to access additional funding facilities from its banks, to obtain waivers from the banks with respect to financial covenants in their funding agreements and to ensure the Company has access to sufficient funding to meet its obligations based on a range of scenarios.
6. The shareholder support requested is in the form of an underwriting of the issue of \$75,757,575 convertible redeemable preference shares (CRPS). Council's share of the underwriting would be \$25,757,575.
7. The underwriting would only be called if the Company is in a position in the future where it actually needs the funding. The intention of the underwriting of the CRPS

issue is to provide comfort to the banks as they increase the facilities available to WIAL and provide waivers around banking covenants. We have worked with Infratil and WIAL to shape the terms of the CRPS to ensure that the Company is required to take all reasonable commercial steps to avoid the drawdown issue of the CRPS and to ensure they are expeditiously redeemed.

8. Council is not required or obliged to participate in the underwriting if it chooses not to, however there are consequences to not participating that include a material risk that the 2019/20 dividend of \$13.9m would not be paid, the dilution of Council's shareholding in WIAL at a time where this would be disadvantageous and the move away from what has been a strong joint Relationship in the Company with Infratil.
9. Officers engaged Keith Sutton to provide commercial advice through this process. Keith is a former Council appointed director of WIAL and widely respected commercial adviser, and officers are advised that Council's interests are best served through participating fully in the underwriting.
10. In essence any drawdown of the CRPS will be new form of equity and will pay a fixed dividend at [REDACTED] per annum. In the event the CPRS cannot be repaid by the Company within two years of the drawdown, then they would convert to ordinary equity (unless the Shareholders agree to extend).
11. Officers recommend that Council participate in the underwriting offer as proposed and note that this will essentially mean that the 2019 dividend of \$13.9m will be received in June 2020 and that Council will have a potential future obligation relating to the CRPS of up to \$25,757,575 for the term of the underwriting, which will expire on [REDACTED]

## **Recommendation/s**

That the Council:

1. Receive the information.
2. Agree to underwrite the issuance of convertible redeemable preference shares (CRPS) in Wellington International Airport Limited up to a maximum amount of \$25,757,575.
3. Agree to delegate to the Chief Executive the authority to finalise the documentation relating to the underwriting in accordance with the terms outlined in this report and execute any associated documentation.
4. Note that officers have taken independent advice regarding the need for the underwriting and the terms of the underwriting.

## **Background**

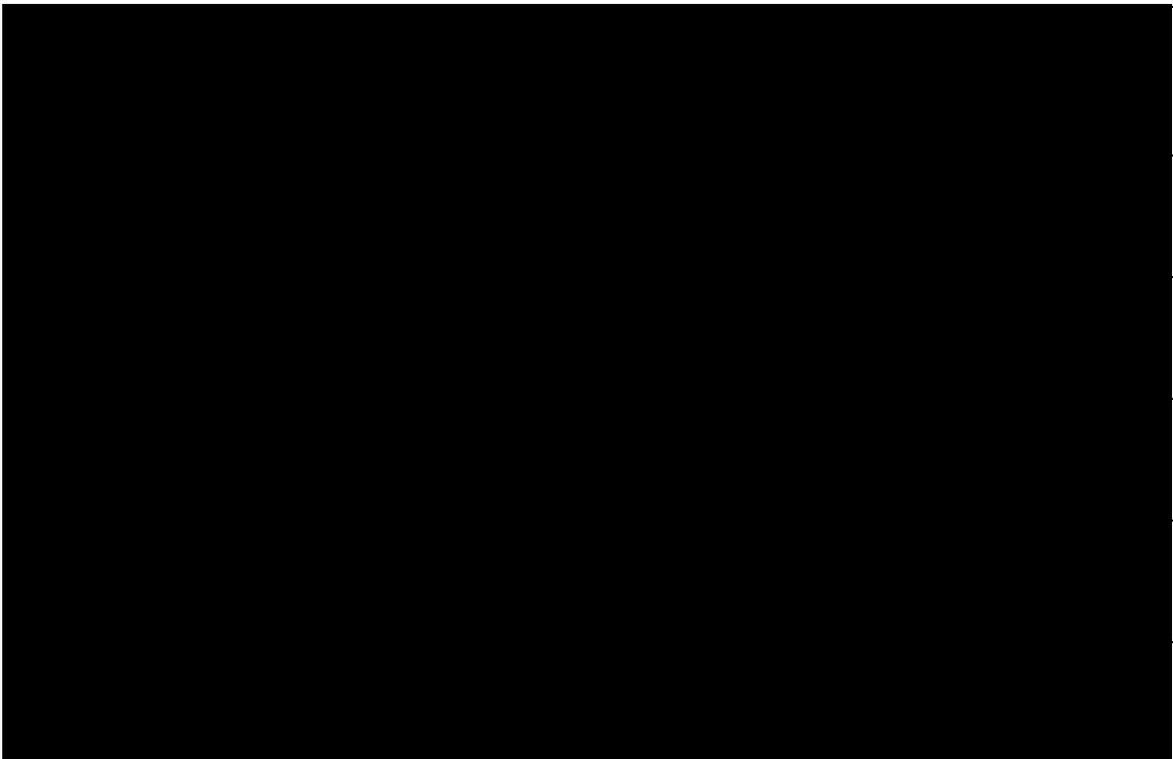
12. Since 1997 WIAL has been jointly owned by Infratil and Council. The Council investment in the Company is 34%. As at 30 September 2019 the Shareholders' funds of the Company were \$582,773,000, the Council's 34% share would represent \$198,142,820.
13. The impacts on the aviation industry as a result of COVID-19 have been significant and WIAL has been active in responding to the impacts at an operational levels. The Company has also engaged with its lenders in terms of ensuring sufficient access to committed bank facilities and to seek appropriate waivers from financial covenants.

14. The lenders to the Company have indicated that they will provide the requisite funding lines and provide the necessary waivers on the condition that the shareholder support is confirmed.
15. A proposal from WIAL has been received, which seeks shareholder support in the form of an underwriting for the issuance of CRPS.
16. The underwriting would be provided by both Shareholders on a pro-rata basis up to a maximum value of \$75,757,575. Council's 34% share would be up to a maximum of \$25,757,575.
17. The underwriting would remain in existence until [REDACTED] unless there has been a drawdown against the underwriting before that date. In the event that there has been a drawdown, then the amount provided to WIAL would be through the issuance of the CPRS and would pay a fixed dividend of [REDACTED] per annum. If the CPRS is not able to be repaid within two years of the drawdown event any outstanding amounts, including accrued interest, would be converted to ordinary shares at that date. The Shareholders would be able to extend the two-year period for conversion to ordinary shares.
18. The intention is that the underwriting provides the lenders to WIAL, the Rating Agencies and the Company itself with the comfort that they are in a strong position to meet all obligations, including any bond refinancing, through until [REDACTED]  
[REDACTED]
19. The Company has produced a range of future scenarios which show a baseline scenario where the underwriting is never drawn down through to a black hat scenario which sees [REDACTED] of the underwriting drawn down in May 2021, of which Council's share is [REDACTED]. The forecasts are discussed in more detail within the report and a full copy of the WIAL proposal is appended.
20. Officers have engaged an independent adviser to provide expert advice around the appropriateness of the request, the mechanism and the terms proposed, the consistency with what others are doing in the aviation sector and how Council's interests are best served and protected.
21. Keith Sutton was appointed due to his strong background in Corporate Finance, Capital Markets and in the industry having been a former Director of WIAL (Council appointee). Keith has worked with Officers, Infratil and the Company to test and refine the proposal to ensure it represents a fair and robust offer and that Council's interests have been well considered. The main points from Keith's report are discussed within the report and a full copy of his report is appended.
22. Council has the choice whether to participate in the underwriting, either fully, partially, or not at all. There are a range of consequences and risks that would arise if Council chose not to participate and these are discussed within the report in more detail. The primary impacts would be: the necessary support from the Company Lenders would be at risk; a material risk that Council may not receive the 2019/20 dividend of \$13.9m which is due to be paid in June; on any redemption and conversion of Infratil's investment in the CRPS Council's shareholding in the Company would be diluted; and any dilution would carry significant price and value risks for Council.
23. Infratil has provided confirmation that they will support the underwriting for \$50,000,000, which represents their 66% pro-rata share of the total offer, [REDACTED]

 This is short of the \$75,757,575 requested by the Company. In this event it is likely that the Company would need to seek the balance of the investment from other sources.

## **Discussion**

24. COVID-19 has impacted many businesses throughout New Zealand but possibly few have been harder hit than those in the aviation industry, the impacts on AirNZ, Airways Corporation and Auckland Airport have been well publicised.
25. WIAL has been impacted similarly and has seen a severe reduction in air travel numbers and therefore revenues. The Company has produced a range of forecast scenarios for the 2020/21 and 2021/21 financial years.
26. The forecasts are summarised in the table below:



27. The review report notes that the circumstances outlined by WIAL warrant the request for shareholder support. Arguably the amount of underwriting may have been larger and the period covered longer but the overarching concept of the request has been for WIAL to try and avoid making use of the underwriting, if possible.
28. It is worth noting that WIAL's services are predominantly provided by National carriers and these airlines are more likely to come through the downturn in reasonable shape. WIAL forecasts are consistent with those publicly announced by AirNZ, which indicate a recovery to 70% within 12 months.
29. The Company has sought to ensure that it has the necessary access to funding and accommodations with its lenders to ensure that it is able to meet its future obligations

as they fall due across the range of these scenarios [REDACTED]

30. The Company has acted quickly to address operational aspects of the business [REDACTED]
31. With respect to liquidity, the Company has negotiated with its lenders an increase in its committed bank facilities of \$70m subject to finalising the position around the shareholder support.
32. The existing bank facilities contain financial covenants that under forecast scenarios are likely to be breached and therefore acting prudently the Company has sought waivers from their lenders for those covenants at risk.
33. WIAL source debt funding from the bond market and it is important that they seek to maintain their credit ratings to assist with future access to the bond market to refinance future maturities and the pricing of any issuances.
34. The funding provisions noted above are essential to the Company and a pre-requisite to the lenders' commitment is confirmation of the nature and extent of shareholder support to the Company.
35. The CPRS proposal has been carefully developed to provide a mechanism that provides the Company with the requisite support to satisfy its Lenders but does not commit the Shareholders to any funding provision until it is actually required by the Company.
36. The table below summarises the key terms of the CRPS:

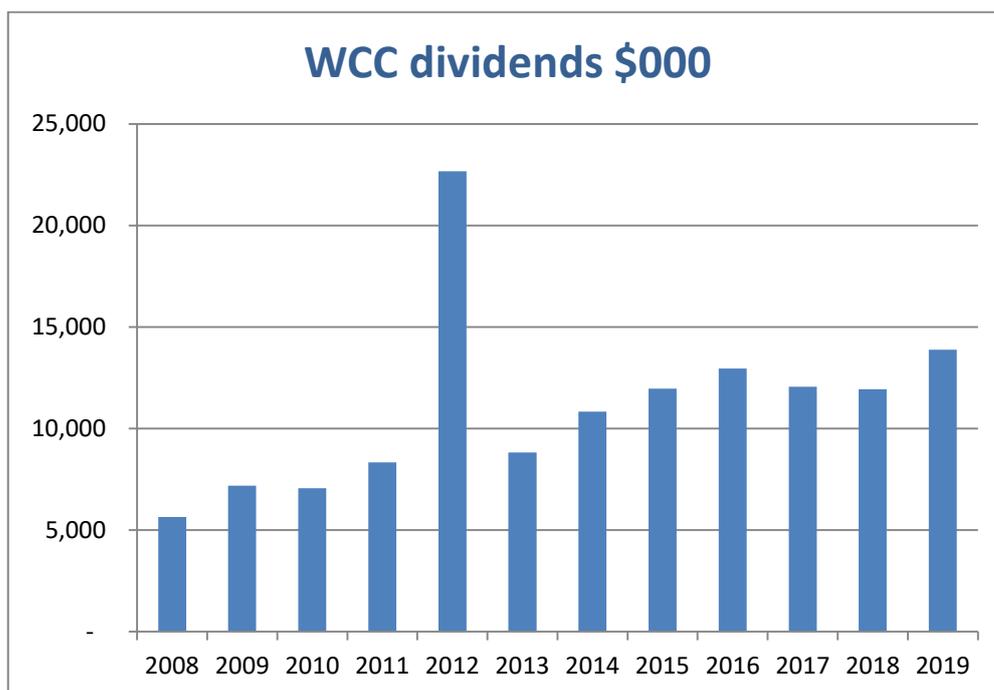
<b>Amount</b>	Convertible redeemable preference shares up to \$75,757,575
<b>Purpose</b>	To retain support of Lenders. It may be drawn to provide funds to refinance maturing bonds or meet operational requirements
<b>Conditions</b>	<p>WIAL undertakes:</p> <ol style="list-style-type: none"> <li>1. to use all commercially reasonable endeavours to not issue CRPS;</li> <li>2. to use all commercially reasonable endeavours to repay any CRPS which are issued as soon as possible;</li> <li>3. to not make any distributions after June 2020 to Shareholders except on any CRPS outstanding while the underwrite commitment is outstanding or any CRPS are on issue; and</li> <li>4. to confirm to Shareholders before they enter into the underwriting commitment that WIAL has received waivers from its lenders until at least 30 September 2021 with regard to loan covenant breaches.</li> </ol>
<b>Term</b>	Underwriting commitments will expire on [REDACTED]
<b>Priority</b>	CPRS will rank ahead of ordinary shares in the event of a liquidation

<b>Voting</b>	CRPS will be non-voting
<b>Dividend</b>	The CPRS will pay an [REDACTED] per annum fixed dividend semi annually
<b>Redemption</b>	CPRS may be redeemed by WIAL at any time subject to lender approval
<b>Conversion</b>	If any CRPS have not been redeemed by the 2 <sup>nd</sup> anniversary of the first tranche being issued, then unless agreed to be extended then the CRPS will convert to ordinary shares. The value of the shares will be determined using the Shareholders funds as at the immediately prior half year or full year financial statements.

37. As set out within the CPRS terms above there will be no ordinary dividend payments beyond the 19/20 payment until the CPRS is either terminated or converted to ordinary shares. Practically this means there will be no dividend payment for 20/21 and a high likelihood that there will be no dividend in 21/22.
38. Working with Keith Sutton the proposal has been developed to require the Company to use all commercially reasonable endeavours to avoid calling on the underwriting and similarly to use all commercially reasonable endeavours to repay any amounts drawn against the underwrite as soon as possible.
39. These are important protections and mean that effectively the Company must have exhausted alternatives [REDACTED]
40. In his report Keith states that the proposed mechanism is not inappropriate and will be effective in providing the support required.
41. One of the main reasons that WIAL is in a position where it is seeking shareholder support is because the model operated by the Shareholders over a long period has been for the Company to pay out its operating earnings in dividends annually to the Shareholders. To illustrate, since 2013 WIAL has paid an equivalent of 104% of its earnings out as dividends – over the same period Auckland Airport has paid out an average of 76%, this equates to an NPV value of \$24.3m that Council received versus the Auckland payout regime.
42. The report from Keith Sutton makes it clear that the performance of the Company is not at issue and that the underwriting should not be viewed as a shareholder bailout. Any business experiencing an earnings-related impact in the current COVID-19 situation will face issues with its bank covenants. He also notes that the requests from the lenders to WIAL appear less stringent than others at present including Auckland Airport.
43. The proposed actions are in keeping with those taken by other NZ aviation market investors in response to COVID-19 revenue collapses, but is more favourable for WIAL Shareholders in comparison as it provides for them to still access the 2019/20 distribution.

## Options

44. The options to Council here are basically to participate (partially or fully) or to not participate. The report has been written on the basis of the recommendation of officers to participate and this section considers the alternative option to not participate.
45. The request from the Company is for an underwriting of \$75,757,575. It is designed to be on a pro-rata basis between the Shareholders. Infratil has already confirmed that they will take up their full share of the underwrite at \$50,000,000 [REDACTED]
46. Obviously the commitment from Infratil alone is insufficient to meet the needs of the Company and its Lenders and in these circumstances the Company would not make the scheduled dividend payments for 2019. The impact on Council would be a direct loss of \$13.9m which is planned and budgeted and would require Council to borrow an equivalent amount before 30 June 2020.
47. The underwriting proposal itself is viewed as being fair and balanced between the Shareholders provided the Shareholders participate on a pro-rata basis. Should the underwriting be used and Council does not participate then there is a risk that if the underwrite converts to ordinary shares then Council's shareholding in WIAL would be diluted. Based on no change in the value of Shareholders funds the Council shareholding would be diluted from 34% down to 30.6%.
48. However, should the Company have operating losses and/or impairment adjustments, then the impacts of any dilution will be higher. A 20% reduction in net total assets would result in the 34% share diluting to 29.9%. This would be a loss of value resulting from the historical impacts of COVID-19 and not be related to future earnings. In this instance Council would be disadvantaged through the dilution as a one-off event and thereafter disadvantaged through having a lower share of the Company and future earnings upon recovery.
49. [REDACTED] To date this has not presented any issues for Council as a minority shareholder and there has been a strong relationship between the Shareholders and this has greatly benefited Council. Infratil has indicated that they are keen to see the dividend payments for 2019/20 take place as they have these factored into their earnings forecasts (remembering that Infratil is a listed Company on the NZ stock exchange). The strong relationship between the Shareholders and the Company could be undermined where Council chooses not to support the underwriting.
50. Council has been able to access 100% of the earnings of the Company through the dividend distributions. The table below shows what a strong growth investment WIAL has been for Council and the extent that it has contributed cash through the annual dividend that reduces the rates impost.



51. Over the last 10 years the total dividends paid to Council have amounted to \$120.5m. We have benefitted strongly from the relationship with Infracore which has been transformational to the performance of WIAL and has been reflected in the earnings. The value of a minority shareholder maintaining a strong and constructive relationship with the majority shareholder in a two shareholder model is not to be dismissed lightly.
52. While not participating is an option for Council, officers strongly recommend that this option is not adopted and that it is not in the best interests of Council.
53. The advice from Keith Sutton is that assuming there are no financial constraints, WCC's interests in this situation are better served by participating fully in the proposal.
54. There are no financial constraints on Council that preclude it from participating fully.

### Next Actions

55. On acceptance of the offer by Council and Infracore then the formal legal documentation for the CRPS underwriting will be completed and executed. It is recommended that the Chief Executive be provided with the delegation to finalise and execute the documentation in accordance with the details provided in this report.

### Attachments

- Attachment 1. WIAL Proposal - Airport Report 20200414
- Attachment 2. WIAL Proposal - K Sutton report 20200417

Author	Danny McComb, Manager Economic & Commercial
Authoriser	Andy Matthews, Chief Financial Officer

## **SUPPORTING INFORMATION**

### **Engagement and Consultation**

Not applicable

### **Treaty of Waitangi considerations**

Not applicable

### **Financial implications**

Covered within the report.

### **Policy and legislative implications**

Not applicable

### **Risks / legal**

Risks are covered within the report. The final documentation will be subject to legal review.

### **Climate Change impact and considerations**

Not applicable

### **Communications Plan**

The paper is public excluded and will be released subject to redactions required for any confidential matters and post any requirements of Infratil to make any required market disclosures

### **Health and Safety Impact considered**

Not applicable