

BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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Infratil, Contact Energy, and IAG

After a drought of good quality fixed interest offers recently we now have three on the go at once. Infratil, IAG and Contact Energy are all seeking to raise money, and all have different characteristics.

Infratil

The Infratil offer is the least complicated being a fixed-term, fixed-rate bond. Infratil will pay interest of 8.00% per annum until maturity in November 2017. In the past Infratil has retained the right to redeem the proceeds of their bonds in shares rather than cash; however they have forfeited their right to do so in this case. At maturity holders of the bonds will be paid in cash. Unlike most other large corporates, Infratil doesn't seek a credit-rating for their bonds. Apart from the significant cost, Infratil's model of regularly issuing (comparatively) smaller amounts of debt to retail investors lessens the need to have their bonds rated.

Insurance Australia Group (IAG)

The IAG bond is more complex and is very similar in structure to the Genesis Energy bond issued in May this year. IAG are seeking to raise \$325 million for general corporate purposes. The bond has a maturity date of 2036; however there is a strong possibility it will be repaid in 2016. The credit ratings agencies (Standard & Poor's in this case) consider the money raised as equity rather than debt because it is such a long-dated bond. This equity rating is lost once the bond has twenty years to maturity (2016) and this would encourage IAG to repay it then. IAG has a credit rating of A+ and the bonds have been assigned a credit rating of A-. The interest rate will be determined on December 13th and will be a sum of the five-year swap rate plus a margin of 3.78%. If the rate was set today the interest rate would be 7.22%, however IAG has guaranteed the rate for the first five years will not be below 7.50%.

Contact Energy

Contact Energy is seeking to raise up to \$250 million for general corporate purposes. Their bond has a maturity date of 2042, and like IAG, will lose its equity rating from Standard & Poor's once the bond has twenty years until maturity. This means it is likely (but not guaranteed) to be repaid in February 2022. Contact Energy has a credit rating of BBB, and their bond is expected to be assigned a credit rating of BB-. Its pricing mechanism is similar to IAG being a sum of the five-year swap rate plus a margin of 4.55%. If the rate was set today the interest rate would be 7.99%, however Contact Energy has guaranteed

the rate for the first five years will not be below 8.00%. At each five-year anniversary if Contact Energy does not redeem the bonds in full they will increase the margin paid over the five-year swap rate by 0.25%. This is another factor that is likely to encourage early repayment.

So what can go wrong? Obviously each of these three companies can suffer some sort of event that prevents them paying back investors, however all three have good track records. Infratil's assets are in transport and energy, industries that have historically proven to be stable. Contact Energy generates approximately 25% of New Zealand's electricity, and like Infratil, is an industry with long-term stable demand. IAG offers an exposure to the insurance industry where the larger losses are covered by reinsurance. Governments around the world have also shown a willingness to step in and support insurance businesses as the type of entity that is too important to fail.

The other possible effect on the IAG and Contact Energy bonds is the movements in interest rates over the coming years. The benchmark used now and at the five-year anniversary is the same – the five-year swap rate (this rate fluctuates on a daily basis). Therefore if interest rates rise over the next five years it's safe to assume the five-year swap rate will rise also. Conversely if interest rates fall, the five-year swap rate should fall in line with those movements. So the rate offered for the second five-year period should be a reflection of where interest rates have moved from today. But what about the margin? In the case of IAG the margin won't change (3.78%). Will this be acceptable five years from now? We have seen large losses in value of the early perpetual securities due to the fact margins offered on those securities were deemed unacceptable following the global financial crisis. Will 3.78% above the five-year swap rate be acceptable in 2016 for a security with an A- credit rating? Only time will tell, but I would suggest it would take a further deterioration in the money markets (not impossible) for those credit margins to grow more than they have already.

CONTACT THE OFFICE AS SOON AS POSSIBLE IF ANY OF THESE BONDS ARE OF INTEREST TO YOU

Powers of Attorney

Have you considered what might happen if you were unable to look after yourself, or make decisions about your own affairs? Who would deal with your property, operate your bank accounts, and pay your bills if you were no longer able to? While a will explains how your assets will be distributed at death, you still need to be mindful of how your affairs are managed while you are alive. A power of attorney allows you to nominate someone to act on your behalf in the event you are unable to manage your own affairs. It gives that person authority to act legally on your behalf to the extent specified in the power of attorney. There are two main powers of attorney – an ordinary power of attorney and an enduring power of attorney.

Ordinary Power of Attorney

With an ordinary power of attorney you appoint someone to help look after your affairs. You decide how wide the powers you grant should be, and you state whether you must act together (jointly) or whether you can act separately (severally). An ordinary power of attorney remains valid only while you still have legal capacity. If you become mentally incapable your ordinary power of attorney ceases immediately, as is the case if you die. If you want someone to be able to act for you when you can no longer manage your own affairs, you need to arrange an enduring power of attorney (EPA)

Enduring Power of Attorney (EPA)

Unlike an ordinary power of attorney, an enduring power of attorney (EPA) allows the attorney to act for you if you become mentally incapable. There are two types of EPA; one for property, and one for personal care and welfare.

A property EPA allows the person you have chosen to act on your behalf with respect to the property you own. This includes land, property, your bank accounts, shares, and other possessions. Under a property EPA you retain control of your affairs after it has been signed, and you decide how it is to be used. You can limit it to certain property or specific circumstances – you do not have to give your attorney unlimited power. You can decide whether you want a property EPA to take effect only if you become mentally incapable, or whether it is to have immediate effect and continue to operate if you become mentally incapable. You may choose to have more than one person to act as your attorney under a property EPA. If you appoint the attorneys to act jointly, they must act together, and anything requiring a signature will require the signature of all the attorneys.

A personal care and welfare EPA enables your attorney to make legal decisions about your personal care in the event of you becoming mentally disabled. Your attorney might decide whether or not you need to go into care, what medical treatment you should receive, and where you should receive that treatment. It only comes into force if you become mentally incapable. You can appoint only one person at any one time to act as your attorney in relation to personal care and welfare.

You must arrange an EPA before you become mentally incapable; otherwise the power will be invalid. If you are already incapacitated, you are deemed not capable of granting a valid power of attorney. If you are already incapacitated, those people who want to care for you and make decisions on your behalf would have to apply for court orders to do so. This takes time and will be considerably more expensive than organising an EPA. Furthermore the person appointed under a court order might be someone you would not have chosen yourself.

You should choose people you trust implicitly to act as your attorney, and should indicate to them exactly how you would want your affairs conducted in the event of your incapacity. The powers granted can be

very wide, and could for example; include making a will for you with the court's approval. You should therefore choose someone who is unlikely to have any conflict of interest when dealing with your affairs. Although you can draw up powers of attorney without consulting a lawyer, your lawyer will be able to advise you on the implications of what you decide. They will have the required forms to prepare your powers of attorney quickly and at a reasonable cost.

Local Government Funding Agency

In September the Government passed the Local Government Borrowing Bill. The legislation allows for the formation of a "bond bank," the Local Government Funding Agency. It will allow local authorities (city and district councils) to borrow money at lower interest rates than they can at present. The funding agency will issue local Government bonds to investors and then on-lend those funds to the participating local authorities. Retail investors will be able to take part and presumably their exposure will be spread over all the participating councils, rather than on an individual basis. Interest rates will be low, based on the low risk, but might suit some risk averse investors who are looking to gain exposure outside the major trading banks. We will watch with interest as this develops in the New Year.

Golf

My eldest son and I are heading to Christchurch to watch the NZ Open golf tournament this weekend, and I will be out of the office on December 2nd and December 5th. Sue will be in the office to answer any queries you may have. I'm available on 0274523980 if you need to reach me.

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