BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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Bramwell Brown Limited – Newsletter – March 2013

Mighty River Power

The Government's asset sales programme has finally been given the green light after the Supreme Court dismissed the Maori Council's bid to halt the process. The Court has ruled the float of Mighty River Power was not such an impediment to the Crown as to constitute a breach of the Treaty of Waitangi. I delayed publishing this month's newsletter until we had a bit more certainty around how the float was going to be administered. At this stage the following steps have been publicised:

- Pre-registration – this gives investors the opportunity to register their interest and to receive an offer document. It does not impose any obligation to purchase shares. Pre-registration became available on March 5th. Those who pre-register may be allocated up to twenty-five percent more shares than those who do not pre-register, if demand exceeds shares available. Pre-registration must be completed before March 22nd.

- Offer document – the offer document is expected to be available from early April at which stage investors will make their application. All applicants will have to supply a valid IRD number, a valid New Zealand bank account, a New Zealand address and a declaration that they are a New Zealand citizen, or permanent resident in New Zealand.

- Bookbuild – the bookbuild process collates how many people have applied for shares, how many shares will be sold, and at what price the shares will be listed.

- Allocation – depending on demand the issue may be scaled in which case investors will receive a refund on their application.

Pre-registration

Bramwell Brown Limited can pre-register on your behalf with your consent. Please call the office as soon as possible if you would like me to do that for you.

Mighty River reported their six month results to the end of December recently and below is some of the commentary released to the market.

Highlights

- Net Profit After Tax increased by $58 million
- Underlying Earnings up 31% ($32 million) on the previous year as a result of gains in market share and higher hydro volumes
- Declared interim dividend of $67 million

Operating Performance

Mighty River Power achieved a solid operating performance as the Company continued to achieve gains in market share in electricity sales to customers and benefited from higher hydro volumes. During the half year, Mighty River Power's electricity price to customers increased 2% and associated volumes increased by 9% as the Company secured more business customers well ahead of the commissioning of the 82MW Ngatamariki geothermal power station. Total electricity purchase costs fell 22% reflecting lower wholesale prices as inflows into our competitors South Island catchments increased, and a less constrained grid.

Overall generation increased by 36GWh due to higher hydro generation and the strong reliability (96%) across the Company's geothermal plants (partly offset by the sale of 10% interest in Nga Awa Purua in April 2012). Gas-fired generation at the Southdown plant in Auckland fell by 130GWh as the Company responded to pricing in the wholesale market. Hydro generation increased by 210GWh as a result of higher inflows than average in the first quarter of the financial year. The price received for the Company's generation outperformed the market over the period reflecting the ability to effectively utilise storage and flexible plant to respond to wholesale prices, and the decision to move the planned outage of Southdown to ensure availability at a time when national electricity supply was impacted by a number of thermal and transmission outages.

KiwiSaver

April 1st 2013 will see some minor changes to the KiwiSaver scheme. From that date the minimum employee deduction and the minimum employer contribution will increase from 2% to 3%. For those who are retired or self-employed and don't receive wages through the PAYE system there is nothing you need to be concerned about. Ensure you continue to contribute at least $1,043 per annum in order to receive the maximum contribution of $521 from the Government. Call the office if you would like to discuss your situation.

Compliance, Compliance, Compliance

Sometimes I wonder if the Government can squeeze any more compliance out of me. After jumping through hoops in order to become authorised I now find myself dealing with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009. There is no question the AML laws are a worthy and necessary addition to the framework we operate within – I just wish they didn't have to apply to my small business in the provinces. The legislation is now typical throughout the world and is a direct result of the 2001 terrorist attacks in New York. All financial institutions now have an obligation to implement policies, procedures and controls to detect and deter money laundering and terrorist financing.

The new regime is based on risk assessment, customer due diligence and suspicious transactions reporting. My first task is to provide a risk assessment for Bramwell Brown. It must be in writing and it must include a description of how I will keep it up to date. It needs to identify the risks my business faces, determine the severity of those risks, and enable me to prepare a programme to manage and mitigate those risks. The type of things the authorities are looking for is large cash transactions, hiding the beneficial owners of an investment through trusts or other structures, and suspicious or unnecessary transactions. I believe the risks to Bramwell Brown are minor; however the process still needs to be completed. The Financial Markets Authority has released a paper stating this is one aspect of compliance they will be actively policing among financial advisers in 2013. Sanctions for non-compliance include fines up to $2 million dollars and two years in prison – I think I'll make a start on this very shortly!

The main effect of this legislation that clients may notice is the increased requirements around identification. In the past we have relied on driver's license, proof of bank account and proof of residential address. The Financial Markets Authority Code of Practice favours passports as the primary source of identification so I will be asking clients to provide their passports as identification where possible. There may also be more scrutiny where trusts and companies are concerned as we have an obligation to identify the beneficial owners of any entity we do business for.

The final part of the legislation is suspicious transaction reporting. All businesses have an obligation to report transactions that they believe may be involved in criminal activity or money laundering. So be warned - if you present me with a suitcase full of cash to pay for your shares I will be obliged to pass that information on to the police. We must have our risk assessment independently audited every two years which will impose yet more compliance costs on small businesses. I realise the importance of all the new regulations that have been introduced over the last five years; however there is no question it has resulted in less time spent in front of clients discussing investments, and more time in front of a computer writing policies and procedures.

BNZ and ANZ Perpetual Securities

The BNZ perpetual shares (BISHA) issued in March 2008 will be called by the bank on their 5-year anniversary (March 28th). I think the bank must have been tempted to roll these over for a further five years considering the attractive reset characteristics. Had they chosen to they could have rolled these over at 2.20% over the five-year swap rate. The five-year swap rate is currently sitting around 3.50% which would have given a new rate of 5.70% until 2018. Why didn't they roll it over for a further five years? Some of the big changes to come out of the global financial crisis have been around bank regulation. Basel III is a global regulatory standard based around banks' capital adequacy, stress testing and liquidity risk. In a nut-shell the regulations place an expectation on banks to hold more equity capital on their balance sheets. This should strengthen our banking sector and lessen the risk of failure. Our Reserve Bank intends to implement the Basel III regulations promptly and this has implications for the banks who have issued perpetual securities. Under the old rules these securities could be treated as equity on the bank's balance sheet, but under the new rules they may be classed as debt.

This may have had some influence over the BNZ's decision, but probably of more importance is their second perpetual security (BNSPA) due for its first call date in June 2014. It has far less favourable terms (for the BNZ) than the first with a reset of 4.09% over the five-year swap rate. At that margin it is fairly certain the bank will repay next year. Investors would have taken a very dim view if the BNZ had rolled the 2013 security over for a further five years at 2.20% over the five year swap rate, but decided to repay the 2014 security because of its 4.09% margin.

The ANZ has decided to roll their perpetual security (ANBHA) over for a further five years and market pricing leading up to the announcement indicated there was no surprise in that decision. Its reset rate is a margin of 2.00% over the five year swap rate so it should reset (on April 18th) at about 5.50%. It loses its equity status progressively over the next five years and it's a fair bet it will be repaid in 2018.