

## Treasury Report: KiwiRail - drawdown request

<b>Date:</b>	11 March 2021	<b>Report No:</b>	T2021/441
		<b>File Number:</b>	SE-2-25-0

### Action sought

	Action sought	Deadline
<b>Minister of Finance</b> (Hon Grant Robertson)	<b>Sign</b> and initial the attached share subscription agreement presenting a counter-offer to KiwiRail for the purchase of \$60.6 million in KiwiRail shares <b>Refer</b> a copy of this report to the Minister of Transport	23 March 2021
<b>Minister for State Owned Enterprises</b> (Hon Dr David Clark)	<b>Sign</b> and initial the attached share subscription agreement presenting a counter offer to KiwiRail for the purchase of \$60.6 million in KiwiRail shares <b>Refer</b> a copy of this report to the Minister of Transport <b>Sign</b> the letter attached as Annex Three	23 March 2021

### Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Michael Moore	Principal Advisor, Commercial Performance [39]	[35]	✓
Maureena van der Lem	Manager, Commercial Performance		

### Minister's Office actions

**Refer** a copy of this report to the Minister of Transport  
**Return** the signed report and share subscription agreement (Annex Two) to Treasury  
**Send** the letter attached as Annex Three to KiwiRail

Note any feedback on the quality of the report

**Enclosure:** Yes (attached)  
[Annex One: letter from KiwiRail Chair \(Treasury:4425217v1\)](#)  
[Annex Two: amended share subscription agreement \(Treasury:4429220v1\)](#)  
[Annex Three: letter regarding the iReX project \(Treasury:4429170v1\)](#)

## Treasury Report: KiwiRail - drawdown request

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### Purpose of report

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1. This report seeks shareholding Ministers' approval for, and execution of, a \$60.6 million equity injection into KiwiRail Holdings Limited (KiwiRail). This would constitute a counter-offer to KiwiRail's original request for \$95.5 million.

KiwiRail has requested an equity injection of \$95.5 million, and we recommend you provide \$60.6 million of this amount

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2. KiwiRail has provided documents asking that Ministers sign a subscription agreement to authorise an equity drawdown from appropriated funds totalling \$95.5 million. These documents are:
  - a a letter from the Chair of KiwiRail, Mr Brian Corban, requesting a capital injection of \$95.5 million to fund KiwiRail's capital expenditure requirements for KiwiRail's Working Capital and strategic capital programmes (attached as **Annex One**)
  - b a share subscription agreement for Ministers' signatures (attached as **Annex Two**).
3. KiwiRail is seeking funding provided in appropriations for 2020/21, as follows:
  - a \$36.0 million is the final tranche of the 'Future of Rail – Working Capital to Support a Resilient and Reliable Rail Freight Network' appropriation of \$266.0 million
  - b \$24.6 million is from the \$246.5 million for 'Rail – KiwiRail Holdings Limited – Rolling Stock Upgrade' appropriation, with the unused portion of the appropriation (\$149.7 million) proposed to be transferred into out-years as part of the March Budget Update 2021 (MBU) process
  - c \$34.9 million is the final tranche of the \$64.9 million 'Rail – KiwiRail Holdings Limited – iReX' (Interislander ferries and terminals) appropriation for FY2020/21.
4. KiwiRail is seeking funding from the FY2020/21 appropriations for the capital projects, as follows:

Project	Annual Total appropriated	Amount Remaining (prior to request)	Amount Requested for payment in March 2021	Amount Remaining in appropriation (after request)
Working Capital to Support a Resilient and Reliable Freight Network	\$276.0m	\$36.0m	\$36.0m	\$0.0m
Rolling Stock Upgrade	\$246.5m	\$174.3m	\$24.6m	\$149.7m
Interislander Ferries and Terminals (iReX)	\$64.9m	\$34.9m	\$34.9m	\$0.0m

5. We have confirmed with the Ministry of Transport that the amounts sought by KiwiRail are within the 2020/21 Vote Transport Appropriations of equity funding made for KiwiRail capital expenditure works.

*We recommend that the \$34.9 million drawdown request for the iReX project be declined*

6. We have reviewed each of the amounts sought against the financial needs of the overall business and of the respective projects.
7. While the current cash position of the company is relatively strong, much of this cash pertains to the strategic projects, such as Rolling Stock Upgrade, New Zealand Upgrade Programme projects, Provincial Growth Fund projects and the iReX project.
8. The Minister of Transport and the Minister for State Owned Enterprises met on 8 March 2021 to discuss KiwiRail's Budget 2021 bid for the iReX project. Given the scale of new funding sought (\$565 million) and outstanding questions for matters such as to the whole of life costs of the project, Ministers asked officials to prepare a letter asking KiwiRail to provide more information regarding the project. This letter is attached, in draft form, as **Annex Three**.
9. Given Ministers' concerns with the future direction of the iReX project, we recommend not providing further funding for iReX in this drawdown, contrary to KiwiRail's request for the \$34.9 million remaining in the FY2020/21 appropriation. KiwiRail has approximately \$6.5 million remaining in iReX funds, excluding any additional funds that may be provided through this drawdown. On this basis, KiwiRail should have sufficient working capital to fund iReX works until Ministers' concerns, and the status of the Budget 2021 bid, have been resolved.
10. We recommend that, following consultation with the Minister of Finance and the Minister of Transport, the Minister for State Owned Enterprises sign and send the letter attached as Annex Three to KiwiRail. The letter notes that the iReX component of KiwiRail's current drawdown request has been declined by Ministers.

*We support the drawdown of the 'Working Capital' and 'Rolling Stock' appropriations*

11. The core 'business as usual' (BAU) cash balance is projected to be \$148 million as at 31 March 2021, with a projected net cash outflow over the final quarter of 2020/21 that would result in a BAU cash balance below its policy minimum working capital of [37]. Accordingly, we advise that the release of the 'Working Capital' appropriation is reasonable. Levels of any future equity injections to support KiwiRail's BAU cash needs will be assessed in the context of the BAU cash balance.
12. The 'Rolling Stock Upgrade' will require more cash in the period to 30 June 2021 than what is currently funded. The cash will be applied to, primarily, works at Woburn and Waltham, deposits for mainline and DL (Diesel-electric) locomotives, and payments for CFT (Container flat top) wagons.
13. As noted in paragraph five above, the Ministry of Transport has been consulted on this paper and in the preparation of the letter to KiwiRail.

## Risks

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14. While there are a range of risks associated with both the rolling stock and iReX projects, there are no significant risks associated with Ministers signing the subscription agreement. KiwiRail's requests are consistent with the Estimates of Appropriations and the current cost schedules for each project.
15. If no new funding is provided for the iReX project, KiwiRail is likely to be more incentivised to engage fully with Ministers and officials to provide further information and clarify concerns around the project's scope and cost.

## Next steps

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16. If shareholding Ministers agree with our recommendation to provide only \$60.6 million to KiwiRail, this will constitute a counter-offer from Ministers. The share subscription agreement, attached as Annex Two, has been amended to be consistent with the \$60.6 million drawdown.
17. Each shareholding Minister would need to initial each of the five handwritten changes in Annex Two, and sign and date the document. The share subscription agreement would then be provided back to KiwiRail, with a recommendation for its Chief Executive to agree to the counter-offer, by also initialling the handwritten changes.
18. Each shareholding Minister can sign a separate copy, or counterpart, of this share subscription agreement. It is not necessary for both Ministers to sign the same copy. The share subscription agreement complies with the legal requirements of the Companies Act 1993, the State-Owned Enterprises Act 1986 and with KiwiRail's constitution. Electronic signatures are acceptable.
19. If KiwiRail accepts the counter-offer, the \$60.6 million equity injection would be provided to KiwiRail by way of a share subscription. Each shareholding Minister would purchase 30.3 million ordinary shares at \$1 per share.
20. The equity drawdown is scheduled on, or soon after, 15 March 2021. We have advised KiwiRail to expect payment by approximately 26 March 2021.

## Recommended Action

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We recommend that you:

- a **sign** and initial the share subscription agreement (attached as Annex Two) constituting a counter-offer to KiwiRail to subscribe for \$60.6 million of ordinary capital in KiwiRail, to enable payment to KiwiRail to be made by approximately 26 March 2021.

*Agree/disagree.*  
Minister of Finance

*Agree/disagree.*  
Minister for State Owned Enterprises

- b **refer** a copy of this report and the attached material to the Minister of Transport.

*Agree/disagree.*  
Minister of Finance

*Agree/disagree.*  
Minister for State Owned Enterprises

- c **agree** the Minister for State Owned Enterprises will, following consultation with the Minister of Transport, sign and send the letter (attached to this report as Annex Three).

*Agree/disagree.*  
Minister of Finance

*Agree/disagree.*  
Minister for State Owned Enterprises

Maureena van der Lem  
**Manager, Commercial Performance**

Hon Grant Robertson  
**Minister of Finance**

Hon Dr David Clark  
**Minister for State Owned Enterprises**

2 March 2021

Hon David Clark  
Minister for State Owned Enterprises  
Parliament Buildings  
WELLINGTON

Hon Grant Robertson  
Minister of Finance  
Parliament Buildings  
WELLINGTON

Dear Ministers

### **INCREASE IN CAPITAL FOR KIWI RAIL HOLDINGS LIMITED**

The purpose of this letter is to request your approval to increase the capital in KiwiRail Holdings Limited ("KRHL") by \$95.5m.

This request is broken down into two different tranches:

- \$36m is related to the final Government appropriation for FY21 in accordance with KiwiRail's operational plan.
- \$59.5m is for the following elements of KiwiRail's capital investment programme:
  - \$24.6m is part of the \$246.5m FY21 Government appropriation for rolling stock; and
  - \$34.9m is part of the \$64.9m FY21 Government appropriation for the iReX (ferries and terminals) project.

On 23 February 2021, the Board of KRHL resolved to recommend to you that the capital of KRHL be increased for the items listed above.

Consistent with the process adopted by Treasury officials and KiwiRail for previous capital increases, if this request is approved it is anticipated that the amount of the capital increase will be deposited with KRHL on 15 March 2021, the date of the share subscription.

Enclosed is a Share Subscription and Entitled Persons' Agreement to record your:

- approval to KRHL issuing ordinary shares in connection with the proposed capital increase (as required by KiwiRail's constitution); and
- agreement to subscribe for such shares.

Yours sincerely

Brian Corban, CNZM QSO  
Chairman

KIWIRAIL HOLDINGS LIMITED ("COMPANY")

SHARE SUBSCRIPTION AND ENTITLED PERSONS' AGREEMENT

DATED 2 March 2021

BACKGROUND

- A. The Minister of Finance and the Minister for State Owned Enterprises (each a "Shareholder" and together "Shareholders") wish to make a capital contribution of NZ\$~~95,500,000~~ <sup>NZ\$60,600,000</sup> in the Company in the Crown's financial year ending 30 June 2021 by way of subscribing for fully-paid shares in the Company.
- B. Pursuant to section 10 of the State-Owned Enterprises Act 1986, the Shareholders may subscribe for shares in the Company in equal proportion from time to time.
- C. Section 107(2) of the Companies Act 1993 ("Act") permits a Company to issue shares without complying with the provisions of section 42, 44 or 45 of the Act if all entitled persons have agreed.
- D. Accordingly, each Shareholder wishes to subscribe for, and the Company wishes to issue to each Shareholder, ~~47,750,000~~ <sup>30,300,000</sup> ordinary shares at the issue price of NZ\$1 per share.

AGREEMENT

1. Each Shareholder agrees to subscribe for, and the Company agrees to issue to each Shareholder, on 15 March 2021 and/or on such later date(s) on which the name of the Shareholder is entered in the share register of the Company as holder of the relevant shares as contemplated in clause 4 below, ~~47,750,000~~ <sup>30,300,000</sup> ordinary shares (a total of ~~95,500,000~~ <sup>60,600,000</sup> newly issued ordinary shares).
2. The shares shall be ordinary shares that shall rank in full for all dividends declared by the Company after the date of issue and shall rank in all respects equally with the existing ordinary shares in the Company. <sup>60,600,000</sup>
3. Each Shareholder shall pay to the Company on <sup>15</sup> March 2021 and/or on such date(s) agreed with the Company (but no later than 30 June 2021), a subscription amount of NZ\$1 per share in respect of each of the ~~95,500,000~~ <sup>60,600,000</sup> shares. The payments shall be made in immediately available funds. The Shareholders shall ensure that they each pay to the Company at the same time equal amounts of the subscription amount(s) so that each Shareholder is issued the same number of shares, and the total number of shares held by each Shareholder remains at one-half of the total shares in the Company.
4. Subject to clause 3, the Company shall issue to each Shareholder one share per NZ\$1 of subscription amount received from the Shareholder, by entering the Shareholder's name in the share register for the Company as the holder of such share.
5. Each Shareholder hereby:
  - (a) pursuant to clause 8.2 of the constitution of the Company, authorises the Company to issue the shares contemplated in this agreement;
  - (b) consents, for the purposes of section 50 of the Act, to becoming the holder of the shares to be issued in accordance with this agreement; and

- (c) agrees, for the purposes of section 107(2) of the Act, to the issue of shares contemplated in this agreement.
- 6. This agreement may be executed in any number of counterparts, all of which will together constitute one and the same instrument. Each of the parties may execute this agreement by signing any such counterpart.

**EXECUTION BY PARTIES**

**SIGNED** by **KIWIRAIL HOLDINGS LIMITED** by its authorised signatory:

Signature of authorised signatory	2 March 2021
Greg Miller	Date
Name of authorised signatory	

**SIGNED** by **MINISTER FOR STATE OWNED ENTERPRISES:**

Hon David Clark
Date

**SIGNED** by **MINISTER OF FINANCE:**

Hon Grant Robertson
Date

# Hon Dr David Clark

MP for Dunedin

Minister of Commerce and Consumer Affairs  
Minister for the Digital Economy and Communications  
Minister for State Owned Enterprises  
Minister of Statistics  
Minister Responsible for the Earthquake Commission



Brian Corban  
Chair, KiwiRail Holdings Ltd  
[23]

Dear Brian

I am writing to you on behalf of shareholding Ministers and the Minister of Transport regarding the iReX Programme.

The Minister of Finance has received your budget bid for the iReX programme, and we are aware that you have tabled a subsequent scaling option for the bid. The bid will be processed and considered alongside other bids in the Budget 2021 process.

While we acknowledge its importance to New Zealand's resilience and transport outcomes, the iReX project is one which continues to cause Ministers concern as there remains considerable uncertainty over scope, costs and funding options. A final detailed business case has yet to be presented to shareholding Ministers.

The Minister for State Owned Enterprises wrote to you in October 2020 outlining expectations around consultation and improved information flows. I also note that Cabinet directed KiwiRail in May 2020 to provide regular reporting to the Minister for State Owned Enterprises, Minister of Finance and the Minister of Transport on progress of the ferry replacement project, including a full breakdown of financial performance and the impact of additional debt on KiwiRail and ability to repay that debt.

We would like to reinforce the need for more transparent information around the proposed project, options available regarding scope and funding, and reassurances around the management of risks.

In particular, we ask that you:

- Prioritise the finalisation, including Board sign-off, of the final detailed business case and submit to our officials for review.
- Advise of the feasibility of reverting to a less capital-intensive option, such as two medium sized ferries, which represented a similar NPV to your preferred option when assessed in December 2018 under pre-COVID-19 conditions.
- Provide further information around the extent to which costs can be met by the ports and their ownership Councils, including whether other parties are supportive and have the financial commitments required.
- Advise what further work you have planned to test your ability to take on more debt funding in relation to the project. I note that we are looking for KiwiRail to debt fund as much of this project as possible to ensure the commerciality of the project.

- Confirm that you have fully considered the whole of life costs of the project, including all land-side costs, and costs that will be met by parties other than KiwiRail. This should include the costs of reconfiguring road and rail networks that connect to the ferry terminals.

Given this request for further information, shareholding Ministers have decided, at this time, to decline KiwiRail's request for a drawdown of \$34.9 million in iReX funding.

We acknowledge that this is a challenging project and appreciate the effort of the Board and staff of KiwiRail on the iReX programme. We look forward to your responses to the above matters.

Yours sincerely

Hon Dr David Clark  
**Minister for State Owned Enterprises**

cc Hon Grant Robertson, Minister of Finance  
Hon Michael Wood, Minister of Transport  
Greg Miller, Group Chief Executive, KiwiRail Holdings Ltd