

Not Relevant

612 ALICE TO DARWIN RAILWAY PROJECT – FREIGHTLINK - NOTED

Not Relevant

612

MINUTE forming ENCLOSURE to

SF05D00020

TO: THE PREMIER - FOR CABINET TO NOTE

RE: ALICE TO DARWIN RAILWAY PROJECT – FREIGHTLINK

1. PROPOSAL

That Cabinet notes that:

- 1.1 A proposal has been received from FreightLink Pty Ltd (FreightLink) to amend the terms of the Government's Tier 2 Mezzanine Note investment in the Alice to Darwin Railway Project.
- 1.2 As Treasurer, I intend to advise FreightLink that the Government will not provide further assistance at this time.

2. BACKGROUND

- 2.1 The Government provided significant financial assistance to the Adelaide to Darwin Railway Project. That assistance included grants of \$125 million, a \$25 million loan and the purchase of \$10 million of Tier 1 Mezzanine Notes (out of \$78.5 million) and \$16.4 million (out of \$26.4 million) Tier 2 Mezzanine Notes through South Australian Government Financing Authority (SAFA). The Northern Territory holds the other \$10 million Tier 2 Mezzanine Notes. The Premier guaranteed SAFA's obligations under the notes.

3 DISCUSSION

- 3.1 On 11 February 2005, I met with representatives from FreightLink and their advisers.
- 3.2 FreightLink operates the Adelaide to Darwin railway and the intermodal terminal at Darwin's East Arm Port. It is the operating company of Asia Pacific Transport Pty Ltd.
- 3.3 The purpose of the meeting was to enable FreightLink to present its revised Business Plan.
- 3.4 Key points from the presentation included:-
 - FreightLink has undertaken a detailed review of its business operations to develop a revised Business Plan;
 - Earnings are significantly below the operating budget prepared at commencement of the project;
 - As a consequence, Senior Debt will be in ratio default from March 2005 and payment default from June 2005;

- A Financing Plan has been developed – involving equity funding of \$50 million to fund financing costs and capital expenditure;
 - Agreement of banks achieved subject to additional equity being raised;
 - Currently negotiating with shareholders for an additional \$50 million new equity;
 - The following are impediments to the new financing plan:
 - Interest capitalising at penalty interest rates on Tier 1 Mezzanine Notes;
 - Interest capitalising on Tier 2 Mezzanine Notes;
 - Not all shareholders are able or willing to provide new equity; and
 - FreightLink is seeking Government support through modification of the terms of the Government's Tier 2 Mezzanine Notes.
- 3.5 Following the meeting with FreightLink, a proposal was received to change the terms of the Tier 2 Mezzanine Notes. The proposal involves:-
- The interest free period on the Tier 2 Mezzanine Notes being extended until two years after the new equity (i.e. the \$50 million) is repaid.
 - The new equity being repaid prior to the Tier 2 Mezzanine Notes.
- 3.6 A number of scenarios have been developed as to when the new equity would be repaid and thereafter interest on the Tier 2 Mezzanine Notes begin– ranging from a base case of 2023 to an equity upside case of 2013. No details were provided on interest and principal payment plans beyond these dates.
- 3.7 The proposal would result in lost revenue to SAFA on the Tier 2 Notes of \$1.97 million per annum on SAFA's current holding of \$16.4 million. Assuming the base case scenario (i.e. 2023), this would represent an indicative present value revenue loss of between \$15 million to \$21 million relative to the original structure where interest was due to be paid in 2006.
- 3.8 Not all equity investors have committed to funding the new equity contribution of \$50 million.
- 3.9 FreightLink views the restructure of the Government's Tier 2 Mezzanine Note as critical to achieving its overall revised financial plan. Treasury & Finance is not in a position to determine whether this is the case or Government assistance has been sought just to enable a more attractive package to be put to the equity investors.
- 3.10 The key question is whether there remains a sufficient commercial incentive for the equity investors to inject additional funds to protect their investment.
- 3.11 If there is not, and the equity investors walk away, then the banks would take over the railway assets. There may be implications for the Government's capacity to recover its \$26 million Tier 1 and Tier 2 investment in this scenario. Of course it is also possible that the Government could provide the assistance requested and still lose the \$26 million. The request proposes that our \$16 million Tier 2 Mezzanine Notes would rank behind any new equity for debt servicing.
- 3.12 On the other hand, if there were sufficient commercial incentives for the equity investors to protect their investment, then any modification to the terms of the Tier 2 Mezzanine Notes would represent a concession to equity investors.

- 3.13 It is reasonable to assume there remains a sufficient commercial incentive for the equity investors to inject the additional funds and not walk away from their investment. This view is supported by the current strong debt/equity ratio for the project (\$464 million debt and \$395 million equity), which would suggest that the equity investors would not risk their investment of \$395 million by not injecting an extra \$50 million to maintain the viability of the project.
- 3.14 It is also relevant that during my meeting, FreightLink advised that the revised Business Plan still assumes all interest obligations on the Tier 1 and Tier 2 Mezzanine Notes are met (paid or capitalised) and a \$15 million buffer has been included when calculating the required equity contribution of \$50 million. This diminishes their argument for Government assistance. However, Treasury and Finance is not in a position to verify the validity of the revised Business Plan but would note that the history of previous plans has indicated over-optimism.
- 3.15 Any variations to the Tier 2 Mezzanine Notes required by the revised Business Plan would need to be considered within the constraints of the *Alice to Darwin Railway Act 1997* (ADR Act), which provided the authority for these notes to be purchased and SAFA's enabling legislation, the *Government Financing Authority Act 1982* (GFA Act). Constraints will be SAFA's commercial operational parameters under the GFA Act, and the Tier 2 Mezzanine Notes remaining to be viewed as a loan for the purposes of the ADR Act, despite the variations.
- 3.16 In the absence of strong evidence that the Government's granting of an extension to the interest free period for its Tier 2 Mezzanine Notes is critical to the short term viability of the project, Treasury and Finance has advised me that it sees no need to provide any further assistance to the Alice to Darwin Railway Project and suggests that the current financial problems be left to be resolved by the equity holders.
- 3.17 I have spoken to the Northern Territory Government, who has indicated a decision regarding any further support has not been made.

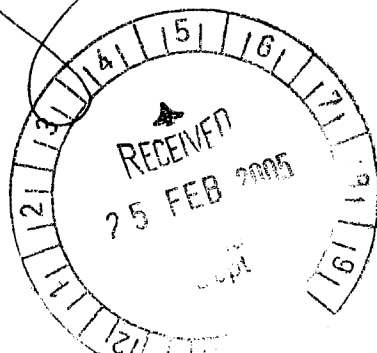
4. RECOMMENDATION

That Cabinet notes that:-

- 4.1 A proposal has been received from FreightLink to amend the terms of the Government's Tier 2 Mezzanine Note investment in the Alice to Darwin Railway Project.
- 4.2 As Treasurer, I intend to advise FreightLink that the Government will not provide further assistance at this time.


 Kevin Foley MP
DEPUTY PREMIER
TREASURER

25/2/2005



In Cabinet

25 FEB 2005

