CHAPTER 3

THE SALE PROCESS

3.1 The Bill provides for the timing of the sale to remain open and gives the Government the flexibility to use a range of approaches for the sale process, the objective being to maximize the returns from the sale of its remaining holdings. Proceeds from the sale will be used to retire debt and may also be allocated to fund other Commonwealth programs. While the Commonwealth will forego future dividends from Telstra, it will continue to benefit from taxation payments, both by the corporation and by private shareholders. Also, by retiring debt the Commonwealth will save an estimated $3.6 billion a year in interest payments, potentially freeing up extra funding for infrastructure and environmental programs and other priority programs.

3.2 In the case of Telstra Sales 1 and 2, the Government considered, but did not use the option of hybrid securities in addition to the release of ordinary shares. In this Bill the Government has both options and may sell its holding in a single or in several tranches.

3.3 Hybrid securities combine a mixture of debt and equity characteristics. They come in many forms, but broadly speaking they pay a fixed return, like a bond, and have an option to convert into equity, that is shares, of the issuing company. More recent styles of hybrid securities typically are issued at $100, have a set dividend rate for a five year period and may be 'reset' (rolled over on new terms) at the end of that period, or converted into shares or redeemed for cash. The holder can convert into shares at a discount to the current share price, eg 5%. With newer style hybrids, the conversion ratio is usually $100 worth of shares, not a fixed number of shares for each security, and because of this they do not track the share price. There are, however, many variables on this model, for example whether conversion is optional or mandatory and whether the securities can or cannot be redeemed, and the degree of choice affects the rate of return. Broadly speaking, hybrid securities offer a lower risk investment than shares, with a guaranteed income and protection against falls in the share price.[1]

3.4 It is important to note that the Government is simply keeping its options open in order to maximize the return at the time of sale and has made no decisions about the way in which it will structure the sale. The configuration of the sale will be the subject of a scoping study. The definition of 'hybrid security' in the Bill is intentionally broad so that if the Government decides that a hybrid security is to be part of the T3 process, an instrument can be designed that fits the needs of the market at the time of the offer.

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1 *Hybrid Securities: A blend of shares and bonds*, Australian Stock Exchange. *Fundraising by using hybrid securities and on-sale of securities*, Penny Grau, Partner, Clayton Utz.

The T3 sale is scheduled in the budget estimates to commence in October 2005 and may be spread over a number of years. It would not be appropriate for the Bill to lock the government into a particular type of instrument, when the nature of markets and the characteristics of an instrument that would be appropriate could change substantially between now and when the government makes a decision to proceed with the sale. As ABN AMRO Rothschild pointed out:

> The use of a hybrid instrument…is really based on tapping those sources of demand to produce the best possible outcome. So the question as to whether or not hybrids should be used in the context of a T3 sell down is really not one that could or should be answered today. It is a question that should be answered at the time of the sell down. Our perspective is that the government should have maximum flexibility to utilise such an instrument if it were decided that that was appropriate. The right forum for that is during the scoping study in relation to a T3 sell down.[2]

3.5 While under the legislation the Government theoretically could sell the whole of its remaining equity in the form of hybrid securities, Mr Heazlett of DOFA pointed out at the hearing on 17 September that, 'It would be foolish to ignore what was a $10 billion source of demand in previous share offers. In Telstra 1 and Telstra 2, you had something like $10 billion subscribed by retail investors. If you are managing an offer, you do not want to turn your back on it'.[3] Mr Heazlett also noted that:

> Australian retail investors were a fundamentally important part of the success of the T1 and T2 offers. You would not go into a subsequent offering ignoring the fact that they were an important body of investors and that their desires and needs are important in structuring how you go about it.[4]

3.6 These observations were confirmed by the Department in an opening statement at the hearing on 7 October:

> In view of the media comment that followed the hearing on the 17th, I would like to affirm for the record that retail will be an important part of any future offering by the Australian government of Telstra shares. We said that at the hearing and I am just affirming that now for the record, given the media coverage.[5]

3.7 The Government's objective with such a large float will be to attract as much demand as possible, which may mean appealing to a market segment that was not previously well established. In other words, were the government to decide to issue

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2 Mr Steve McCann, *Proof Committee Hansard*, 30.09.03, p. 94.

3 Mr Mark Heazlett, *Proof Committee Hansard*, 17.09.03, p. 16.

4 Mr Mark Heazlett, *Proof Committee Hansard*, 17.09.03, p 13.

5 Mr David Yarra, *Proof Committee Hansard*, 7.10.03, p. 2.

hybrid securities, the reason would be to tap into new sources of demand to supplement private shareholdings.