

ITEM 8 SOUTHERN PHONE - PROPOSED PURCHASE BY AGL

Wollongong City Council owns shares in the Southern Phone Company Limited, together with 34 other local councils. Council has recently been advised of an offer by AGL Energy Limited to acquire 100% of the shares in Southern Phone. The offer has been recommended to all councils by the Board of Southern Phone, and this report outlines the offer and the matters for consideration by Wollongong City Council.

RECOMMENDATION

- 1 That Council agrees to sell its two shares (being one A Class Ordinary Share and one Preference Share) in Southern Phone Company Limited to AGL Energy Limited for \$785,714.00.
- 2 That the General Manager be delegated the authority to execute the Share Sale Agreement, and any other related or ancillary transaction document for the purpose of giving effect to the sale.

REPORT AUTHORISATIONS

Authorised by: Renee Campbell, Director Corporate Services - Connected + Engaged City

ATTACHMENTS

There are no attachments for this report.

BACKGROUND

In 2001, Wollongong City Council supported the establishment of the Southern Phone Company Limited (the Company). The establishment of the Company was funded by two federal government grants under the *Networking the Nation* scheme to deliver low cost telecommunication services to regional areas in South Eastern NSW. The Company was formed in 2002 and Wollongong City Council acquired two shares in the Company, being one ordinary share and one preference share, at a cost of \$2. All shareholders in the Company are local government authorities (currently 35 councils).

Since the establishment of Southern Phone in 2002, Southern Phone has returned \$16.8M to shareholders in dividends and community grants. Wollongong City Council has received \$1.347M in dividends, with the funds directed towards natural area management and on-ground works.

In October 2019, Wollongong City Council received advice that Southern Phone and AGL Energy Limited (AGL) had entered into an agreement under which AGL is proposing to acquire 100% of the shares in Southern Phone. The general terms of the proposed share sale transaction are outlined in a Shareholder Information Pack.

In summary, the Shareholder Information Pack advises that the AGL Offer is “the result of extensive negotiations and consideration by the Southern Phone board (Board) and follows a strategic review process undertaken in mid-2019, which led to the decision to appoint corporate advisers and investigate a possible sale of the Company.”

The Southern Phone Board has unanimously recommended the acceptance of the AGL Offer and are of the view that it is in the best interests of the Company and its shareholders.

The Advantages to the proposal as advised by Southern Phone are:

- Fixed Cash Payment – AGL has offered to acquire Wollongong City Council’s Shares in Southern Phone at a fixed price of \$785,714.00 (GST not applicable). If the transaction that results from the AGL Offer is completed, Council will receive this amount in full and in cash on the completion date.

- Special Dividend – the AGL Offer permits Southern Phone to declare and pay a special dividend to shareholders from Southern Phone’s excess cash reserves before completion of the AGL Transaction (Special Dividend). The value of the Special Dividend pool has been estimated by Southern Phone at approximately \$1M (to be shared amongst all 35 shareholders), of which Wollongong City Council would receive approximately \$90K. Southern Phone have advised that the Special Dividend is only payable if the AGL transaction proceeds and that the amount is subject to final transaction costs.
- Fair Value – Ernst & Young were engaged to review the terms of the AGL Offer and have advised it provides fair value for each shareholder’s Southern Phone shares.
- Best Alternative – Southern Phone have advised the total return from the AGL Offer is higher than the indicated interest of other potential buyers and provides greater certainty and value than would be the case if the AGL transaction did not proceed.
- Employment Commitment – AGL has contractually committed to retain Southern Phone’s employees and ongoing operations at Moruya for at least three years.
- Capital Constraints – Southern Phone have advised if the sale does not proceed, they will likely require additional capital in order to remain competitive and the current ownership structure may constrain the amount of additional capital that can be raised, potentially negatively impacting on the Company’s competitive position.

The Disadvantages to the sale as advised by Southern Phone are:

- Shareholders will no longer own and will be unable to realise any future value from their shares in the Company.

It is noted Southern Phone did not declare a dividend this financial year, and have advised if the sale does not proceed, they are unlikely to declare dividends in the foreseeable future and will likely need to raise capital.

Wollongong City Council has been using the dividends from Southern Phone to fund natural area management and works, and alternate funding sources may need to be found to meet these commitments in to the future. It is noted that as Southern Phone have not declared a dividend for 2019 and have advised they are unlikely to issue dividends in the foreseeable future, the need to find alternate funding sources is likely irrespective of whether the sale proceeds. This will be considered as part of Council’s annual planning process.

PROPOSAL

Following a review of the information provided to Council, it is recommended Council resolve to sell its Southern Phone shares to AGL by entering into a Share Sale Agreement and executing related transaction documents. If Council resolves to sell its shares, the resolution must be made by 29 November 2019. Council will also be required to vote in favour of a special resolution to update the Company’s constitution that is required to facilitate the AGL Transaction, including to permit non-council shareholders of the Company. An Extraordinary General Meeting is proposed for 2 December 2019 to put the constitution changes to shareholders.

CONSULTATION AND COMMUNICATION

Wollongong City Council was issued with a Shareholder Information Pack and related documents from Southern Phone. Council participated in a webinar presented by Southern Phone and has received a briefing from the Managing Director of Southern Phone and a representative from AGL.

PLANNING AND POLICY IMPACT

This report contributes to the delivery of Our Wollongong 2028 goal “We are a connected and engaged community”.

It specifically delivers on core business activities as detailed in the Governance and Administration Service Plan 2019-20.

RISK ASSESSMENT

The risks to Wollongong City Council of resolving to sell its shares in Southern Phone are considered low. The fixed cash payment, together with the dividends received by Council over the years, represents a good return on the initial investment of \$2. The loss of revenue as a result of future dividends not being received will need to be considered as part of future annual planning processes, however Council has been advised that if the sale does not proceed, Southern Phone are unlikely to issue dividends in the foreseeable future. The terms of the sale require AGL to retain Southern Phone employees and ongoing operations in Moruya for at least three years. It is noted that Council’s two shares are presently encumbered by two separate interests. Council staff are working to have those encumbrances removed from the shares in order to be in a position to complete the sale, should Council so determine to sell.

The risks related to Council resolving not to sell its shares in Southern Phone are primarily financial and are considered to be medium to high.

AGL have advised their desire is for the acquisition of all shares in Southern Phone. It is not confirmed whether the sale would proceed if one or more councils resolve not to sell their shares. If the sale were to proceed and Wollongong City Council resolve to retain its shares, there is a risk those shares could be compulsory acquired by AGL under the Corporations Act, at ‘fair value’. The value of Council’s shares in this scenario could be less than the fixed cash payment being offered under the current sale proposal. The special dividend payment may also not be received.

If the sale to AGL does not proceed, Southern Phone have advised that dividends are unlikely in the foreseeable future and the Company may need to raise capital to remain competitive. As the Company is owned by 35 local councils, capital revenue raising opportunities may be constrained.

FINANCIAL IMPLICATIONS

As noted above, Wollongong City Council has received \$1.347M in dividends from Southern Phone since the Company was formed. The value of the dividend received each year increased, with the highest dividend received in 2015/16 and since then, the dividend has declined (refer table below). In 2019, Southern Phone did not declare a dividend.

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	Total
	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's
Dividend received	2.9	2.8	3.8	13.5	38.0	115.6	242.9	275.9	278.6	185.0	93.0	95.4	1,347.4

The Southern Phone dividend has been held in a restricted asset, with the funding used for natural area management and works. The restricted asset has a balance as at September 2019 of \$238.5K. There are ongoing commitments of approximately \$100K per annum from this funding for natural area management.

If Council resolves to sell its shares and the sale to AGL proceeds, Council will receive in the order of \$875K (being \$785K fixed cash payment and approximately \$90K special dividend). Council can determine the future allocation of these funds through the annual planning process. No further dividends will be received by Council if the sale proceeds.

Council has been advised by Southern Phone that should the sale to AGL not proceed, Southern Phone is unlikely to issue dividends in the foreseeable future and the company will likely need to raise capital to remain competitive. The quantum of capital required is unknown.

CONCLUSION

The offer from AGL to acquire 100% of the shares in Southern Phone will provide a fixed cash payment and special dividend, returning approximately \$875K to Council.