The Treasury

Mixed Ownership Model for Crown Commercial Entities: Treasury Advice Information Release

March 2016

Release Document

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Treasury Report: Dividends from Genesis Energy, Mighty River Power and Meridian Energy

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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Note** contents.	None
Associate Minister of Finance (Hon Steven Joyce)	**Note** contents.	None
Minister for State Owned Enterprises (Hon Tony Ryall)	**Note** contents.	None

Contact for Telephone Discussion (if required)

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Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Enclosure: No

Treasury Report: Dividends from Genesis Energy, Mighty River Power and Meridian Energy

1. Included in this report are graphs showing the dividends paid[1] since 2000 by Genesis Energy, Mighty River Power (MRP) and Meridian Energy, and the dividends that are forecast to be paid in the future (based on the financial forecasts in the offer documents for each of the companies).

2. Also attached for comparison is a graph of the dividends that have been paid by Contact Energy (like most listed companies, Contact Energy does not provide dividend forecasts). The graphs have different vertical scales, which in part reflect the different sizes of the companies.

The importance of dividends

3. Dividends are an important measure of company performance, but not the only one - there are many others.

4. A shareholder in a company wants to be paid a dividend to ensure they are receiving some of the company's profits, and generating an income from their investment in the company without having to sell some of their shares. A shareholder may also be concerned that a company that retains cash rather than paying out dividends might make poor choices about what to do with that cash. This would particularly be a concern for a minority shareholder who has little or no ability to influence company strategy. Based on this, a widely-held company should pay significant dividends, and the dividends should be consistent and reliable. If the company needs to retain cash for investment purposes, it should have to justify this to shareholders, and there should be a high threshold for reducing dividends.

5. For a company that is 100% owned by a single shareholder, that shareholder may be more relaxed about dividend payments, as they should have a greater ability to assess whether the company retaining cash will deliver greater long-term returns than paying dividends. A 100% shareholder also has a greater influence over company strategy, and a greater ability to hold the board (and through the board, management) accountable for performance. Therefore we would expect dividends from wholly-owned companies to be more variable than those from widely-held entities, such as listed companies.

6. SOEs are wholly owned by the Government, and therefore in theory the Crown should be willing to accept variability in dividends from year to year, and willing to let the companies retain cash for investments, where this can be justified as value-adding.

7. In practice, SOEs are significantly different to wholly-owned private companies. For good reasons, SOEs are at arms-length from the Government, with independent boards. It can be difficult to assess the quality of SOE investment plans in advance, and the quality of SOE justifications for retaining cash rather than paying dividends. There are numerous examples of SOEs (in general, not specifically the three electricity companies) making poor investment decisions, where the Crown as shareholder would have been better off if dividends had been paid instead.

[1] When shareholders received cash, rather than when the dividend was declared

8. This is why successive Governments have had an expectation that SOEs pay dividends that are consistent and reliable, and provide an appropriate commercial return to the Crown as shareholder. Of course, as with all companies, dividend payments need to be balanced against the SOE's investment requirements.

9. It is in this context that we have assessed the dividends paid by the three majority Crown-owned electricity companies, and the change in their dividends now that they have become listed entities with minority private shareholders.

What have the three electricity companies paid in dividends?

10. If the three Crown-owned companies had paid consistent and reliable dividends while they were State Owned Enterprises, then the change from the Crown receiving 100% to 51% of the companies' dividends would be easily visible in the graphs. As you can see, it is, but only because we have separately identified the dividends paid to the Crown and the dividends paid to other shareholders. If the graph had just shown dividends paid to the Crown, an observer could not tell when the companies moved to 51% Crown ownership.

11. And, if the graphs were not labelled with the company names, it would be easy to work out which three were Crown owned and which one was not.

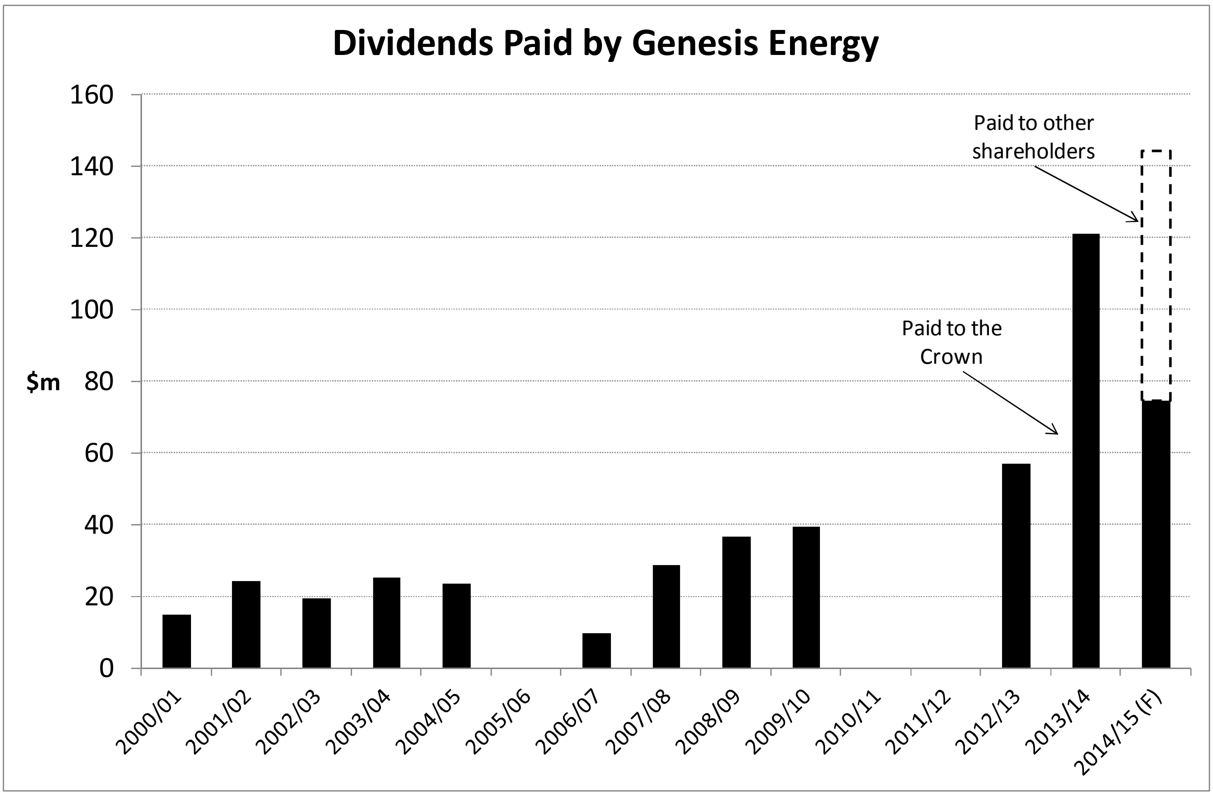
12. The graph for Genesis Energy is particularly notable. Despite selling just under half of the shares in the company, the Crown will receive nearly twice as much in dividends from Genesis Energy next year than it did in the best year between 2000/01 and 2011/12, when the Crown was a 100% shareholder; and four times as much as the average dividend over this period. The Crown is also forecast to receive more in dividends from Genesis Energy next year as 51% owner than it did last year as 100% owner.

13. The graphs also undermine one criticism of the GSO programme, which is that 49% of the forecast future dividends from the three companies is a supposed "cost" of the GSO programme. Even setting aside the fact that the Government received proceeds from the programme that reflected investors' valuations of the expected future dividends from the companies (so the dividends were paid for, not "lost") this criticism ignores the impacts of the GSO programme on the incentives for the companies to perform and to pay dividends.

14. Without the GSO programme, the Crown probably would not have received all of the dividends that the companies are now forecasting. There are strong pressures on listed entities to pay consistent, reliable and attractive dividends. The incentives on State Owned Enterprises to pay dividends are much weaker. As the graphs illustrate, the dividends from the three companies prior to them being listed were neither consistent nor reliable. And arguably, for two of the three companies, the dividends were also not attractive as a return on a commercial investment.

15. The GSO programme also increases the incentives on the companies to improve their performance, which should result in greater dividends than would have been paid if the companies had remained 100% Crown owned, but this is not observable from the graphs.

Genesis Energy



16. In the period from 2000/01 to 2011/12, the largest dividend the Crown received in any one year from Genesis Energy was around $39 million, and in three of these years no dividends were paid[2]. The average dividend from Genesis Energy over this period was just $18 million a year; a poor return for a company now valued by the market at around $1.8 billion.

17. In 2014/15, the company's first full year as a listed entity, the Genesis Energy investment statement and prospectus forecasts dividends paid to the Crown, as 51% shareholder, will be $74 million.

18. This means that despite selling just under half of the shares in the company, the Crown will receive nearly twice as much in dividends from Genesis Energy than it did in the best year between 2000/01 and 2011/12 when the Crown was a 100% shareholder; and four times as much as the average dividend over this period.

19. The Crown is also forecast to receive more in dividends from Genesis Energy in 2014/15 as 51% owner than it did in 2012/13 as 100% owner.

20. Genesis Energy paid significantly higher dividends to the Crown in 2012/13 and 2013/14 compared to previous years. This represents Genesis Energy increasing its dividends in preparation for becoming a listed company, to meet the expectation that dividends are consistent, reliable and attractive. We do not believe these dividends would have been paid at the same level if the company had remained in 100% Crown ownership.

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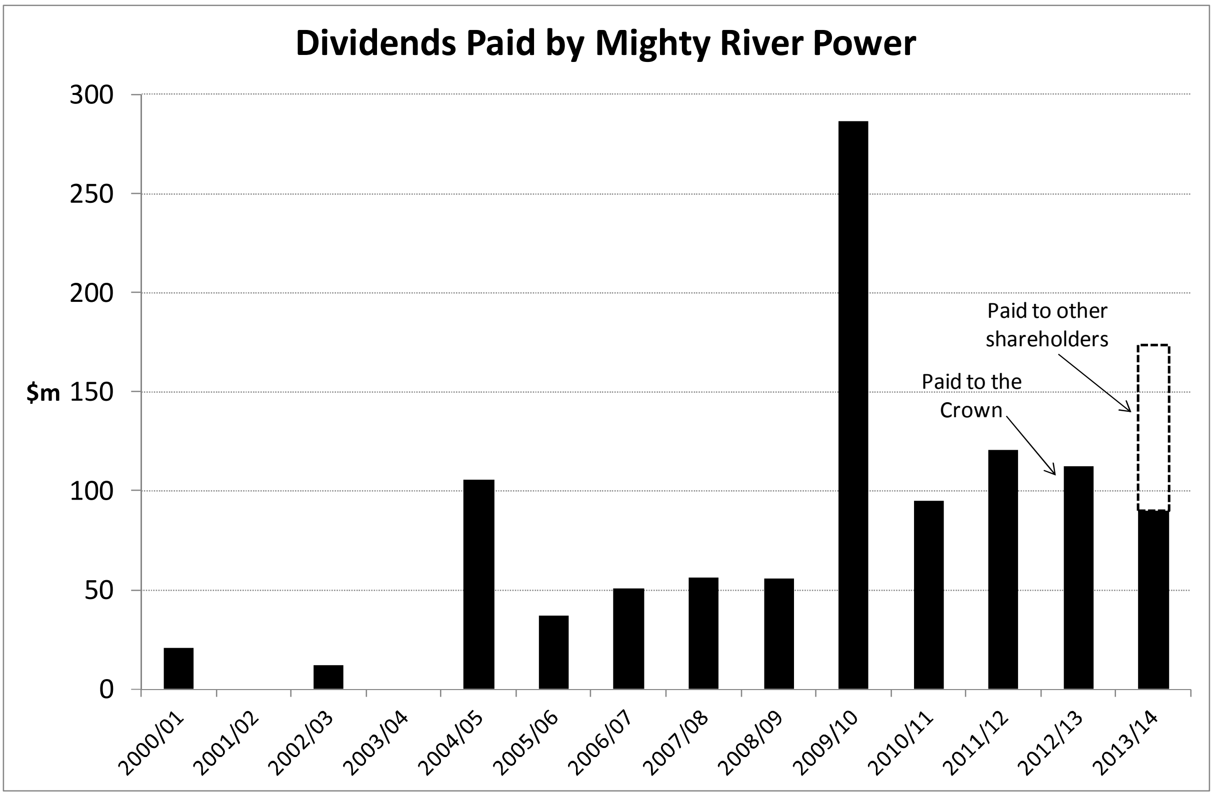
[2] Genesis chose to pay no dividends in 2010/11 and 2011/12 following its purchase of the Tekapo power stations from Meridian Energy, in order to reduce the level of debt it carried. This purchase was directed by the Government as part of its electricity sector reforms. The Government did not provide any equity to Genesis Energy to fund the purchase.

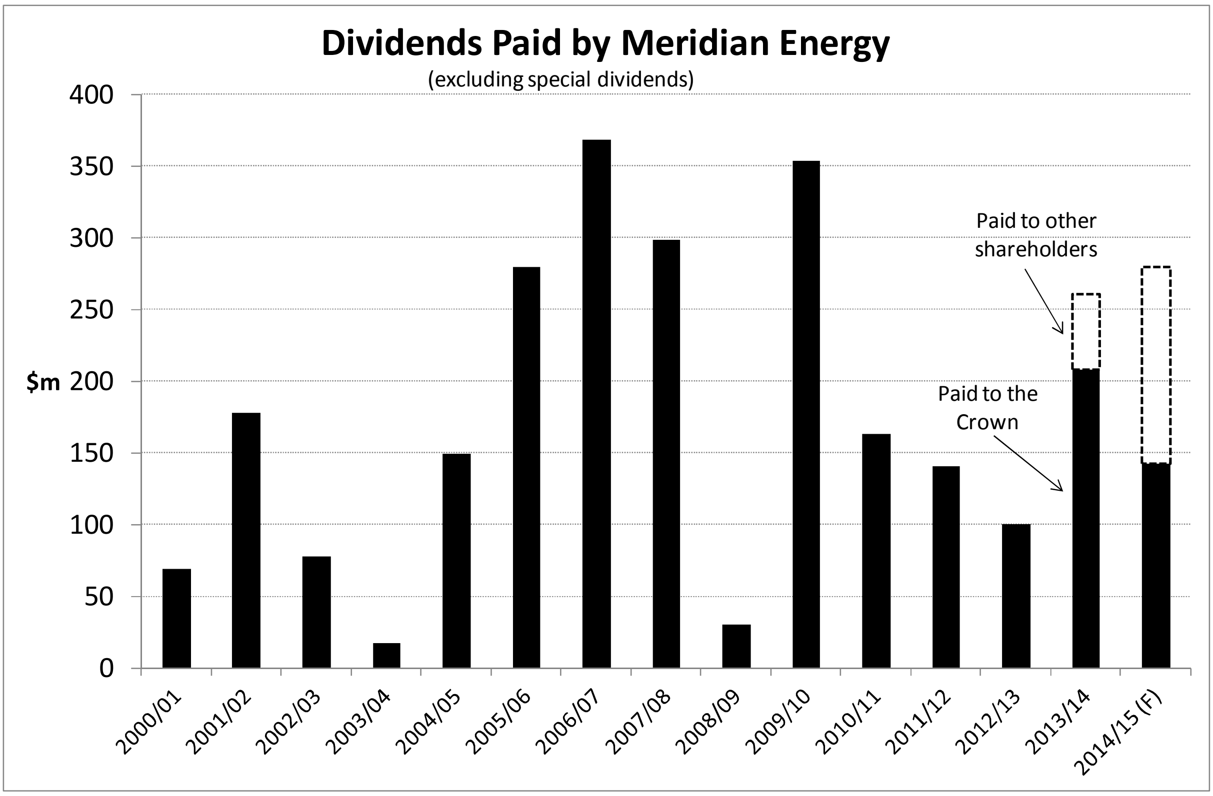
Mighty River Power



21. In MRP's case, there is no obvious difference between dividends paid to the Crown in 2013/14 as 51% shareholder ($90 million) and dividends paid in the previous years when the Crown was the 100% shareholder, which ranged from zero to $286 million[3], and averaged $73 million. The dividend to the Crown in 2013/14, as 51% shareholder, was a 23% increase on this average, not the significant decrease that you might simplistically expect to be the result of the GSO programme.

[3] This included a one-off $150 million special dividend.

Meridian Energy



22. As with MRP, Meridian's dividends have been highly variable from one year to the next, ranging from $17 million in 2003/04 to $279 million just two years later; or from $30 million in 2008/09 to $353 million the following year. Because of this variability, as with MRP, if we had graphed just the dividends paid to the Crown, it would not have been possible to tell from the graph when Meridian became 51% Crown owned.

23. Forecast 2014/15 dividends to the Crown as 51% shareholder ($142 million) are less than the average to the Crown as 100% shareholder during 2000/01 to 2012/13 ($171 million, excluding special dividends) but certainly not a 49% decrease.

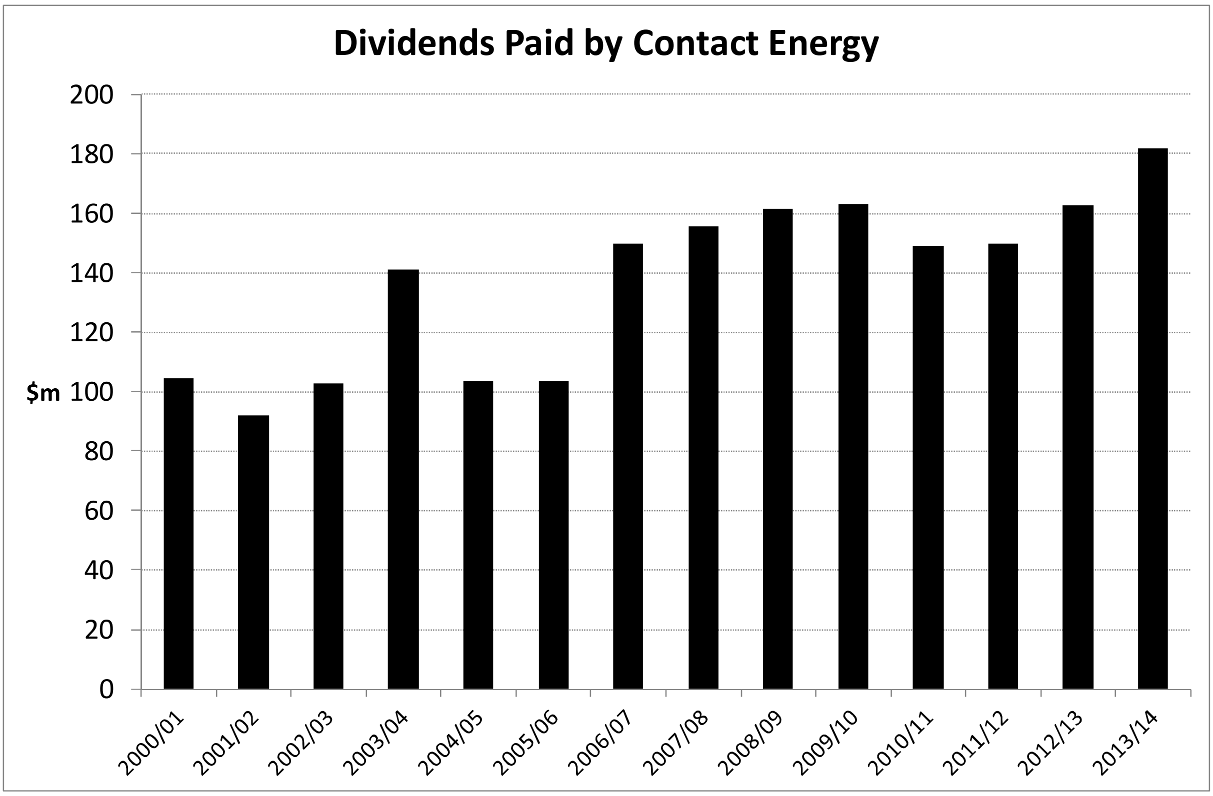
Exclusion of Meridian's special dividends

24. We have removed two significant special dividends paid by Meridian in recent years: $600 million in 2005/06 related to the sale of Southern Hydro in Australia, and $521 million in 2010/11 related to the sale of the Tekapo power stations.

25. Both of these special dividends were the consequence of Meridian Energy selling some of its assets, rather than dividends from "business as usual" activities. On this basis we have chosen to exclude them from the graph. The sale of the Tekapo power stations to Genesis Energy was directed by the Government as part of its electricity sector reforms, rather than a decision taken by the Meridian board, which is another reason for excluding the related special dividend.

26. The $150 million special dividend from MRP in 2009/10 has not been excluded, on the basis that it was the result of "business as usual" activities and not an asset sale.

Contact Energy



27. In contrast to the three Crown-owned companies, Contact Energy's dividend payment history has been much more consistent and predictable, with relatively small variations in total dividends paid from one year to the next, and a trend of increasing dividends over time, as you would expect.

Dividends and prices

28. Another criticism of the GSO programme is that the pressure for higher dividends from private (minority) shareholders will result in the companies increasing their prices. This criticism is incorrect. Genesis Energy, MRP and Meridian Energy operate in a workably competitive electricity market. Their ability to increase prices is constrained by competition from the other companies in the sector, which is unaffected by the GSO programme. Contact Energy has been able to pay consistent dividends to its shareholders, and Contact Energy's electricity prices and its price increases over time have not been out of line with its competitors.

29. As we have advised previously, there is no basis for the argument that the GSO programme will result in higher electricity prices, even if it does result in higher dividends to shareholders.

Recommended Action

We recommend that you **note** the contents of this report.

Stacey Wymer
Manager, Commercial Advice

Hon Bill English
Minister of Finance

Hon Steven Joyce
Associate Minister of Finance

Hon Tony Ryall
Minister for State Owned Enterprises