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Saskatchewan's Commercial Crown Corporation Dividend Policy: Change Isn't Always Progress

By Sheldon Schwartz

"Saskatchewan has afforded SaskPower a dividend holiday for 2010, the second year in a row..."

INTRODUCTION

One might expect that a public debate over Crown corporation dividend policy might be the cure for insomnia. Not so in Saskatchewan, where dividends from commercial Crown corporations are a major revenue item in the provincial budget and a thus matter of public interest.

Recently, there has been controversy in Saskatchewan over the provincial government requiring all but one of its commercial Crown corporations to pay 100% of their 2010 profits as a dividend.[1] The Saskatchewan government admits this is unsustainable.[2]

At the same time, in recognition of its significant investment requirements, Saskatchewan has simultaneously afforded SaskPower, its largest commercial Crown corporation, a dividend holiday for 2010, the second year in a row.

A little background

Crown Investments Corporation of Saskatchewan (CIC) is the holding company for Saskatchewan's investments in its subsidiary commercial Crown corporations such as SaskPower, SaskTel, SaskEnergy and SGI. CIC receives dividends from its subsidiary Crown corporations. CIC in turn pays dividends to the province's General Revenue Fund (GRF) to help fund government priorities.

In 1997, the CIC Board approved a new dividend policy for its commercial Crown corporations.[3] Based on commercial practice, under the policy the CIC Board determines each commercial Crown's ability to pay dividends after allocating a portion of its cash profits to reinvestment and to debt reduction, if necessary to achieve its debt ratio target.[4] The debt ratio measures the proportion of debt in a company's capital structure. Each corporation's debt ratio target is based on industry benchmarks.[5] CIC uses a Crown corporation's debt ratio as a primary indicator of its financial health.[6]

Under the policy, since dividends are determined on an individual basis, Crown corporations could have different dividend rates. For commercial Crown corporations that declared dividends in 2009, dividend rates were between 65% and 90% of profits.[7]

That was then, this is now

For 2010 the Saskatchewan government has decided that dividends from Saskatchewan's commercial subsidiary Crowns will be a uniform 100% of their respective profits except for SaskPower. SaskPower says that its dividend has been suspended to assist in accommodating record reinvestment in Saskatchewan's electrical system.[8]

Saskatchewan's most recent 2010–2011 provincial budget projects that over the next four years, commercial Crown corporation debt is forecast to balloon both in absolute terms and relative to the size of Saskatchewan's economy. While general government purpose debt is expected to remain static at $4.1 billion, government business enterprise debt[9] (almost totally comprised of CIC commercial Crown corporation debt)[10] is expected to nearly double to $5.9 billion at March 31, 2014 from $3.1 billion at March 31, 2010.[11] This Crown debt is also forecast to grow much faster than the provincial economy, rising to 8.2% of Saskatchewan's GDP at March 31, 2014 from 5.4% of GDP at March 31, 2010.[12]

Detailed forecast information is not public regarding the longer-term profitability, investment requirements, debt levels and dividend payments for the individual Crown corporations. However, it is reasonable to believe that the major factor in the overall increase in forecast Crown debt is SaskPower borrowing to fund its record capital program.

It is also reasonable to believe that the Saskatchewan government's requirement that the other commercial Crowns pay 100% of their profits as a dividend for 2010 signals it is less concerned about debt levels in the commercial Crown sector than about the level of government purpose debt.

“The major factor in the overall increase in forecast Crown debt is SaskPower borrowing to fund its record capital program...”

SaskPower now appears to be strapped for cash for its capital program even while paying no dividend at all in 2009 and 2010...

Come again?

"I do think we need to acknowledge the fact that for years SaskPower was never given a break by the shareholder, by the government. (Under the NDP) they were required to pay dividends in the order of half a billion dollars just in the last 10 years and that has had an impact on infrastructure. So we know what that did, and we're trying to fix that by freeing them of any dividend."[13]

—Saskatchewan Premier Brad Wall, quoted March 25, 2010

SaskPower reports that its long-term target is to have a debt ratio between 60% and 75%.[14] SaskPower's debt ratio was 56% in 2000.[15] It was 60.7% in 2008, the last year it paid a dividend to CIC.[16] If SaskPower was strapped for cash for electrical infrastructure spending because dividend payments were too high, then in 2008 how could it still be within one percentage point of the 60% bottom of the long-term target range for its debt ratio that is used by CIC as a primary indicator of its financial health?

As would be expected under a policy where dividends are determined after first allocating cash profits to reinvestment and any required debt reduction, SaskPower's dividend payments did not seem to have left it with too little cash for its capital investment needs over this period.

In contrast, SaskPower now appears to be strapped for cash for its capital program even while paying no dividend at all in 2009 and 2010. According to SaskPower's 2009 Annual Report, despite paying no dividend in 2009 or 2010, SaskPower's debt ratio is expected to soar to 74.1% by 2012, close to the 75% top of its long-term target range.[17] The reason seems to be the sheer magnitude of its capital investment program.

SaskPower indicates that its capital investments for electrical infrastructure were a record $640 million in 2009, and are projected to rise to $832 million in 2010[18], or $1.47 billion over two years. By comparison, SaskPower's 2009 profit was $103 million.[19] Its 2010 profit is forecast to be $134 million.[20] That's a two year total of $237 million.

To get a rough idea of the relative magnitudes, even if SaskPower's dividend rate would otherwise have been 100% of its 2009 and forecast 2010 profits, a dividend holiday would only fund about 16% of SaskPower's expected $1.47 billion capital requirements for the two years. And that's only the beginning; SaskPower forecasts that it needs a total of $8 billion to finance its capital investment program over the next decade.[21]

It appears that SaskPower's $8 billion capital investment program over the next 10 years will dwarf its ability to finance it without massive borrowing or infusions of capital from its government owner. It is hard to see how the dividends SaskPower paid in the last ten years caused the problem or how a dividend holiday alone can solve it.

> **The Wall government decided that it was a higher priority to use money CIC received ... to help finance government priorities in the GRF...**

There was cash in the Crown sector to help SaskPower

"June Draude, minister responsible for CIC, said the decision to take extra cash available within the Crown sector due to the 2007 New Grade upgrader sale and the 2008 SaskFerco sale helped make up for the $1.9 billion potash shortfall. 'There was a profit in the Crowns from the sale of some of the assets. This year with the decline in the money that we received from potash revenues there was definitely a void, there was a need within the general revenue fund to fill it. We had the cash within the Crowns,' *said Draude.* [22]
--Regina Leader-Post, April 29, 2010

The 'extra cash' due to the sale of NewGrade and Saskferco helped to boost CIC's payments to the GRF from $388 million in the two years between January 1, 2006 and December 31, 2007[23] to $1.45 billion between January 1, 2008 and December 31, 2009. [24] In other words, the Wall government decided that it was a higher priority to use money CIC received due to the sale of NewGrade and Saskferco to help finance government priorities in the GRF rather than to help finance SaskPower's record capital requirements.

To take 100% of the 2010 profits as a dividend is neither a commercial dividend policy nor a sustainable one...

What's next?

To take 100% of the 2010 profits of commercial Crown corporations other than SaskPower as a dividend is neither a commercial dividend policy nor a sustainable one. If Saskatchewan were to continue the current year's practice, it would represent a large step backwards from applying best practices to the governance of Saskatchewan's commercial Crown corporations.

As ratepayers, as consumers, as taxpayers and as the ultimate owners of these commercial enterprises, Saskatchewan citizens deserve to know how, after this year, their government will determine the level of commercial Crown corporation dividends, including for SaskPower; how it will ensure that these corporations have adequate capital for their reinvestment and any debt reduction needs; and to what extent much higher forecast debt at SaskPower in the years ahead will affect the rates they pay for electricity.

In the words of Ricky Ricardo, somebody has some 'splainin' to do.

ENDNOTES

1. Angela Hall, "Saskatchewan NDP Foresee Utility Rate Hikes due to Government Using Crown Corporation Profits," *Leader Post*, March 25, 2010.
2. "It wouldn't be sustainable over time to continue to take 100 per cent dividends."—June Draude, CIC Minister. Angela Hall, "Crown Investments Corporation (CIC) Posts Profit," *Leader Post*, April 29, 2010.
3. CIC 1997 Annual Report, 35.
4. CIC 2009 Annual Report, 39.
5. Ibid., 39.
6. Ibid., 51.
7. Ibid., 40. SaskPower did not declare a dividend in 2009.
8. SaskPower 2009 Annual Report, 5.
9. Government business enterprises are entities that are self-sufficient and have the financial and operating authority to sell goods and services to individuals and organizations outside the government reporting entity as their principal activity. 2008–09 Saskatchewan Public Accounts, Volume 1, 87.
10. Ibid., 65.
11. Saskatchewan 2010–11 Budget Summary, 62.
12. Ibid., 63.
13. Angela Hall, "Saskatchewan NDP Foresee Utility Rate Hikes due to Government Using Crown Corporation Profits," *Leader Post*, March 25, 2010.
14. SaskPower 2009 Annual Report, 35.
15. CIC 2000 Annual Report, 19.
16. CIC 2009 Annual Report, 56.
17. SaskPower 2009 Annual Report, 35.
18. Ibid., 6.
19. Ibid., 36.
20. Ibid., 50.
21. Ibid., 6.
22. Angela Hall, "Crown Investments Corporation (CIC) Posts Profit," *Leader Post*, April 29, 2010.
23. In 2006, CIC paid the GRF $221 million in dividends. In 2007, CIC paid the GRF $167 million in dividends. CIC 2007 Annual Report, 118.
24. In 2008, CIC paid the GRF $415 million in dividends and a $130 million equity repayment. In 2009, CIC paid the GRF $905 million in dividends. CIC 2009 Annual Report, 136.

FURTHER READING

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http://www.fcpp.org/publication.php/2799

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http://www.fcpp.org/pdf/FB073%20Kneecapping.pdf

About the author:

Sheldon Schwartz worked for the Province of Saskatchewan for 25 years, including as Assistant Deputy Minister of Finance, responsible for Saskatchewan's treasury and debt management functions and as the Chief Financial Officer and Vice President of Finance and Administration for Crown Investments Corporation, the Province's holding company for its commercial Crown corporations. Born in Regina, he has a Masters degree in Economics from Carleton University, and holds the Chartered Financial Analyst (CFA) designation.

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Frontier Centre for Public Policy

MB: 203-2727 Portage Avenue,
Winnipeg, Manitoba Canada R3J 0R2
Tel: 204 957-1567

SK: 2353 McIntyre Street,
Regina, Saskatchewan Canada S4P 2S3
Tel: 306 352-2915

AB: Ste. 2000 – 444, 5th Avenue SW
Calgary, Alberta Canada T2P 278
Tel: (403) 230-2435