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On dividends and market valuations of Australia's listed electricity utilities: regulated vs. merchant

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Abstract

Restructuring of Australia's electricity supply industry during the 1990s and the string of M&A events that followed led to two clear lines of business emerging, i). regulated utilities (i.e. poles & wires), and ii). merchant utilities (i.e. competitive generation and retail). There are dozens of utility businesses in Australia but only four are listed on the Australian Stock Exchange – two regulated and two merchant. Operating in parallel for most of the past two decades, the two utility segments followed very different earnings trajectories over recent years. Unlike merchant firms, regulated utilities avoided the large swings in dividends which characterised merchant firms as Australia's climate change policy conditions began to tighten. In turn, the comparative stability of regulated utility dividends in the context of a low interest rate environment led to soaring valuations, culminating in simultaneous takeover events. Co-incident delisting of the regulated utilities marks the end of our ability to observe continuous market valuations, and real capital market reactions to changes in network regulation. In this article, the dividend policy and market valuations of the listed regulated utilities are analysed in the context of a falling interest rate environment. Results are consistent with Grullon & Michaely's lifecycle theory of dividend policy – it would seem the stability provided by Australia's regulatory framework made the network utilities, rightly or wrongly, a proxy for bond investors in a falling-rate environment. For merchant utilities, the pattern of dividends and earnings are consistent with information content theory. But their valuations have been adversely impacted by a tightening of Australian climate change policies – ironically, this also being the likely trigger of regulated utility takeover events.

Keywords: electricity, regulated utilities, dividend policy.

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