

# Appendix 13f: Financeability – Price Controls

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### 1. Objective

To ensure that the Company is financeable on both a notional balance sheet and actual balance basis at an individual price control level.

This document focuses on our financeability at an individual price control level. Further more detailed testing has been undertaken on a total Appointee basis, which can be found in Appendix [x] – Financeability testing.

### 2. Method

We have assessed financeability primarily at the appointee level. There are a number of issues when it comes to assessing financeability at the individual price control in the same level of detail i.e. a full suite of key financial indicators. The key issue, although not the only issue, is allocating the existing debt and associated interest charge across the individual price controls.

We can, however, take some assurance that the individual price controls can stand alone for financing by the method we have used to derive revenues for said controls. Each control has revenue designed to cover:

- Overall totex for wholesale and cost to serve for retail
- On going day to day expenditure (fast money through it's PAYG rate).
- Longer term expenditure (slow money through RCV run-off)
- A consistent cost of capital applied across each control; separate margins for retail

This building block method, totally consistent with the PR19 methodology and Ofwat's financial model (run in parallel with our own internal model), gives us assurance that each price control has the correct revenue requirement to cover its day to day expenditure, longer term expenditure needs and the return needed to cover past and future borrowing requirements.

Despite the issues discussed above, we have sought to replicate the methodology used to assess financeability at the Appointee level, which is outlined below

- i) Determine the key financial ratios to be tested
- ii) Determine the targets (on both a notional and actual basis) against which the above key financial ratios will be tested
- iii) Calculate the key financial ratios on both a notional and actual basis
- iv) Compare the calculated ratios against the target levels

Further detail on each of these stages is provided below.

#### a. Key financial ratios to be tested

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Within Ofwat's PR19 methodology it includes a number of financial ratios and we have reported all of these within App10.

We have chosen to focus our financeability analysis on the following three key ratios:

- Gearing
- Adjusted interest cover (on both an Ofwat and Ratings Agency basis)
- Funds from operations ("FFO") to debt (on both an Ofwat and Ratings Agency basis)

We have focused on these three ratios as these are the applicable ratios included within the covenants of our bonds and are also the ratios most commonly referenced by the Ratings Agencies. On this basis we believe they are the most relevant ratios when assessing our financeability.

### b. Target ratios

When assessing our notional financeability, we have considered our financial ratios against the targets required to achieve a rating between A and BBB grade, as these are the ratings used within the business plan methodology to determine the notional cost of debt.

Based on ratings guidance provided by Moody's and S&P, we have set a target for adjusted interest cover ratio of 1.50 times and FFO to debt of 9.0%.

When assessing our actual financeability, we have considered our financial ratios against the targets required to safely maintain our current rating.

For the principal adjusted interest cover ratio this equates to a target of 1.30 times and for FFO to debt this equates to a target of 6.0%.

### c. Ratio calculation

Ratios have been calculated using Ofwat's financial model as follows:

- Notional ratios – all calculated using Ofwat's financial model, though some adjustments have been made to the ratio calculations (see below)
- Actual ratios – all calculated using Ofwat's financial model, though some adjustments have been made to the ratio calculations (see below)

We have made the following amendments to Ofwat's financial model within the results presented in the tables below:

- Line 178 of the "Analysis Appointee" tab was amended to be a positive figure rather than a negative figure. This impacts the alternative calculation of the adjusted ICR.
- Lines 105 and 106 of "Analysis PC" tab for each price control was amended so the interest adjustment within FFO agrees with the interest figure used to

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calculate the ICR. This adjustment was made to ensure consistency with the calculation used for the Appointee.

- Line 107 of “Analysis PC” tab for each price control was amended so that both lines 105 and 106 were deducted from line 104. This adjustment was made to ensure consistency with the calculation used for the Appointee.

The following alternative calculations have been included within Ofwat’s model to determine the key ratios for our financeability assessment (on both a notional and actual basis):

- Adjusted interest cover (Moody’s) – This is the same as Ofwat’s adjusted interest cover (alternative) calculation, except for the following adjustment:
  - Inclusion of additional revenue (c£6m pa) arising from an IFRIC18 accounting adjustment that could not be incorporated within Ofwat’s model.
- Adjusted interest cover (Covenanted) – This is the same as Ofwat’s adjusted interest cover (alternative) calculation, except for the following adjustments:
  - Inclusion of additional revenue (c£6m pa) arising from an IFRIC18 accounting adjustment that could not be incorporated within Ofwat’s model.
  - Working capital movements in year
- FFO to debt (S&P) – This is the same as Ofwat’s FFO to debt (alternative) calculation, except for the following adjustment:
  - Inclusion of additional revenue (c£6m pa) arising from an IFRIC18 accounting adjustment that could not be incorporated within Ofwat’s model.
- Gearing – This is the same as Ofwat’s gearing calculation, except for the following adjustment:
  - RCV re-calculated based on year end nominal rather than average nominal

### d. Comparison to target

Please see results section below for a comparison of the calculated ratios to the target level.

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### 3. Results

The tables below summarise the results of the financeability analysis undertaken.

Results are included for each of the five years of the AMP, together with the average across the AMP. In accordance with Ofwat’s guidance the key figure used in our assessment is the average figure for each ratio.

#### a. Notional financeability

The tables below show the output of notional financeability testing conducted within Ofwat’s financial model for the Appointee and each of the four wholesale price controls. Ofwat’s financial model does not contain any financial ratios for the two retail price controls; therefore we have assessed financeability for the two retail price controls on an earnings after tax and net cashflow basis.

#### Appointee level

Appointee Financeability Notional	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		60.9%	62.5%	63.6%	64.0%	63.7%	62.9%
ICR (Ofwat basis)	1.50	2.37	2.25	2.23	2.18	2.22	2.25
FFO:Debt (Ofwat basis)	9.00%	10.53%	9.96%	9.89%	9.79%	10.06%	10.04%
ICR (Moody's basis)	1.50	1.61	1.59	1.57	1.56	1.57	1.58
FFO:Debt (S&P basis)	9.00%	9.72%	9.15%	9.05%	8.93%	9.19%	9.21%
ICR (Covenanted senior)		n/a	n/a	n/a	n/a	n/a	n/a
ICR (Covenanted default)		n/a	n/a	n/a	n/a	n/a	n/a

#### Water Resources

Water Resources Financeability Notional	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		61.0%	60.9%	60.9%	61.0%	60.4%	60.8%
ICR (Ofwat basis)	1.50	2.24	2.20	2.27	2.27	2.35	2.26
FFO:Debt (Ofwat basis)	9.00%	8.14%	8.05%	8.17%	8.17%	8.54%	8.21%
ICR (Moody's basis)	1.50	1.49	1.49	1.52	1.53	1.55	1.51
FFO:Debt (S&P basis)	9.00%	7.45%	7.31%	7.38%	7.34%	7.67%	7.43%
ICR (Covenanted senior)		n/a	n/a	n/a	n/a	n/a	n/a
ICR (Covenanted default)		n/a	n/a	n/a	n/a	n/a	n/a

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### Water Networks

Water Networks Financeability Notional	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		59.0%	59.7%	60.2%	60.8%	60.9%	60.1%
ICR (Ofwat basis)	1.50	2.54	2.50	2.54	2.48	2.51	2.51
FFO:Debt (Ofwat basis)	9.00%	10.91%	10.55%	10.58%	10.36%	10.53%	10.58%
ICR (Moody's basis)	1.50	1.68	1.71	1.72	1.71	1.70	1.70
FFO:Debt (S&P basis)	9.00%	10.05%	9.64%	9.63%	9.40%	9.57%	9.66%
ICR (Covenanted senior)		n/a	n/a	n/a	n/a	n/a	n/a
ICR (Covenanted default)		n/a	n/a	n/a	n/a	n/a	n/a

### Waste water network

Waste Networks Financeability Notional	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		62.8%	65.3%	66.9%	67.5%	67.2%	66.0%
ICR (Ofwat basis)	1.50	2.26	2.07	1.99	1.93	1.96	2.04
FFO:Debt (Ofwat basis)	9.00%	9.65%	8.91%	8.71%	8.62%	8.84%	8.95%
ICR (Moody's basis)	1.50	1.49	1.42	1.38	1.36	1.37	1.41
FFO:Debt (S&P basis)	9.00%	8.85%	8.13%	7.92%	7.81%	8.02%	8.15%
ICR (Covenanted senior)		n/a	n/a	n/a	n/a	n/a	n/a
ICR (Covenanted default)		n/a	n/a	n/a	n/a	n/a	n/a

### Bioresources

Bioresources Financeability Notional	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		57.5%	59.4%	60.5%	60.3%	58.8%	59.3%
ICR (Ofwat basis)	1.50	1.51	1.48	1.57	1.56	1.70	1.56
FFO:Debt (Ofwat basis)	9.00%	18.22%	17.51%	17.76%	18.10%	19.22%	18.16%
ICR (Moody's basis)	1.50	1.64	1.64	1.70	1.70	1.80	1.69
FFO:Debt (S&P basis)	9.00%	17.73%	16.92%	17.08%	17.34%	18.39%	17.49%
ICR (Covenanted senior)		n/a	n/a	n/a	n/a	n/a	n/a
ICR (Covenanted default)		n/a	n/a	n/a	n/a	n/a	n/a

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### Residential retail

Residential retail Financeability Notional	Target	FY21	FY22	FY23	FY24	FY25	Average
Earnings after cash	n/a	6.57	7.49	7.92	8.37	8.84	7.84
Net cashflow	n/a	18.35	4.68	5.02	5.12	5.93	7.82

### Business retail

Business retail Financeability Notional	Target	FY21	FY22	FY23	FY24	FY25	Average
Earnings after cash	n/a	1.42	1.81	3.20	3.72	3.89	2.81
Net cashflow	n/a	6.54	1.81	3.20	3.73	3.89	3.84

The analysis shows that:

- Average ratios are above target for all ratios at the Appointee level.
- Ofwat's ratios are above the target level on an average basis for all wholesale price controls except Water Resources and Wastewater FFO to debt.
- Ratings Agency ratios vary per wholesale price control; however these ratios are only formally tested an Appointee level.
- Retail price controls are both profitable and cash generative.

The ratios above per wholesale price control vary significantly from the overall Appointee ratio, which is due to the assumptions within Ofwat's model in relation to the allocation of Appointee interest and debt across the individual price controls.

Whilst the analysis above shows that Ratings Agency ratios might fall below target in some years, this will not necessarily have an impact on credit ratings as the levels are trigger levels and not default levels. Other factors would come into the assessment such as: trend, reason for cost shock; management response; mitigation put in place; exceptional nature of shock.

#### b. Actual financeability

The tables below show the output of notional financeability testing conducted within Ofwat's financial model for the Appointee and each of the four wholesale price controls. Ofwat's financial model does not contain any financial ratios for the two retail price controls; therefore we have assessed financeability for the two retail price controls on an earnings after tax and net cashflow basis.



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### Appointee

Appointee Financeability Actual	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		77.5%	78.2%	78.7%	78.8%	78.4%	78.3%
ICR (Ofwat basis)	1.30	2.10	2.00	1.98	2.02	2.05	2.03
FFO:Debt (Ofwat basis)	6.00%	7.94%	7.64%	7.66%	7.74%	7.96%	7.79%
ICR (Moody's basis)	1.30	1.43	1.41	1.39	1.44	1.45	1.42
FFO:Debt (S&P basis)	6.00%	6.22%	6.00%	6.07%	6.16%	6.35%	6.16%
ICR (Covenanted senior)	1.20	1.72	1.43	1.31	1.32	1.33	1.42
ICR (Covenanted default)	1.00	1.72	1.43	1.31	1.32	1.33	1.42

### Water Resources

Water Resources Financeability Actual	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		78.5%	78.4%	78.4%	78.5%	78.3%	78.4%
ICR (Ofwat basis)	1.30	1.99	1.94	1.95	1.99	2.01	1.98
FFO:Debt (Ofwat basis)	6.00%	6.00%	5.91%	5.95%	6.01%	6.17%	6.01%
ICR (Moody's basis)	1.30	1.32	1.32	1.30	1.34	1.33	1.32
FFO:Debt (S&P basis)	6.00%	4.32%	4.19%	4.22%	4.25%	4.34%	4.27%
ICR (Covenanted senior)	1.20	0.79	1.33	1.44	1.27	1.23	1.21
ICR (Covenanted default)	1.00	0.79	1.33	1.44	1.27	1.23	1.21

### Water Networks

Water Networks Financeability Actual	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		76.3%	76.6%	77.0%	77.3%	77.4%	76.9%
ICR (Ofwat basis)	1.30	2.16	1.99	1.94	1.95	2.00	2.01
FFO:Debt (Ofwat basis)	6.00%	7.99%	7.58%	7.52%	7.46%	7.64%	7.64%
ICR (Moody's basis)	1.30	1.42	1.36	1.31	1.34	1.36	1.36
FFO:Debt (S&P basis)	6.00%	6.19%	5.81%	5.79%	5.75%	5.93%	5.89%
ICR (Covenanted senior)	1.20	1.92	1.38	1.34	1.30	1.30	1.45
ICR (Covenanted default)	1.00	1.92	1.38	1.34	1.30	1.30	1.45

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### Waste water network

Waste Networks Financeability Actual	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		78.9%	80.0%	80.7%	80.6%	80.1%	80.1%
ICR (Ofwat basis)	1.30	2.07	2.00	1.98	2.04	2.08	2.03
FFO:Debt (Ofwat basis)	6.00%	7.45%	7.18%	7.21%	7.36%	7.59%	7.36%
ICR (Moody's basis)	1.30	1.36	1.37	1.38	1.44	1.45	1.40
FFO:Debt (S&P basis)	6.00%	5.78%	5.63%	5.72%	5.88%	6.07%	5.82%
ICR (Covenanted senior)	1.20	1.30	1.39	1.22	1.29	1.29	1.30
ICR (Covenanted default)	1.00	1.30	1.39	1.22	1.29	1.29	1.30

### Bioresources

Bioresources Financeability Actual	Target	FY21	FY22	FY23	FY24	FY25	Average
Gearing		74.3%	75.7%	77.1%	77.8%	78.0%	76.6%
ICR (Ofwat basis)	1.30	1.21	1.04	1.02	0.98	0.99	1.05
FFO:Debt (Ofwat basis)	6.00%	13.48%	12.72%	12.63%	12.61%	12.81%	12.85%
ICR (Moody's basis)	1.30	1.31	1.15	1.10	1.07	1.05	1.14
FFO:Debt (S&P basis)	6.00%	11.98%	11.31%	11.25%	11.19%	11.30%	11.41%
ICR (Covenanted senior)	1.20	3.12	1.26	0.97	0.89	0.91	1.43
ICR (Covenanted default)	1.00	3.12	1.26	0.97	0.89	0.91	1.43

### Residential retail

Residential retail Financeability Notional	Target	FY21	FY22	FY23	FY24	FY25	Average
Earnings after cash	n/a	6.57	7.35	7.75	8.16	8.59	7.68
Net cashflow	n/a	18.35	4.55	4.85	4.90	5.67	7.67

### Business retail

Business retail Financeability Notional	Target	FY21	FY22	FY23	FY24	FY25	Average
Earnings after cash	n/a	1.42	1.76	3.14	3.64	3.78	2.75
Net cashflow	n/a	6.54	1.77	3.14	3.64	3.78	3.77

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The analysis shows that:

- Average ratios are above target for all ratios at the Appointee level
- Ofwat's ratios are above the target level on an average basis for all wholesale price controls except for Bioresources adjusted ICR.
- Our covenanted ratios are above target level on an average basis for all wholesale price controls
- Ratings Agency ratios vary per wholesale price control; however these ratios are only formally tested at Appointee level.
- Retail price controls are both profitable and cash generative.

The ratios above per price control vary significantly from the overall Appointee ratio, which is due to the assumptions within Ofwat's model in relation to the allocation of Appointee interest and debt across the individual price controls.

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### 4. Conclusion

A summary of the results above is shown in the table below.

Financeability Notional	Target	WR	WN	WWN	BIO	App
Gearing		60.8%	60.1%	66.0%	59.3%	62.9%
ICR (Ofwat basis)	1.50	2.26	2.51	2.04	1.56	2.25
FFO:Debt (Ofwat basis)	9.00%	8.21%	10.58%	8.95%	18.16%	10.04%
ICR (Moody's basis)	1.50	1.51	1.70	1.41	1.69	1.58
FFO:Debt (S&P basis)	9.00%	7.43%	9.66%	8.15%	17.49%	9.21%
ICR (Covenanted senior)		n/a	n/a	n/a	n/a	n/a
ICR (Covenanted default)		n/a	n/a	n/a	n/a	n/a

Financeability Actual	Target	WR	WN	WWN	BIO	App
Gearing		78.4%	76.9%	80.1%	76.6%	78.3%
ICR (Ofwat basis)	1.30	1.98	2.01	2.03	1.05	2.03
FFO:Debt (Ofwat basis)	6.00%	6.01%	7.64%	7.36%	12.85%	7.79%
ICR (Moody's basis)	1.30	1.32	1.36	1.40	1.14	1.42
FFO:Debt (S&P basis)	6.00%	4.27%	5.89%	5.82%	11.41%	6.16%
ICR (Covenanted senior)	1.20	1.21	1.45	1.30	1.43	1.42
ICR (Covenanted default)	1.00	1.21	1.45	1.30	1.43	1.42

- Forecast ratios are above the target level in all cases at the Appointee level.
- Our covenanted ratios are above target level on an average basis for all wholesale price controls
- At least one of Ofwat's ratios are above the target level on an average basis for all wholesale price controls.
- Ratings Agency ratios performance versus target varies per wholesale price control; however these ratios are only formally tested at Appointee level.
- The ratios above per wholesale price control vary significantly from the overall Appointee ratio, which is due to the assumptions within Ofwat's model in relation to the allocation of Appointee interest and debt across the individual price controls.

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- Retail price controls are both profitable and cash generative.

In light of the above we can conclude:

- The Company is financeable at the Appointee level on both a notional and actual basis.
- The Company is financeable at an individual price control level on both a notional and actual basis.
- There is insufficient evidence to justify altering the pay as you go rates between the individual price controls.