

# Consultation on financial monitoring framework

## About this document

This consultation considers the proposals of the Water Services Regulation Authority (Ofwat) for the financial monitoring framework under which we will monitor the financial stability of the water and wastewater sector in England and Wales. The purpose of this financial monitoring framework is to enhance visibility and transparency of company financing and capital structures to help ensure that all stakeholders can maintain trust and confidence in the sector.

The financial monitoring framework forms one part of a suite of company monitoring tools Ofwat is putting in place, which also includes the strategic assessment framework, the annual performance report and company monitoring framework. In this document, we present:

- draft proposals for our pilot financial monitoring report; and
- a summary of the proposed reporting requirements, along with our rationale for these requirements.

We also discuss how we may develop the scope of the framework and form of the report in the future. We are interested in stakeholders' views on the preferred form, scope and content of the financial monitoring framework in these areas.

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## Responding to this consultation

We would welcome any comments on this document. Please email them to [FinanceAndGovernance@ofwat.gsi.gov.uk](mailto:FinanceAndGovernance@ofwat.gsi.gov.uk) or post them to:

Financial Monitoring Framework Response  
Ofwat, Centre City Tower  
7 Hill Street  
Birmingham  
B5 4UA.

The closing date for this consultation is **3 August 2015**. We will publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk), unless you indicate that you would like your response to remain unpublished.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004. If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ which deals, among other things, with obligations of confidence.

In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

## Executive summary

Our vision for the water sector in England and Wales is one where customers, the environment and wider society have trust and confidence in vital public water and wastewater services. We oversee how the sector is performing and seek assurance that service providers are engaging with customers and delivering services they want and can afford. We are ready to step in when things go wrong, and to act clearly and predictably with the right tools to achieve the best results. We are putting the financial monitoring framework in place to enable us to identify whether there is an appropriate level of corporate and financial resilience within regulated water companies and that the service to customers is not being put at risk by companies' choice of capital structure or financing arrangements.

We are developing a suite of company monitoring tools, including the **financial monitoring framework**, the proposals for which are set out in this consultation.

The purpose of the financial monitoring framework is to provide interested stakeholders with more transparent and accessible financial information about the regulated water companies and trends in financial developments within the sector as a whole.

It also aims to enable Ofwat to:

- monitor the **financial stability** of the businesses that we regulate;
- **identify financial or structural risks** that may impact on the companies' ability to deliver for customers; and
- determine when we need to intervene to protect the interests of customers, using the regulatory tools available to us.

We intend to publish financial information on the sector and to provide a high-level review of that information which identifies key trends and significant changes and reports on an exceptions basis.

We are not seeking to place an unnecessary burden on companies to provide additional information to us unless it adds value to customers and other stakeholders. Where possible, we intend to use information that companies are already providing in the regulatory accounts, and from 2016 in the annual performance report, or which is already publicly available. But, if we have concerns about a company's financial stability, we will seek to obtain additional information and collect it more frequently.

We have identified an initial set of financial metrics that we intend to monitor, the details of which are set out later in this document. We may not report against all these metrics, but will focus on those that provide the most useful information to the users of the report. We intend to publish an initial pilot report once the 2015 regulatory accounts have been reviewed. This consultation seeks stakeholders' views on the form and contents of that report including the metrics stakeholders' would find most useful, and how it should be developed in the future

We also expect the financial monitoring framework to apply to all regulated companies, including retailers following the opening of the non-household retail market in 2017.

We do not expect the scope of the financial monitoring framework to remain static, but we will keep it under review. We expect it to develop over time in response to specific issues arising or changes within the sector.

Our analysis of company data may identify further areas where we wish to focus our reports in the future. As a result, we may revise the set of financial metrics that we use. If the results of our analysis lead us to conclude that we need to look beyond the regulatory ring fence at the financial stability, financing arrangements, tax structuring and other arrangements entered into by holding companies or shareholders, then we will consider how we obtain this information and whether we need to change company licences.

Again, we are seeking stakeholders' views about:

- whether the financial monitoring framework should apply to companies other than the regulated water and waste water companies (by which we mean companies holding appointments as water and/or sewage undertakers) and any future regulated companies such as retailers following the opening of the non-household retail market in 2017 and a licenced infrastructure provider for the Thames Tideway Tunnel or a similar project;
- whether there are other metrics we should be including in our analysis; and
- the frequency with which we should be publishing our reports so that they are of maximum use to stakeholders without burdening companies unnecessarily.

In considering how the financial monitoring framework should develop, we also propose that from 2016 companies stress test their financial plans, by carrying out sensitivity analysis, and we are asking them to publish the results of that analysis. This consultation outlines our proposals in this area – we are keen to obtain stakeholders' views on the scope of stress testing.

## Questions for consultation

Throughout this consultation, we raise a number of specific questions, which we have summarised here. As well as responses to these specific questions, we welcome stakeholders' views on any of the issues and matters we raise in this document.

**Q1** Do you think that the financial metrics we are proposing to include in our pilot financial monitoring report (see appendix 1) are appropriate measures?

**Q2** Are there any other financial metrics that you consider should be included in the pilot financial monitoring report or that should be considered for future reports?

**Q3** Do you agree that the financial metric definitions set out in appendix 2 are appropriate? Are there alternative definitions that we should be considering? If so, why?

**Q4** Do you agree that the financial monitoring report should be published each year with additional information being requested from companies only when required, or should we be asking all companies to provide financial information to us on a more frequent basis?

**Q5** The financial monitoring report will focus on the regulated companies and their holding companies, including retailers. Are there any other companies that we should be including within the financial monitoring framework?

**Q6** How far outside the regulatory ring fence do you think that we should be looking? Should the scope of the financial monitoring framework include more information in respect of principal holding companies, the ultimate controlling parties of the regulated companies or other key shareholders?

**Q7** Do you agree that we should be asking companies to carry out stress testing by way of sensitivities on their business plans, based on their actual capital structures and expenditure plans, and to publish the results?

**Q8** Are the sensitivities proposed appropriate, or should we be asking companies to apply a different set of sensitivities?

## 1. Introduction and background to the financial monitoring framework and report

In 2013, our Chairman, Jonson Cox, gave a speech on '[Observations on the regulation of the water sector](#)', in which he highlighted that concerns had been raised with him about the lack of transparency of corporate structures within the water sector and the sustainability of increasingly highly geared structures. He stressed that "... a point strongly made to me by some customer and public interest representatives was the belief that corporate behaviours, public trust and transparency of companies ranked equal with price and service in maintaining legitimacy in today's world."

In his speech, he proposed that "... it seems a sensible idea, in the public interest, as proposed by some external parties without sophisticated financial resources, that we reintroduce an appropriate targeted annual report on financial and efficiency performance, dividends and capital structures which will enable parties to form a better view on the sectoral risks."

Supported by PwC, we carried out further work in this area (see PwC's report on '[Cost of capital for PR14: Methodological considerations](#)'). In our methodology for the 2014 price review – PR14 ('[Setting price controls for 2015-20 – final methodology expectations for companies' business plans](#)'), we concluded at that point in time there was no systemic risk arising from companies choice of capital structures and noted that there was no immediate need for regulatory invention.

But we recognised that new risks may emerge and that it was important to continue to monitor company financial structures to ensure that both the water sector and the regulatory framework remain robust over time.

In our PR14 methodology, we announced that we would introduce a financial structure monitoring framework and stated that this framework would provide a published annual review of:

- financial performance of all water companies;
- key risks faced by the sector;
- stress testing of water company financial performance;
- sector analyst and rating agency assessment; and
- ad hoc special interest topics that relate to the risk environment of water company financial structures.

We have since completed PR14, and have given further consideration to the form of a suitable financial monitoring framework. We now present our proposals for a pilot financial monitoring report and for the development of the framework and report in subsequent years.

This is just one of the ways in which we are seeking to monitor the regulated water companies on an ongoing basis in line with our strategy. We are also introducing our strategic assessment framework, annual performance report and company monitoring framework which together are intended to provide customers, investors and other stakeholders with on-going trust and confidence in the sector.

## 2. Objectives of the financial monitoring framework

The objectives of the financial monitoring framework are to:

- enhance visibility and transparency of financial and capital structures in the sector;
- enable Ofwat to monitor the financial stability of the businesses that we regulate;
- identify financial and structural risks which may impact on service delivery over time and prove harmful to customers; and
- help us to determine when we need to use the regulatory tools available to us to intervene to protect customers' interests.

We intend to gather, analyse and report on information on the regulated companies, which will give us a clearer and broader view of solvency, liquidity, risk management and longer-term financial viability in light of anticipated investment programmes. This information will identify trends at both a company and sector level. It will also enable us to identify those companies which have financial metrics that are deteriorating over time, which indicates that the company may be experiencing financial distress. We may also include explanations of the reasons why companies have specific metrics.

Using this information, we will be able to:

- better monitor each company's performance against our final determinations; and
- improve the quality of the conversations that we have with companies about their ongoing performance.

This will enable us to confirm that companies have exercised their responsibilities appropriately.

This information will also improve our ability to determine when companies are or could become at risk. It will mean that we are better informed when we need to make timely decisions about how best to intervene to protect customers – and to prevent a poor situation deteriorating further.

In line with our approach of encouraging companies to be transparent, we will publish the information that we collate and our analysis of that information on our website.

One purpose of this is to create a database of accessible public information that will enable stakeholders to see clearly the movement in company financial metrics over time and to identify trends within the sector. It will also allow stakeholders to benchmark companies' financial results compared with industry averages, which will encourage companies to improve their performance, and it will allow easier comparisons with the performance of other utilities. This is consistent with our strategy of ensuring that there is trust and confidence in water.

### 3. Company monitoring tools

The proposed financial monitoring framework forms part of a suite of company monitoring tools that Ofwat is putting in place. We are developing an overall strategic assessment framework which will work together with the financial monitoring framework set out in this document, the annual performance report and company monitoring framework which sets out the level of assurance required from companies to ensure that customers, investors and other interested parties have the information they need to enable them to assess the performance of each company and the industry.

The financial monitoring framework will focus on key financial metrics for each regulated company. It will also include specified information about the companies which own or control them as these holding companies or ultimate controllers are able to influence the activities of the regulated companies.

We are not seeking to place an unnecessary burden on companies to provide information to us and we will not be duplicating or adding large data burdens, but we will, as far as possible, re-use data collected in different contexts for different purposes.

The companies are already reporting many of these financial metrics as part of the normal [regulatory accounting process](#), including the [annual performance report](#), which we have already consulted on, and which companies are required to complete for regulatory reporting periods from April 2015 onwards

In most cases, companies are already preparing and publishing the additional information that we have identified, or it can be calculated from published information or from information that is already available to us. Where we identify that further information from a company or companies is required then we will request it.

## 4. Information to be published

The financial monitoring report will:

- set out a suite of key financial metrics for each company;
- provide an overall commentary on the financial health of the sector; and
- highlight changes and trends.

The published information will also:

- inform our discussions with companies, identifying areas where we need company management to provide additional assurance to us about the security and stability of company financial arrangements; and
- help to determine the level of any regulatory intervention that may be required.

We will base the calculation of the financial metrics on each company's:

- actual capital structure;
- actual expenditure levels;
- statutory and regulatory accounts; and
- other company published information.

So, they may differ from any financial metrics that were calculated on the basis of the notional capital structure used for price setting purposes. We use a notional capital structure for price setting purposes as it ensures that the risks associated with any particular capital structure are not transferred to customers. Company management retain the responsibility for determining each company's actual financing structure and for managing actual company performance.

In appendix 2, we set out the initial suite of financial indicators that will be considered in the report, along with the associated definitions.

We may consider including further metrics in future reports if we determine that they are required to provide us with additional information that enhances our understanding of the sector and are of value to stakeholders.

We will continue to keep the suite of financial metrics that we are using under review. We may amend, remove or add to these metrics following a review of the outcome of the pilot report.

We will also provide a high-level analysis of the financial data presented, identifying trends within the sector and taking account of the key risk areas that we and other parties (such as investors – and potential investors – credit rating agencies and analysts) identify.

The analysis that accompanies the company metrics will report on an exceptions basis. It will comprise both narrative and illustrative charts and will focus on specific areas which we consider to be of most interest to companies and other stakeholders.

### Consultation questions

**Q1** Do you think that the financial metrics we are proposing to include in our pilot financial monitoring report (see appendix 1) are appropriate measures?

**Q2** Are there any other financial metrics that you consider should be included in the pilot financial monitoring report or that should be considered for future reports?

**Q3** Do you agree that the financial metric definitions set out in appendix 2 are appropriate? Are there alternative definitions that we should be considering? If so, why?

## 5. Frequency of publication

We intend to publish an initial pilot financial monitoring report by the end of September 2015 that will be based on the 2015 regulatory accounts and other financial information that is publicly available at that time. But we acknowledge that certain information that will be included in the full financial monitoring report, such as retail margins, will not be available at that date.

We will publish the first full financial monitoring report following the publication of the first annual performance reports including the 2016 regulatory accounts after the first year of the 2015-20 control period. We intend to publish full financial monitoring reports on a yearly basis.

Where companies publish interim financial information, we will prepare and publish an interim financial monitoring report to reflect the latest data that is available.

At this point in time, we are not proposing to require companies to provide information to us on a basis that is more frequent than is currently specified. If however, the information that we obtain indicates that information for specific companies needs to be reviewed on a more frequent basis to provide us with assurance that there is no risk to customers, then we will request additional information from those companies and will explain why we require more information.

We will agree the level of company and third party assurance that is required in respect of this additional information on a company-by-company basis, and will reflect and influence the company's assurance categorisation under Ofwat's company monitoring framework.

### Consultation question

**Q4** Do you agree that the financial monitoring report should be published each year with additional information being requested from companies only when required, or should we be asking all companies to provide financial information to us on a more frequent basis?

## 6. Which companies will be included?

The principles of the financial monitoring framework will apply to all companies that Ofwat regulates, both now and in the future, taking account of the relative size and impact of each entity on the sector and customers.

Initially, this will comprise all the companies for which Ofwat set full price controls at PR14 (ten water and sewerage companies, eight water only companies).

A licenced infrastructure provider for the Thames Tideway Tunnel or similar project will also be included within this framework.

In due course, we will consider whether to extend the framework to small water companies and other licensed businesses, or whether the principles are applied in an alternative way proportionate to their size and impact on customers. With the opening of the non-household retail market in 2017, water retailers will also become subject to the financial monitoring framework and their results will be included in the annual financial monitoring report. We recently consulted on [licensing and policy issues in relation to the opening of the non-household retail market](#), and noted that elements of our proposals covered potential events such as a retailer ceasing to trade or if a company did not have enough resources to deal with a large increase in customer numbers. We have also sought to make sure that the existence of the new retail market does not undermine the duties and obligations of the water companies that will continue to play a key role. To complement this, we are also considering how we might be given early warning, by both water companies and separate retailers, of any increased financial risks to regulated companies in the competitive market if and when they start to emerge. This will help us identify when we might need to intervene in line with the regime introduced by the Water Act 2014. Applying the annual financial monitoring framework to regulated retailers will help to support these other monitoring safeguards.

Initially, the financial monitoring framework will focus only on the regulated entities. But if our assessment of the financial information that companies provide leads us to consider that we need to look beyond the regulatory ring fence at the financial stability, financing arrangements (including tax), other arrangements entered into by holding companies, the ultimate controlling parties of the regulated companies or other key shareholders, we may request this information from companies and their investors. Each of the regulated companies is part of a group which has a different capital structure. We may therefore need to designate a “Principal Holding Company” for each company, which will be considered as part of our review.

If it becomes necessary to consider seeking changes to company licences to enable us to obtain the information that we determine is necessary, then we will consult separately about this.

### Consultation questions

**Q5** The financial monitoring report will focus on the regulated companies and their holding companies, including retailers. Are there any other companies that we should be including within the financial monitoring framework?

**Q6** How far outside the regulatory ring fence do you think that we should be looking? Should the scope of the financial monitoring framework include more information in respect of principal holding companies, the ultimate controlling parties of the regulated companies or other key shareholders?

## 7. Further developments – stress testing

In our PR14 methodology, we said that we would ask companies to stress test their business plans and to provide us with information on the outcomes of those stress tests.

As set out in our methodology for the 2014 price review – PR14 ([‘Setting price controls for 2015-20 – final methodology expectations for companies’ business plans’](#)) the proposed stress tests will allow us to continue to assess industry financial resilience and the risks to customers posed by companies’ financial structures (including new approaches that may emerge over time) – and to identify whether (and when) it might be appropriate for us to intervene to protect customers. The purpose of carrying out stress tests of this type is two-fold.

- First, it identifies how sensitive companies’ business plans are to variations in the level of the costs, including financing charges, they face.
- Second, it assesses the impact of changes in the inflation assumptions that are being used.

The results of these tests will reveal how much financial headroom there is in companies’ plans (that is, whether the assumed changes in costs result in companies breaching their financial covenants).

The types of sensitivities we are proposing would include; cost shocks, liquidity and interest rate risks and lower than expected inflation rates.

For example we could ask companies to perform stress testing which reflects the impact one or all of the changes below:

- [10]% increase in totex;
- [1.0%] increase in the cost of debt; and
- [1.0%] increase/decrease in RPI.

The proposed sensitivities have been set at a level which is considered to be a realistic assessment of how actual costs could vary during the period up to the determination of the next wholesale price review.

They are not extreme or unlikely sensitivities that may be unrealistic. However they may not test the full extent of the available headroom.

We do not expect companies to report the results of their stress testing against all of the metrics which we are using for assessing the company's actual financial position. Instead we would require them to report against a subset of these metrics including:

- Earnings before interest and tax (EBIT)
- Post tax return on Regulated Equity
- Regulatory gearing
- Interest cover and adjusted interest cover
- FFO/Debt

Companies will be required to carry out this stress testing on their actual financial plans which include their actual capital structure and their actual expenditure plans, which is the basis on which company funders, investors and the credit rating agencies evaluate the business. This differs from the notional financial structure and allowed totex which Ofwat use when setting price controls where we consider the financeability of a notionally efficient company.

Where the results of the stress tests show that companies have insufficient headroom and there is a risk that they may breach their financial covenants, management will also be expected to set out and explain the actions they would take to prevent this from happening if the conditions assumed in the tests were to arise.

This type of analysis will not be new to companies – it is the type of analysis that they are likely to have had to provide to their investors, funders and to the credit rating agencies. However, it will be the first time they are being asked to publish information of this type.

We are not asking companies to provide any information on their stress tested business plans when they publish their regulated accounts for the year ended 31 March 2015. We will ask them to publish this information along with their regulatory accounts for the year ended 31 March 2016, and will provide further guidance on the format of that publication before then.

### Consultation questions

**Q7** Do you agree that we should be asking companies to carry out stress testing by way of sensitivities on their business plans, based on their actual capital structures and expenditure plans, and to publish the results?

**Q8** Are the sensitivities proposed appropriate, or should be we asking companies to apply a different set of sensitivities?

## **Appendix 1: Format of the pilot financial monitoring report**

The financial monitoring report will set out the financial metrics for each company in a table that allows a straightforward comparison between companies across the sector.

The narrative that will accompany the table will focus on significant observations from the data, supported by charts to illustrate each point if appropriate.

Pages 20 to 28 show the draft format of the report.



## Water and sewerage companies

KPI	Calculation	Point of Measurement	Units	ANH	WSH	NES	SVT	SRN	SWT	TMS	UU	WSX	YKY
Revenue - Actual vs Final Determination		Year ended 31 March XX	£m										
			%										
Earnings before Interest and Tax (EBIT) - Actual vs Final Determination		Year ended 31 March XX	£m										
			%										
Profit after tax - Actual vs Final Determination		Year ended 31 March XX	£m										
			%										





KPI	Calculation	Point of Measurement	Units	ANH	WSH	NES	SVT	SRN	SWT	TMS	UU	WSX	YKY
Funds from operations - Actual vs Final Determination		Year ended 31 March XX	£m										
			%										
Regulatory Gearing	Ratio of net debt to RCV	As at 31 March XX	%										
Accounting Gearing	Ratio of net debt to equity	As at 31 March XX	%										
Credit rating	Credit rating issued by a recognised rating agency	As at 31 March XX	Rating										
Post-tax return on capital	Post-tax profits as % of regulated equity	Year ended 31 March XX	%										





KPI	Calculation	Point of Measurement	Units	ANH	WSH	NES	SVT	SRN	SWT	TMS	UU	WSX	YKY
Return on Regulated Equity	Return due to shareholders/ Equity component of RCV	Year ended 31 March XX	%										
Return on RCV	Profit after tax as a % of RCV	Year ended 31 March XX	%										
Dividend yield	Total dividend declared/regul ated equity Regulated equity = (RCV-net debt)	Year ended 31 March XX	%										
Dividend Cover	Profits before dividends for the year/dividends declared	Year ended 31 March XX	Number										
Retail profit	Retail	Year ended 31	HH%										





KPI	Calculation	Point of Measurement	Units	ANH	WSH	NES	SVT	SRN	SWT	TMS	UU	WSX	YKY
margin	earnings before interest and tax/revenue	March XX	NHH%										
Interest cover (Measures ability to pay interest costs)	Funds from operations before payment of interest/interest paid	Year ended 31 March XX	Number										
Adjusted Interest Cover	(Funds from operations before payment of interest-regulatory depreciation)/interest paid	Year ended 31 March XX	Number										





KPI	Calculation	Point of Measurement	Units	ANH	WSH	NES	SVT	SRN	SWT	TMS	UU	WSX	YKY
FFO/Debt (Measures ability to repay debt costs)	Funds from operations after payment of interest /Net debt	Year ended 31 March XX	Number										
Effective tax rate	Tax charge for the year as a % of profit before taxation	Year ended 31 March XX	%										
Free cash flow	Post interest FFO less dividends paid	Year ended 31 March XX	£m										
RCV/Cape x	Free cash flow/capex	Year ended 31 March XX	£m										
Trade creditor days	Trade and capex creditors/(annual expenditure) x 365 days	As at 31 March XX	Number of days										





KPI	Calculation	Point of Measurement	Units	ANH	WSH	NES	SVT	SRN	SWT	TMS	UU	WSX	YKY
Average embedded cost of debt	Interest paid on debt/average debt balance	Year ended 31 March XX	%										
Tenor of debt		As at 31 March XX	Years										
Profile of debt	Percentage of debt which is due to be repaid within 1 year, within 1-2 years, within 2-5 years and in more than 5 years	As at 31 March XX	% Fixed rate										
Mix of debt between fixed rate debt, floating rate debt and can index linked debt		As at 31 March XX	% Index linked										
			% Floating rate										





KPI	Calculation	Point of Measurement	Units	ANH	WSH	NES	SVT	SRN	SWT	TMS	UU	WSX	YKY
Company monitoring category	The company's assurance category under Ofwat's monitoring framework	As at 31 March XX	Self assurance , targeted, prescribed										
Principal parent company gearing	Net Debt/Equity	As at 31 March XX	%										



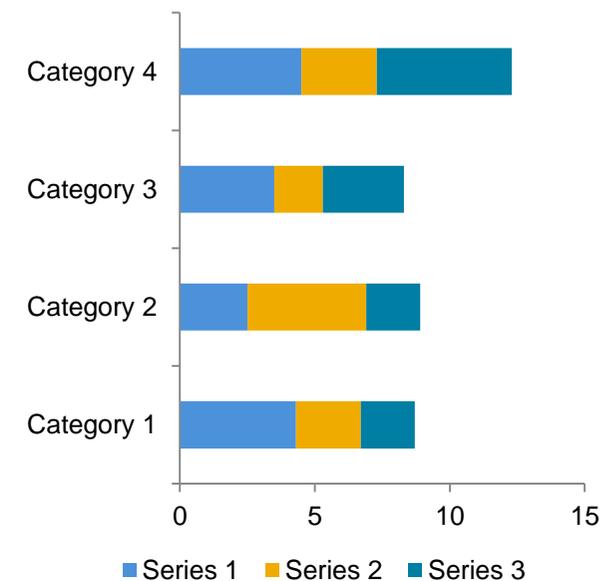


## Analysis

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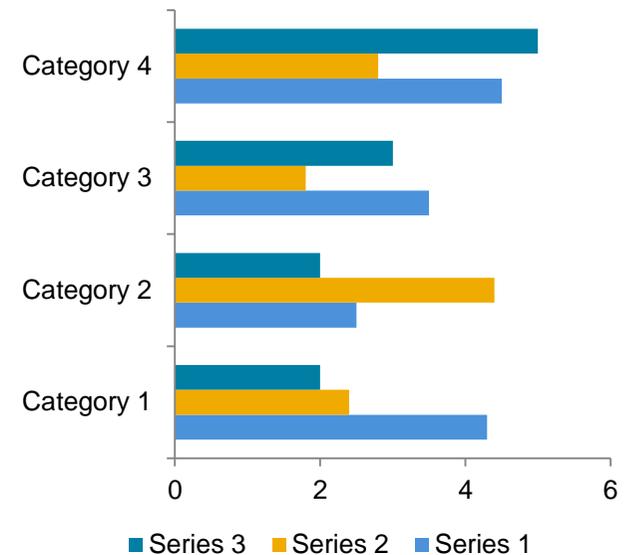
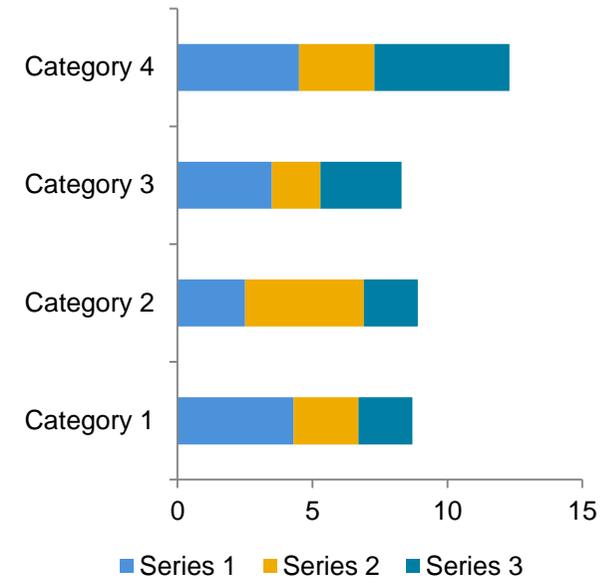




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## Appendix 2: Financial metrics included in the report

Below, we set out the definitions of the financial metrics we plan to include in the pilot financial monitoring report.

Financial metric	Definition
Revenue – actual versus final determination	<p>Total appointed revenue for the year compared with allowed revenue as set out in each company’s final determination, which has been inflated from a real to nominal basis using actual the Retail Prices Index as published by the ONS (“RPI”).</p> <p>The difference will be presented as value in £m and as % compared with the final determination value.</p>
Earnings before interest and tax (EBIT) – actual vs final determination	<p>Total earnings before interest and tax for the regulated business taken from the regulatory company accounts compared with the equivalent figure from the final determination financial model, inflated from a real to nominal basis using actual RPI.</p> <p>The difference will be presented as value in £m and as % compared with the final determination value.</p>
Profit after taxation – actual vs final determination	<p>Total profit after tax for the appointed business taken from the appointed company accounts compared with the equivalent figure from the final determination financial model, inflated from a real to nominal basis using actual RPI.</p> <p>The difference will be presented as value in £m and as % compared with the final determination value.</p>
Funds from operations (FFO) – actual vs final determination	<p>Funds from operations should be calculated as net cash generated from operations as set out in Pro forma 1D in regulatory accounting guideline (RAG 3.08) adjusted to remove the impact of changes in working capital.</p>
Net debt	<p>Net debt is defined as set out in Pro forma 1E to RAG 3.08 and is the net of all debt and cash balances. It excludes any amounts due in respect of retirement benefit scheme obligations.</p>
Regulated equity	<p>Calculated as Regulated Capital Value as updated and published by Ofwat (“RCV”) less net debt.</p>

Financial metric	Definition
Regulatory gearing	Calculated as the ratio of net debt to RCV.
Accounting gearing	Calculated as the ratio of net debt to total equity (share capital and reserves).
Credit rating	Credit rating (corporate family where available) issued by a recognised credit rating agency.
Post-tax return on capital	Profit after tax for the appointed business for the year as % of regulated equity.
Return on regulated equity	Return due to shareholders/equity component of the RCV assumed in the notional capital structure. The return due to shareholders is calculated as profit before interest and tax calculated using the regulatory building blocks less tax less (cost of debt x average net debt).
Return on RCV	Profit after tax for the appointed business for the year as % RCV.
Dividend yield	Total dividend declared in the year as a percentage of the regulated equity at the year end.
Dividend cover	Profits before dividends for the year divided by dividends declared.
Retail profit margin	Retail earnings before interest and tax as a percentage of revenue.
Interest cover	Funds from operations before payment of interest/ interest paid.
Adjusted interest cover	Funds from operations before payment of interest less regulatory depreciation/interest paid.
FFO/debt	Funds from operations (as defined above) / year average net debt.
Effective tax rate	Tax charge for the year as a % of profit before taxation
Free cash flow (RCF)	Post interest FFO (as defined above) less dividends paid
RCF/Capex	Free cash flow / capex
Trade creditor days	Calculated as trade creditors/(annual expenditure) x 365 days.
Average embedded cost of debt	Interest paid on debt / average debt balance

Financial metric	Definition
Tenor of debt	The average term of the company's net debt.
Profile of debt repayments	Percentage of net debt which is due to be repaid within one year, in 1 to 2 years, 2 to 5 years and in more than 5 years
Mix of debt between, fixed rate debt, floating rate debt and index linked debt.	Percentages of total debt which is fixed rate, floating rate and index linked
Analysis of financial instruments, including SWAPs	Analysis to include – nature of swaps, start and finish dates, interest rates, mark to market value etc.
Company monitoring category	The company's assurance category as defined by Ofwat's company monitoring framework.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a leading economic regulator, trusted and respected, challenging ourselves and others to build trust and confidence in water.



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