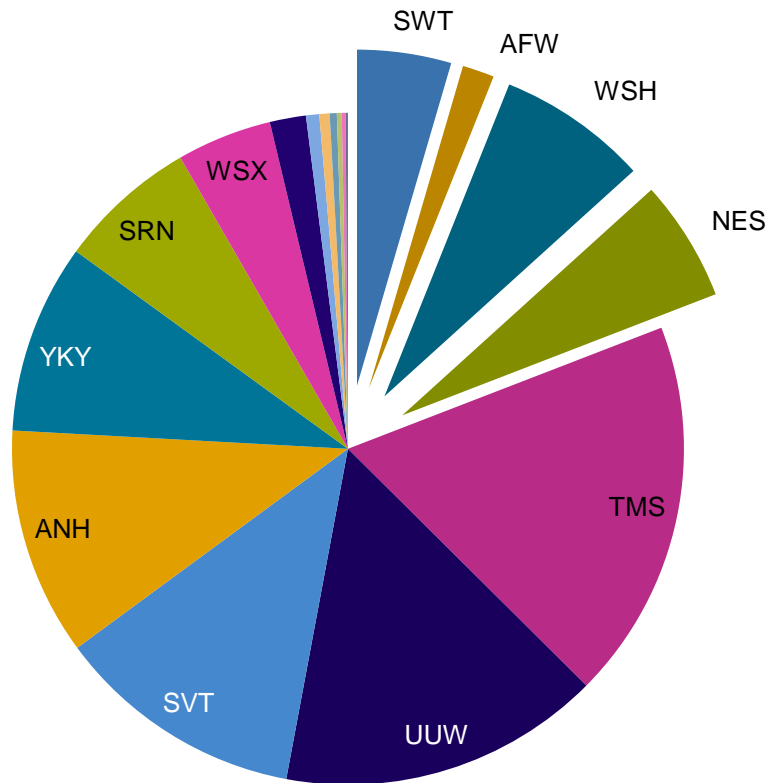




## June Investor Reference Pack

Sonia Brown, Chief Regulation Officer  
Graham Taylor, City Adviser

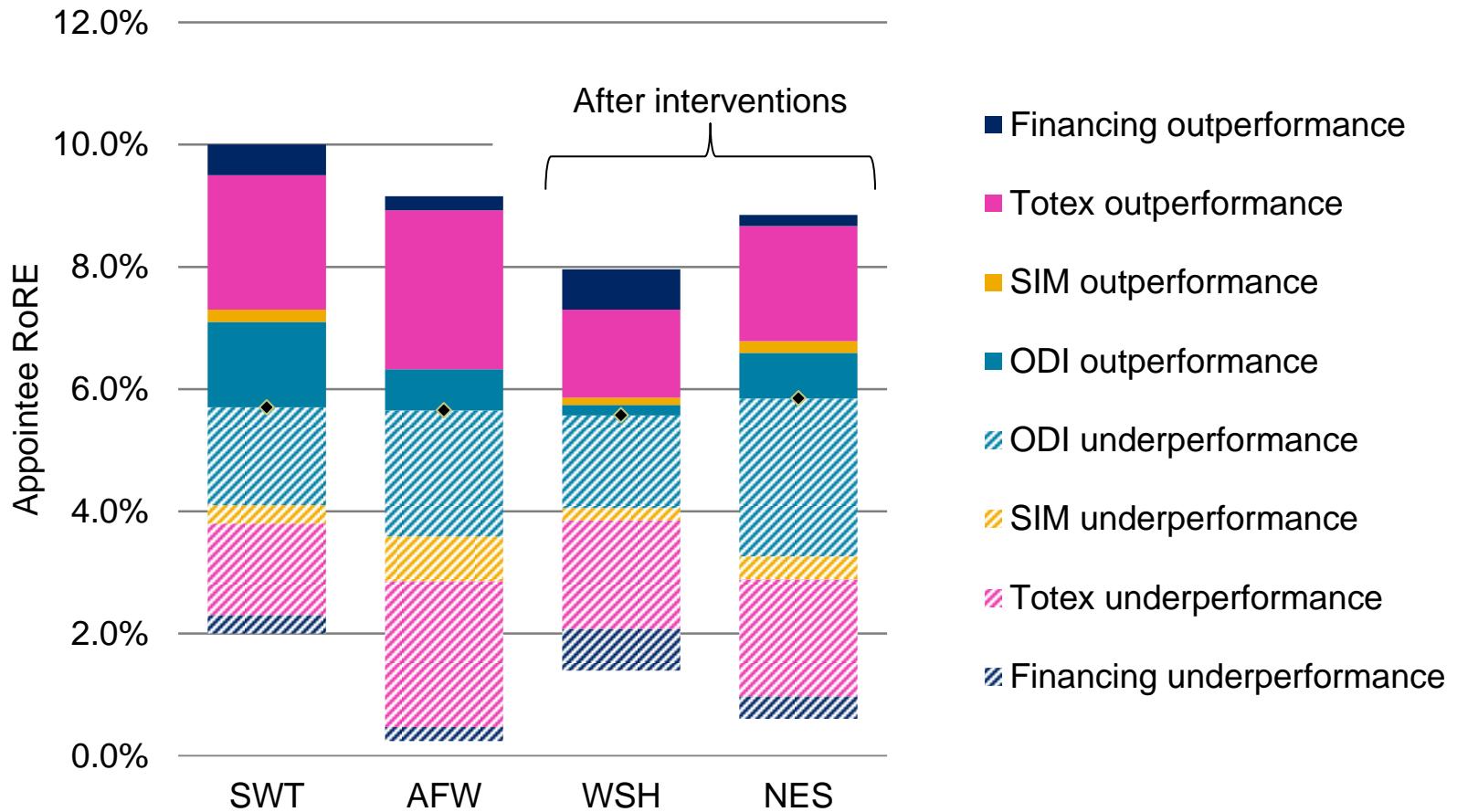
## Industry by 2014-15 RCV



- Draft determinations now published for four of eighteen companies, representing 19% of industry RCV
- Consultations open until **4 June**
- Remaining companies will revise business plans by **27 June** for a determination on **29 August**
- Final determinations will be published **12 December**
- Price controls take effect **1 April 2015**

Source: Business plans.

# Returns linked to value delivered for customers



Note: Ranges based on notional capital structure and exclude financial benefits of enhancement.

Source: Draft determinations.

# Financeability

RCV run-off rate affects cash interest cover and FFO/Debt

	Cash Interest Cover	ACICR	FFO/Debt	PAYG (Water/Waste)	RCV Run-Off <sup>(1)</sup>
Affinity	3.7x	2.2x	12.4%	77.4%	4%
South West	3.2x	1.6x	10.4%	57.1%/54.4%	3.8%/4.7%
Northumbrian	3.5x	1.3x	11.8%	56.5%/43.1%	6.7%/5.5%
Welsh	2.5x	1.6x	7.0%	69.7%/57.0%	3.4%/2.3%

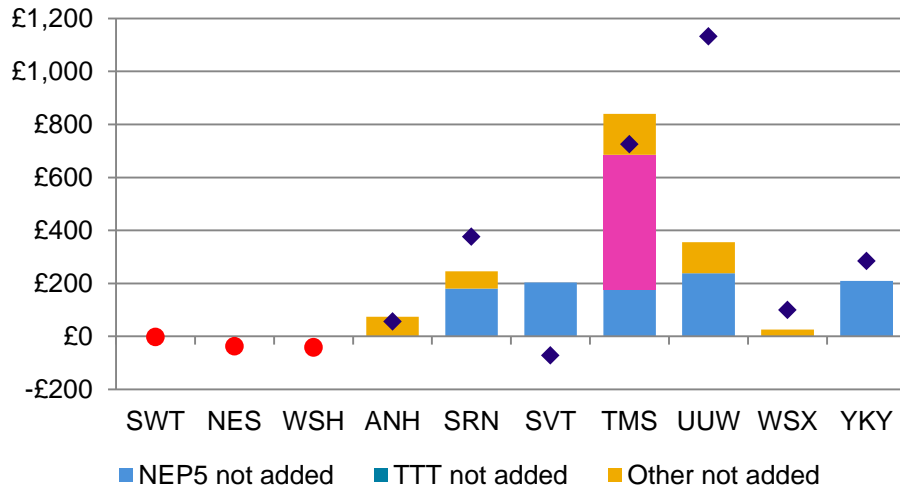
'Pay-as-you-go' ratio affects all financeability metrics

We required additional assurance around weak notional FFO/debt at Welsh, caused by slower RCV run-off

(1) Run-off rate on 2015 RCV.  
Source: Draft determinations.

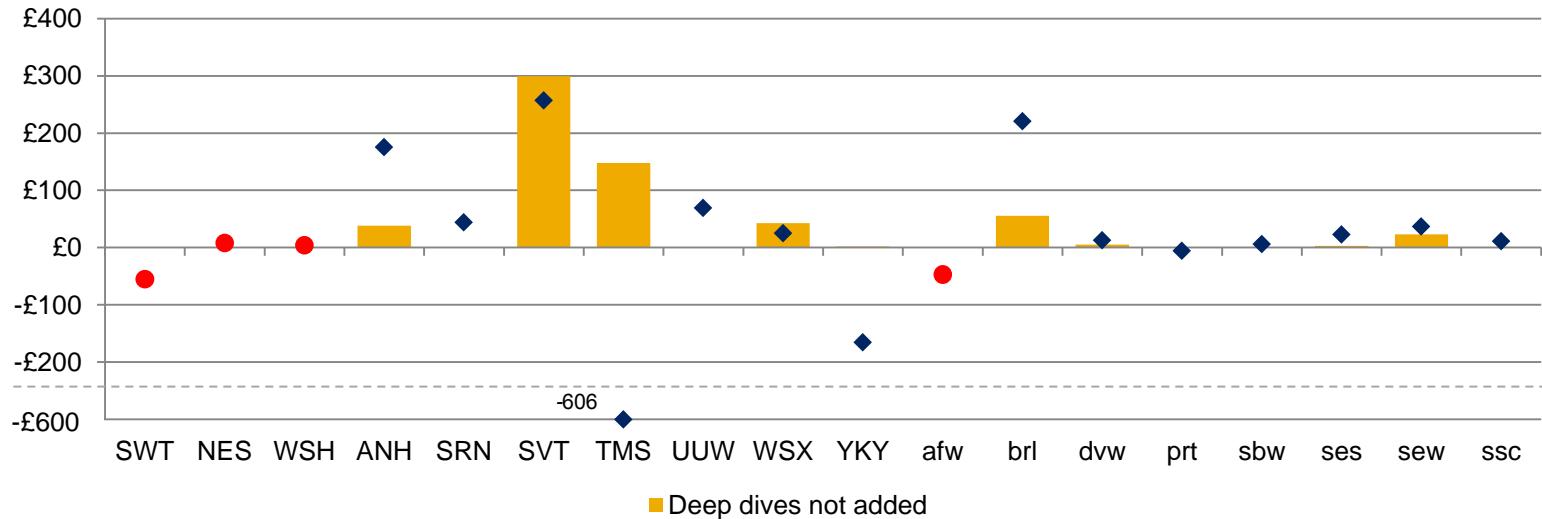
# Wholesale cost gap from RBR and Draft Determinations

Wastewater



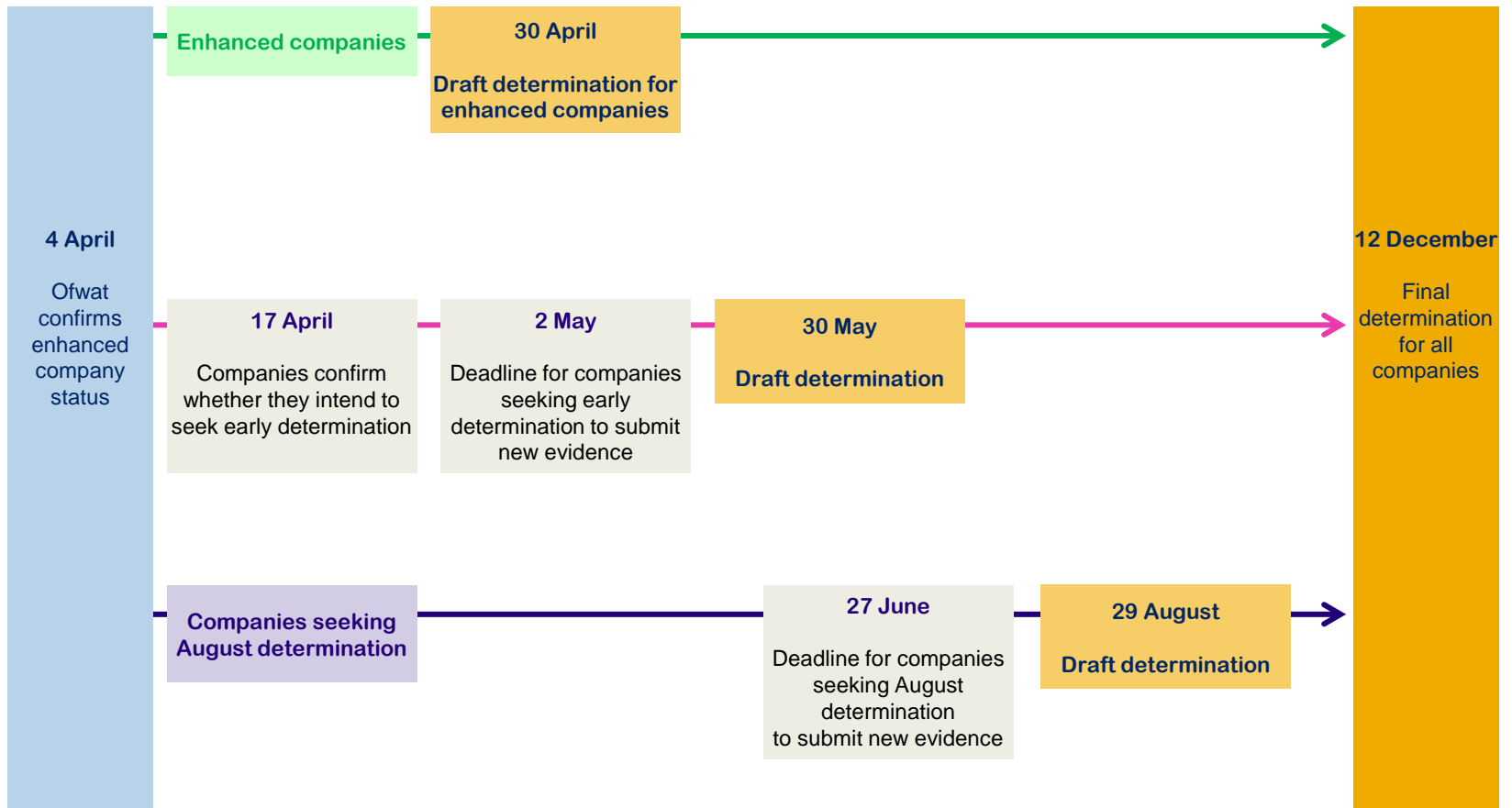
These graphs show the gap between companies' plans and Ofwat's RBR thresholds (◆) or draft determination thresholds (●), and specific expenditure items which were included in company plans but excluded from the RBR threshold.

Water



Source: Risk based review and draft determinations.

# Getting to final determinations



# A base return and meaningful incentives

Driver	Examples	Return guidance	
		On Regulated Equity	On RCV
Base return		5.65%	3.85% (3.7% wholesale)
Cost performance	Where companies find new or more cost-efficient ways of delivering services to customers they will be allowed to share this outperformance with their customers	+/- 2.0%	+/- 0.75%
Performance commitments and Outcome Delivery Incentive (ODI) targets	Where companies deliver an outcome, supported by customer engagement, to a higher level of satisfaction for customers it should be possible for them to earn additional returns	+/- 1.0% to 2.0%	+/- 0.4 to 0.75%
Service Incentive Mechanism	A relative measure of performance to assign rankings and rewards	-0.5% to +0.25%	-0.2% to +0.1%

Source: Risk and Reward Guidance.

# WACC guidance

WACC inputs	Ofwat (point)	Ofwat range	Industry range
<b>Total equity market return</b>	<b>6.75%</b>	<b>6.25% to 6.75%</b>	<b>6.50% to 7.25%</b>
Real risk-free rate	1.25%	0.75% to 1.25%	1.25% to 2.1%
Equity market risk premium	5.5%	5.5%	5.0% to 5.75%
Gearing (Net Debt:RCV)	62.5%	60% to 62.5%	57% to 70%
<b>Asset beta</b>	<b>0.3</b>	<b>0.3</b>	<b>0.33 to 0.40</b>
Equity beta	0.8	0.75 to 0.80	0.84 to 1.07
<b>Cost of equity (post-tax)</b>	<b>5.65%</b>	<b>4.9% to 5.7%</b>	<b>6.0% to 7.9%</b>
Ratio of embedded to new debt	75%:25%	75%:25%	60%:40% to 94%:6%
Cost of new debt	2.65%	2.6% to 2.8%	0.6% to 3.5%
Cost of embedded debt	2.65%	2.6% to 2.8%	1.8% to 3.8%
Allowance for debt fees	0.1%	0.1%	n/a
<b>Overall cost of debt</b>	<b>2.75%</b>	<b>2.7% to 2.9%</b>	<b>2.3% to 3.6%</b>
<b>Appointee (vanilla) WACC</b>	<b>3.85%</b>	<b>3.6% to 3.9%</b>	<b>4.1% to 4.9%</b>

Source: Summarised from Table 8 of Risk and Reward Guidance (January 2014).