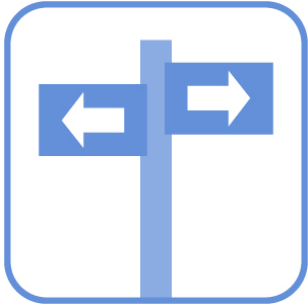




Financial modelling workshop

7 April 2014

# Agenda



- 1 About this workshop
  - 2 Introduction
  - 3 Structure of the financial model
- Break**
- 4 Running the financial model
  - 5 Risk assessment tool
  - 6 Questions and answers
  - 7 Next steps

# About this workshop



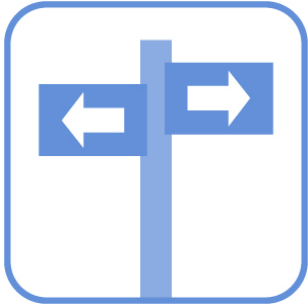
Following the announcement of the risk based review results, we are holding a series of workshops across the elements of the business plan

The purpose of these sessions is to provide companies with the opportunity to raise questions with the Ofwat team. We are doing this in a workshop format to allow us, and companies, to use time effectively and efficiently

Our objective is to support companies to understand our approach and our requirements. We want to help companies to improve aspects of their plans, to address any gaps identified during the risk based review, and to continue to take ownership and accountability of their plans

The workshop materials will be put on our website, along with the main points/questions and answers, without attribution. There will be no detailed meeting note

# Agenda



- 1 About this workshop
- 2 **Introduction**
- 3 Structure of the financial model
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As part of the price review we have developed a financial model to help us assess companies' business plans. The three main purposes of the financial model are to:

Determine the wholesale price controls

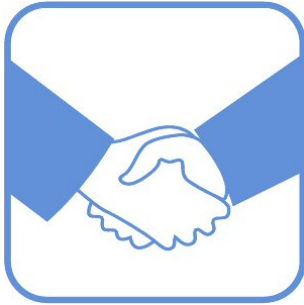
Calculate the revenues arising from the retail price controls

Help assess financeability of the company

Ahead of updating your business plans, in March we asked you to run your results through both your model and the Ofwat model and explain any differences between the two, including the calculation of financeability ratios

To assist companies a key focus of today's session will be to demonstrate the financial model including the calculation of the financeability ratios

# Objectives



At the end of today's session companies should have an understanding of:

How to populate the financial model with company data

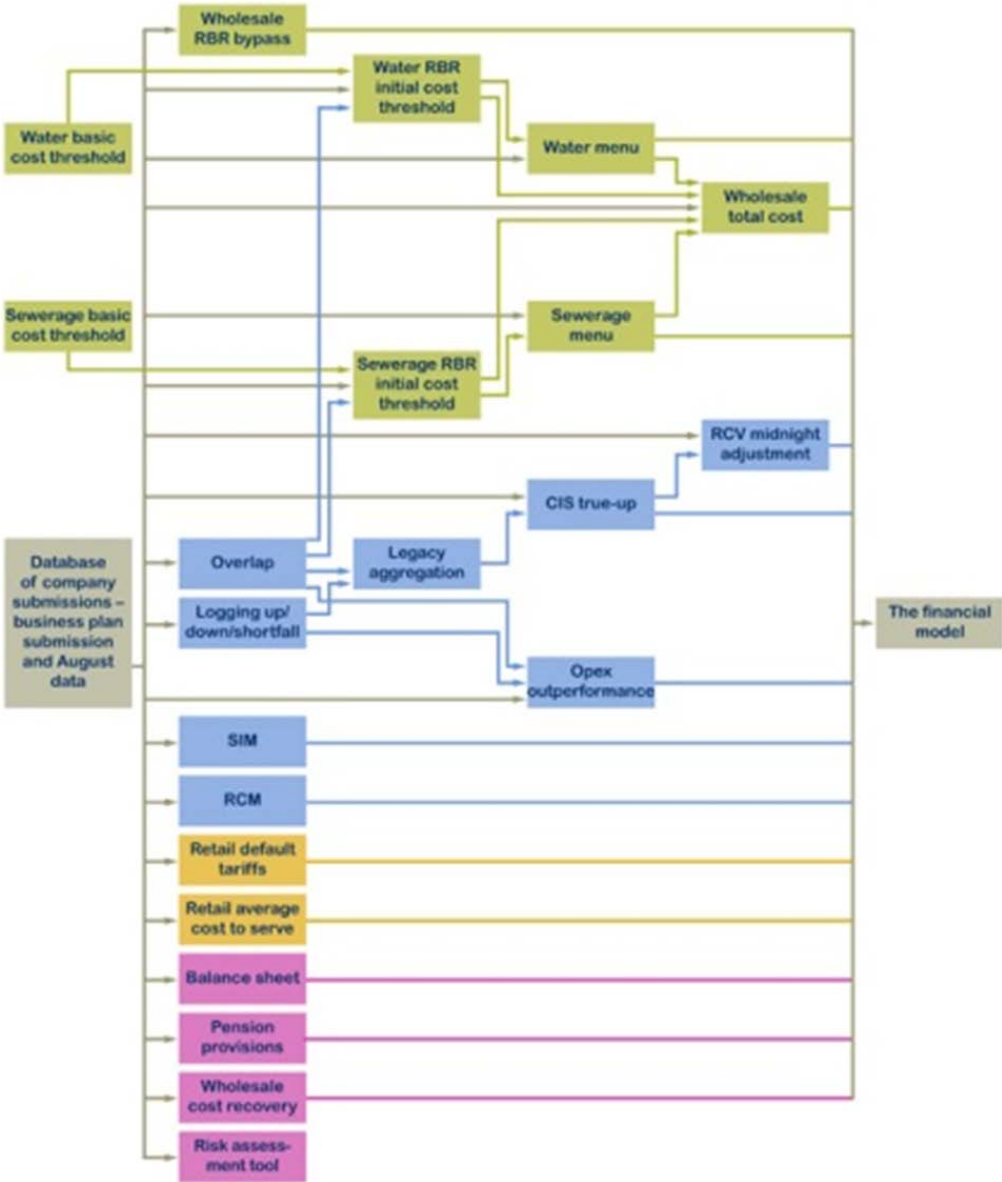
The structure and calculations of the financial model

How to operate and run the financial model including how to adjust their actual structure to the Ofwat notional structure

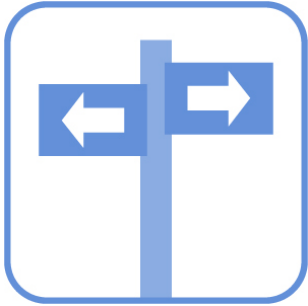
The calculation of financeability ratios both in the financial model and in the risk assessment tool

The risk assessment tool and Ofwat's expectations on the assessment of risk

# Model suite



# Agenda



- 1 About this workshop
  - 2 Introduction
  - 3 Structure of the financial model
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- 4 Running the financial model
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## Demo

We will now provide an overview of the four input sheets in the financial model:

F input sheet

Adjustments sheet

Input real sheet

Input nominal sheet

Inputs from feeder models (pensions/balance sheet model)



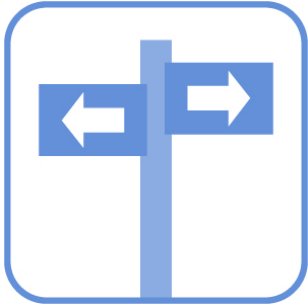
We will now go through a demonstration of the financial model covering:

Wholesale

Retail

Appointee

# Agenda



- 1 About this workshop
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- Break**
- 4 **Running the financial model**
  - 5 Risk assessment tool
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A blue rounded square icon containing the word "Demo" in a bold, blue, sans-serif font.

## Demo

We will now go through a demonstration on running the financial model covering:

Notionalisation

Price control solving

Ratios and reconciliation

# Notionalisation: procedure



Amend to reflect notional WACC and associated financing costs per our risk and reward guidance (Jan 2014)

Running model gives gearing consistent with actual plan (only impacted by cash flow changes from difference between actual interest rates and notional)

Set gearing to notional assumption but preserve tax shield from debt based on actual level of gearing

Determine bankable revenue or overwrite with original revenue determined under actual capital structure

Reconciliation company modelled ratios to Ofwat financial model ratios

# Notionalisation: input assumptions



## Amend financing costs:

### Input real sheet:

Wholesale WACC

3.7

### Input nominal sheet:

Margin HH

1.0

Margin NHH

2.5

Overdraft/cash interest rate

5.627

Interest rates for existing and new fixed rate debt

5.627

Interest for existing and new index linked debt

2.75

## **RUN MODEL PHASE 1: Reset allowed revenues**

# Notionalisation: using the PR14 model ribbon (1)

Phase 1

Reset allowed revenues  
RUN

Phase 2

Adjust gearing to notional gearing assumption  
Opening gearing 62.5%  
Interest rate 5.627  
Tick box 1 (default) to preserve tax shield from debt based on actual level of gearing  
APPLY

Phase 3

Target rate of return (annual blended cost of capital)  
RUN

Phase 4

Adjust dividends if necessary to maintain AMP6 gearing consistent with notional  
Override adjustment  
Manual adjustment  
APPLY

# Notionalisation: using the PR14 model ribbon (2)

## Phases 5 and 6

Stage selections

Stage 5: Adjust PAYG and Run off – APPLY

Stage 6: Apply equity injection – SKIP REMOVE EFFECTS

Stage 7: Adjust allowed revenues – SKIP REMOVE EFFECT

## Phase 7

Allowed revenue adjustment

Assess financial ratios reported in “Appointee nominal” sheet

## Reconciliation

Reconciliation – company submitted table A8 vs Outputs of Ofwat financial model





## Financial indicators

Tool for measuring financial returns made by the company and credit metrics used in considering whether a company is financeable

Suite of indicators as set out in the methodology document.

We recognise that each of the rating agencies use a different approach to calculating financial indicators when issuing credit ratings

We ask you to submit details of the financial indicators based on the company's actual structure, under a notional structure (A8) and in connection with the scenario analysis on A20



### Financial indicators (continued)

The financial model calculates the suite of indicators for water, waste water and at an appointee level at each of the phases in the model

When we consider financeability we look at indicators at the appointee level on a notional structure, but before post financeability legacy adjustments and other incentives received ex-post



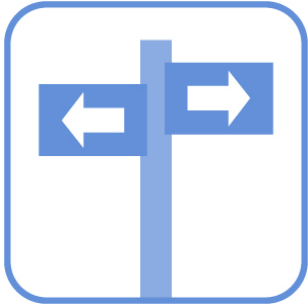
## What do we need you to provide?

Suite of financial indicators as set out on A8 and A20

Copies of the detailed calculations to support the figures submitted

Evidence, including appropriate Board assurance, setting out why you believe that the company is financeable taking into account the financial indicators and the target credit ratings

# Agenda



- 1 About this workshop
  - 2 Introduction
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- Break**
- 4 Running the financial model
  - 5 **Risk assessment tool**
  - 6 Questions and answers
  - 7 Next steps



**The aim of this session is to explain the assessment of risk and the risk assessment tool**

The right balance of risk and reward matters for customers  
Provides meaningful incentives to companies to provide the best service  
Ensures risks are allocated where they are best placed to manage them

It is important that companies have the incentive to outperform

The potential for higher return on regulatory equity (RoRE) for cost and outcome outperformance aligns the interest of companies and customers

Why measure the range for RoRE?

Identifies the scale of risk on returns  
Impacts on financeability

# RoRE range expectations



In January, we published guidance on an appropriate risk and reward range:

	Range of RoRE
Overall RoRE variance	±3.5% to ±4.5%
Cost performance	at least ±2.0%
ODI	±1.0% to ±2.0% (upside at least 1.0%)
SIM	-1.0% to +0.5%
Financing	±0.1% to ±0.5%

The package of incentives should be consistent with evidence on affordability and related to willingness to pay (WTP)  
The RoRE ranges are guidance



We will assess how revised plans have reflected our risk and reward guidance

This may raise questions such as:

Are the impacts sufficiently evidenced?

Is sufficient risk mitigation in place?

Is the allocation of risk efficient?

To help us answer such questions, we will analyse table A20 and supporting documentation. Moreover, we will examine the company's reconciliation of its own RoRE range with the range calculated by the risk assessment tool

The risk assessment tool:

Assesses risk

Is not used to assess the revenue requirement

Does not feed into the financial model

Risk scenarios are used in the assessment of financeability

# Data requirements



Compared to December, we have reduced table A20 to just one scenario: Scenario I, the overall scenario. We need you to complete table A20, and supporting documentation, as part of your business plan revisions

This scenario shows a P10 and P90 on RoRE

Other key differences to the table:

We have added a price base column – **in 2012-13 prices**

We have moved the individual outcome delivery incentive impacts to table A20a, leaving totals in table A20

We have added lines for notional financing performance impact

We have added lines for uncertainty mechanisms, showing the incremental allocation to customers

We have added lines for the element-level RoRE values and margins in the high case, in the low case, and in the base case





Table A20 and the risk assessment tool are based on constant 2012-13 prices

If high and low scenarios include different assumptions on inflation, this should impact on cost and revenue:

Wholesale revenue – there should be no change as revenue is indexed to RPI

Retail revenue – this should be adjusted by the change in RPI as the revenue is constant in nominal terms

Wholesale and retail expenditure – the change will depend on whether expenditure is expected to increase by more or less than RPI

ODIs – the change will depend on whether incentives are linked to RPI (whether directly or indirectly)

SIM – this should be adjusted by the change in RPI as the incentive is defined is linked to retail revenues which is constant in nominal terms

# Risk assessment tool: inputs

Ofwat - Risk assessment tool

## User inputs

### Select company identifier

Select

### Incentive selection

- Cost performance (water)
- Cost performance (wastewater)
- ODIs
- SIM
- Water trading - export
- Water trading - import

### Uncertainty mechanisms

On Select

### Live Scenario Selection

Select scenario:

Low  High

### PAYG ratio overrides

	Water	Wastewater	<input type="button" value="Reset defaults"/>
2015-16	0.0%	0.0%	
2016-17	0.0%	0.0%	
2017-18	0.0%	0.0%	
2018-19	0.0%	0.0%	
2019-20	0.0%	0.0%	

### Weighted average cost of capital (vanilla, wholesale) overrides

Select source of WACC inputs:

	Water	Wastewater
Gearing	62.50%	62.50%
Cost of debt	2.75%	2.75%
Vanilla WACC	3.70%	3.70%

### Retail input overrides

Select source for net margins:

Average cost to serve (£ per HH)	Retail net margin (%)
2015-16	0.00
2016-17	0.00
2017-18	0.00
2018-19	0.00
2019-20	0.00

	Household	Non-Household
2015-16	1.0%	2.5%
2016-17	1.0%	2.5%
2017-18	1.0%	2.5%
2018-19	1.0%	2.5%
2019-20	1.0%	2.5%

### Cost performance incentives

#### Menus: Performance inputs

	Water	Wastewater
Totex ratio	100	100

#### Menus: 50% sharing rate assumption or full menu

Select method:

#### Menus: Incentive parameter calibration

	Water	Wastewater
Select menu type	Standard	Standard
Menu "kink"	100	100
Minimum ratio	80	80
Maximum ratio	130	130

	Ratio	<=100	<=100
Eff. incentive (slope)	-0.002	-0.002	-0.002
Eff. Incentive (constant)	0.700	0.700	0.700
All. exp.: baseline (slope)	0.250	0.250	0.250
All. exp.: baseline (constant)	75.000	75.000	75.000
Add. Inc.: baseline (2nd order)	-0.0005	-0.0005	-0.0005
Add. Inc.: baseline (1st order)	-0.025	-0.025	-0.025
Add. Inc.: baseline (constant)	7.500	7.500	7.500

	Ratio	>100	>100
Eff. incentive (slope)	-0.002	-0.002	-0.002
Eff. Incentive (constant)	0.700	0.700	0.700
All. exp.: baseline (slope)	0.250	0.250	0.250
All. exp.: baseline (constant)	75.000	75.000	75.000
Add. Inc.: baseline (2nd order)	-0.0005	-0.0005	-0.0005
Add. Inc.: baseline (1st order)	-0.025	-0.025	-0.025
Add. Inc.: baseline (constant)	7.500	7.500	7.500

### Illustrative RORE range

	Water	Sewerage
Low	2.0%	2.0%
High	10.0%	10.0%

### Outcome delivery incentives (ODIs)

Cost performance sharing rate used to calculate reward/penalty (set to 0% to use menu rate)

#### ODI impact from BP scenarios that is in-year (% of total)

	Water	Wastewater	Households
2015-16	0.0%	0.0%	0.0%
2016-17	0.0%	0.0%	0.0%
2017-18	0.0%	0.0%	0.0%
2018-19	0.0%	0.0%	0.0%
2019-20	0.0%	0.0%	0.0%

### Water trading incentives

#### Water trading ceilings

Trading (exports) - ceiling	5%	% of wholesale water revenue
Trading (imports) - ceiling	0%	% of wholesale water revenue

### Service incentive mechanism

% of non-HH revenue to include (Wales only)

Key:

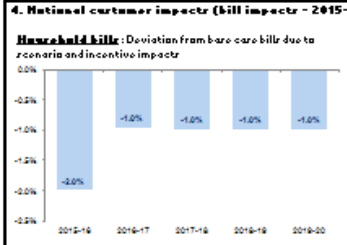
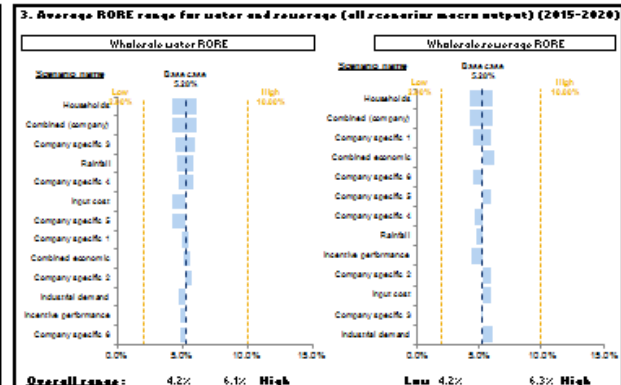
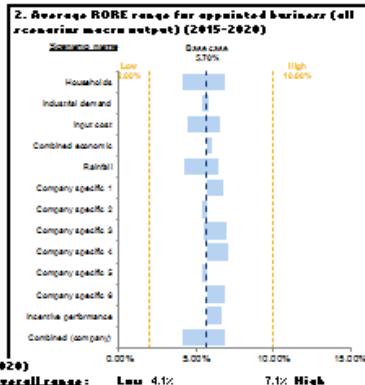
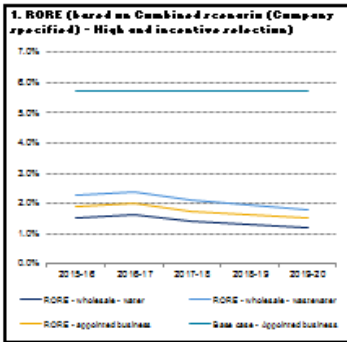
### Notes:

- In the base case all incentive payments are calibrated to equal 0.
- The average cost to serve (ACTS) is assumed to be equal to the company's submitted CTS per household unless the user enters a value for the ACTS in the "Retail input overrides" box to the left.

# Risk assessment tool: outputs

## Ofwat - Risk assessment tool Dashboard

Combined scenario (Company specified) - High



### 5. Household impacts in the PR19 period (2020-2025)

Scenario name	2020-21		2021-22		PR19 Total
	£/ha	£/ha	£/ha	£/ha	
<b>Innovative water</b>	10.00	10.00	50.00	50.00	70.00
6/16 ODI-water	10.00	10.00	50.00	50.00	70.00
6/16 ODI-wastewater	10.00	10.00	50.00	50.00	70.00
6/16 ODI-households	10.00	10.00	50.00	50.00	70.00
6/16 Cost performance-water	10.00	10.00	50.00	50.00	70.00
6/16 Cost performance-wastewater	10.00	10.00	50.00	50.00	70.00
6/16 Water leading impacts	10.00	10.00	50.00	50.00	70.00
6/16 SIM	10.00	10.00	50.00	50.00	70.00
<b>6/16 Total innovative water</b>	<b>50.00</b>	<b>50.00</b>	<b>250.00</b>	<b>250.00</b>	<b>400.00</b>

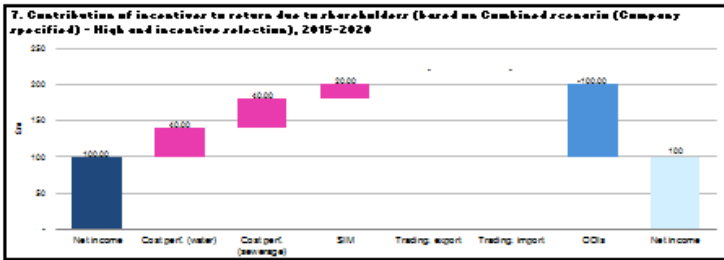
Scenario name	2020-21		2021-22		PR19 Total
	£/ha	£/ha	£/ha	£/ha	
<b>Incremental income from scenario innovation less incremental</b>	<b>-5.00</b>	<b>-4.00</b>	<b>0.00</b>	<b>0.00</b>	<b>-9.00</b>
6/16 Wholesale water	-5.00	-4.00	0.00	0.00	-9.00
6/16 Wholesale wastewater	0.00	0.00	0.00	0.00	0.00
6/16 Retail-households	-2.50	-2.50	0.00	0.00	-5.00
<b>6/16 Total scenario impact</b>	<b>-7.50</b>	<b>-6.50</b>	<b>0.00</b>	<b>0.00</b>	<b>-14.00</b>

Scenario name	2020-21		2021-22		PR19 Total
	£/ha	£/ha	£/ha	£/ha	
<b>Incremental expenditure impact (per household)</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
6/16 Wholesale water (total)	0.00	0.00	0.00	0.00	0.00
6/16 Wholesale wastewater (total)	0.00	0.00	0.00	0.00	0.00
6/16 Retail-households	0.00	0.00	0.00	0.00	0.00
<b>6/16 Total expenditure impact</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>

### 6. Summary of key metrics (based on Combined scenario (Company specified) - High and incentive selection)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
<b>Revenue less incremental</b>						
6/ Wholesale water	200.0	210.0	190.0	200.0	205.0	1,005.0
Change scenario/RY	5.00	5.00	5.00	5.00	5.00	25.00
6/ Wholesale wastewater	100.0	105.0	95.0	100.0	102.5	500.0
Change scenario/RY	5.00	5.00	5.00	5.00	5.00	25.00
6/ Retail-households	10.0	10.0	10.0	10.0	10.0	50.0
Change scenario/RY	0.00	0.00	0.00	0.00	0.00	0.00
6/ Retail-wastewater	0.0	0.0	0.0	0.0	0.0	0.0
Change scenario/RY	0.00	0.00	0.00	0.00	0.00	0.00
6/ Incentive revenue	15.0	15.0	15.0	15.0	15.0	75.0
<b>6/ Total revenue</b>	<b>330.0</b>	<b>345.0</b>	<b>315.0</b>	<b>330.0</b>	<b>337.5</b>	<b>1,662.5</b>
X <b>Change Revenue Cost</b>	<b>-50.0</b>	<b>-50.0</b>	<b>-50.0</b>	<b>-50.0</b>	<b>-50.0</b>	<b>-250.0</b>
<b>Revenue less final scenario and incremental impact</b>						<b>Average</b>
X RORE - wholesale water	1.50X	1.50X	1.48X	1.50X	1.50X	1.49X
X RORE - wholesale wastewater	1.00X	1.00X	0.95X	1.00X	1.00X	0.99X
X Retail water-households	1.00X	1.00X	1.00X	1.00X	1.00X	1.00X
X Retail water-wastewater	1.00X	1.00X	1.00X	1.00X	1.00X	1.00X
X <b>RORE - appointed business</b>	<b>1.00X</b>	<b>1.00X</b>	<b>1.00X</b>	<b>1.00X</b>	<b>1.00X</b>	<b>1.00X</b>
X RRCV - wholesale water	1.85X	1.92X	1.80X	1.85X	1.84X	1.87X
X RRCV - wholesale wastewater	1.00X	1.00X	1.00X	1.00X	1.00X	1.00X
X <b>RRCV - appointed business</b>	<b>1.95X</b>	<b>1.98X</b>	<b>1.90X</b>	<b>1.94X</b>	<b>1.95X</b>	<b>1.95X</b>

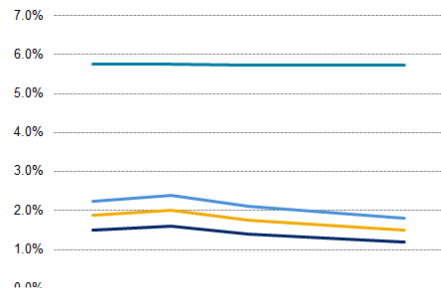


# Risk assessment tool: RoRE ranges

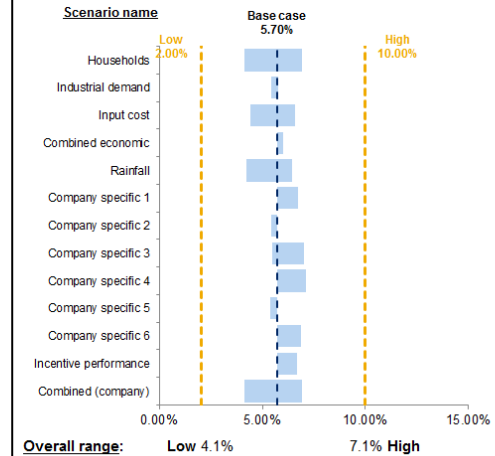
## Ofwat - Risk assessment tool Dashboard

Combined scenario (Company specified) - High

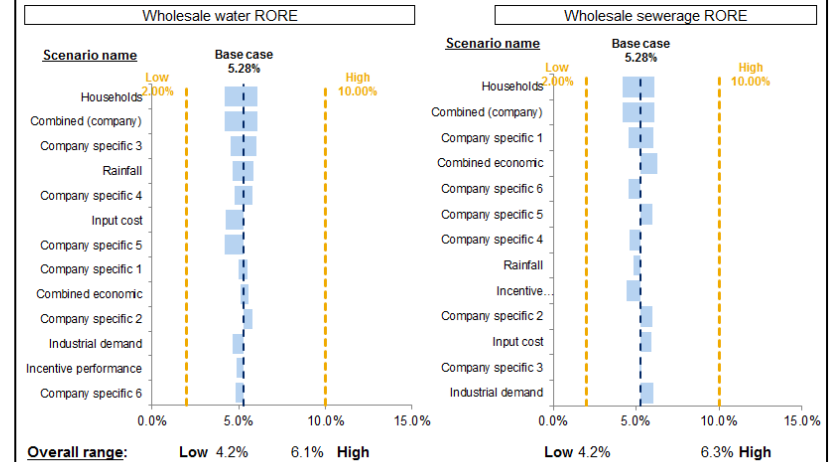
### 1. RORE (based on Combined scenario (Company specified) - High and incentive selection)



### 2. Average RORE range for appointed business (all scenarios macro output) (2015-2020)



### 3. Average RORE range for water and sewerage (all scenarios macro output) (2015-2020)



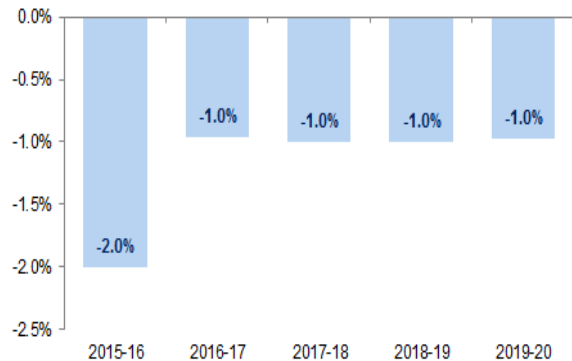
### 4. Notional customer impacts (bill impacts - 2015-2020)

**Household bills:** Deviation from base case bills due to scenario and incentive impacts

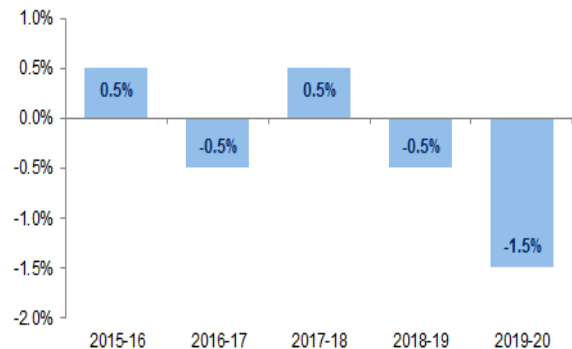
# Risk assessment tool: bill risk and numbers

## 4. Notional customer impacts (bill impacts - 2015-2020)

**Household bills:** Deviation from base case bills due to scenario and incentive impacts



**Non-household bills:** Deviation from base case bills due to scenario and incentive impacts



\* Scenario bills include incentive & scenario impacts

## 6. Summary of key metrics (based on Combined scenario (Company specified) - High and incentive selection)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
<b>Revenues (ex. incentives)</b>						
£m Wholesale - water	200.0	210.0	190.0	200.0	205.0	1,005.0
Change in revenue (%)		5.00%	-9.52%	5.26%	2.50%	
£m Wholesale - wastewater	180.0	189.0	171.0	180.0	184.5	904.5
Change in revenue (%)		5.00%	-9.52%	5.26%	2.50%	
£m Retail - households	18.0	18.9	17.1	18.0	18.5	90.5
Change in revenue (%)		5.00%	-9.52%	5.26%	2.50%	
£m Retail - non-households	6.0	6.3	5.7	6.0	6.2	30.2
Change in revenue (%)		5.00%	-9.52%	5.26%	2.50%	
£m Incentive revenue	-	11.0	-	9.3	-	27.3
£m <b>Total revenue</b>	<b>393.0</b>	<b>414.9</b>	<b>381.9</b>	<b>400.8</b>	<b>412.3</b>	<b>2,002.8</b>
% % change from Base Case	-12.5%	-8.5%	-15.4%	-11.9%	-9.8%	-11.6%

### Return metrics (incl. scenario and incentive impact)

	2015-16	2016-17	2017-18	2018-19	2019-20	Average
% RORE - wholesale - water	1.50%	1.60%	1.40%	1.30%	1.20%	1.40%
% RORE - wholesale - wastewater	2.25%	2.40%	2.10%	1.95%	1.80%	2.10%
% Retail margin - households	1.22%	1.59%	1.80%	1.29%	1.05%	1.39%
% Retail margin - non-households	2.84%	3.44%	3.25%	2.89%	2.66%	3.02%
% <b>RORE - appointed business</b>	<b>1.88%</b>	<b>2.00%</b>	<b>1.75%</b>	<b>1.63%</b>	<b>1.50%</b>	<b>1.75%</b>
% RoRCV - wholesale - water	1.05%	1.12%	0.98%	0.91%	0.84%	0.98%
% RoRCV - wholesale - wastewater	1.58%	1.68%	1.47%	1.37%	1.26%	1.47%
% <b>RoRCV - appointed business</b>	<b>1.31%</b>	<b>1.40%</b>	<b>1.23%</b>	<b>1.14%</b>	<b>1.05%</b>	<b>1.23%</b>

# Risk assessment tool: RoRE ranges

Ofwat - Risk assessment tool

## Components of out(under) performance

**Notes:**  
 The data set out in the tables below are sourced from the "Combined scenario (company specified)" scenario.  
 The tables and calculations are structured such that the high case of the scenario should correspond to outperformance and the low case should correspond to underperformance.  
 Wholesale and appointee level out(under) performance is expressed as a proportion of regulated equity.  
 Retail Households out(under)performance is measured as a proportion of total household invoiced revenue.

### Appointee level

	Incremental impacts to RORE - Low						Incremental impacts to RORE - High						Incremental impact to RORE		
	2015-16	2016-17	2017-18	2018-19	2019-20	Average	2015-16	2016-17	2017-18	2018-19	2019-20	Average	Impact on RORE	RORE	
Base case RORE	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%			
Regulated equity	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00			
Tax rate	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%			
ODI performance	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%			
Totex performance	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%			
Water trading performance	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%			
SIM performance	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%			
Financing performance	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%			
<b>RORE</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>			
Check	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%			

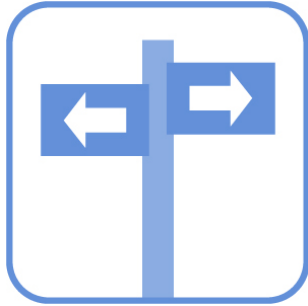
### Wholesale: Water

	Wholesale: Water -		Out-performance	Incremental impact to RORE	Impact on RORE	RORE	2019-20		Average		Incremental impact to RORE		
	2015-16	2016-17					0.00%	0.00%	0.00%	0.00%	Impact on RORE	RORE	
Base case RORE	0.00%	0.00%					0.00%	0.00%	0.00%	0.00%			
Regulated equity	0.00	0.00					0.00	0.00	0.00	0.00			
Tax rate	0%	0%					0%	0%	0%	0%			
ODI performance	0.0%	0.0%					0.0%	0.00%	0.0%	0.00%			
Totex performance	0.0%	0.0%					0.0%	0.00%	0.0%	0.00%			
Water trading performance	0.0%	0.0%					0.0%	0.00%	0.0%	0.00%			
Financing performance	0.0%	0.0%					0.0%	0.00%	0.0%	0.00%			
<b>Base case RORE</b>	<b>0.0%</b>	<b>0.0%</b>					<b>0.0%</b>	<b>0.00%</b>	<b>0.0%</b>	<b>0.00%</b>			
ODI	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
Totex	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
Water trading	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
SIM	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
Financing	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
<b>RORE</b>	<b>0.0%</b>	<b>0.0%</b>					<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>			
Check	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			

### Wholesale: Wastewater

	Wholesale: Wastew		Out-perfor.	Incremental impact to RORE	Impact on RORE	RORE	2019-20		Average		Incremental impact to RORE		
	2015-16	2016-17					0.00%	0.00%	0.00%	0.00%	Impact on RORE	RORE	
Base case RORE	0.00%	0.00%					0.00%	0.00%	0.00%	0.00%			
Regulated equity	0.00	0.00					0.00	0.00	0.00	0.00			
Tax rate	0%	0%					0%	0%	0%	0%			
ODI performance	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
Totex performance	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
Financing performance	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
<b>Base case RORE</b>	<b>0.00%</b>	<b>0.00%</b>					<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>			
ODI	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
Totex	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
Water trading	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
SIM	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
Financing	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			
<b>RORE</b>	<b>0.0%</b>	<b>0.0%</b>					<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>			
Check	0.0%	0.0%					0.0%	0.0%	0.0%	0.0%			

# Agenda

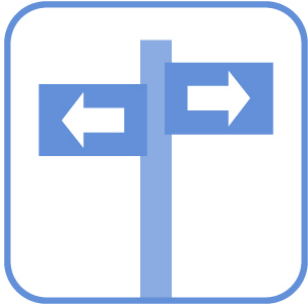


- 1 About this workshop
  - 2 Introduction
  - 3 Structure of the financial model
- Break**
- 4 Running the financial model
  - 5 Risk assessment tool
  - 6 Questions and answers
  - 7 Next steps





# Agenda



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## Next steps



As noted earlier, today's workshop materials will be put on our website, along with the main points/questions and answers, without attribution. There will be no detailed meeting note

Companies wishing to receive an early draft determination in June now need to prepare a 'gap analysis' by 17 April – see 'Setting price controls for 2015-20 – policy and information update'. We are keen to ensure that companies are in the best possible position to complete their gap analyses so we are open to having further working-level meetings to discuss issues related to the gap analysis, if that would be helpful for companies. Once we have received the gap analysis, we will meet with all companies as part of the draft determination process

Please continue to liaise with your portfolio lead if there are further queries after today

Thank you for attending

## Questions and answers on financial model

**Q1.** What is the latest version of the financial model, risk assessment tool and each of the feeder models? How will Ofwat notify companies if models are updated?

We have released an updated version of the financial model and the risk assessment tool:

- version 3 of the financial model and its supporting documents; and
- version 2 of the risk assessment tool.

These updated models are aligned with the revised business plan templates.

These two updated models and the latest versions of the feeder models can be accessed from the [2014 price review financial model](#) web page.

When these are updated we will notify companies through the portfolio leads.

**Q2.** Do companies need to submit a populated copy of the Ofwat financial model?

No. As advised, companies will need to use the Ofwat financial model to perform the financial indicator reconciliation that we have asked them to provide as part of their revised business plan submission.

**Q3.** Why, if the 'Adjustments' sheet in the financial model is intended for Ofwat use only, might companies also need to use it in order to replicate their own financial indicators in the Ofwat financial model?

The adjustments sheet is primarily for Ofwat to use. If companies use it when reconciling the outcomes of their model with the Ofwat model (for the reconciliation analysis) then they should clearly explain which adjustment lines they have had to use and why.

Should companies wish to short-cut entering the non-household (NHH) tariff inputs (Ofwat will capture details directly from the business plan tables), then they can use the NHH override items on the adjustments sheet. The NHH override items are located on rows 100,113, 117 and 118.

**Q4.** When populating the revised business plan templates, should companies reflect their actual financial structure or a notional structure?

Companies should reflect their actual structure when completing the financial tables in the plan with the two exceptions of:

- table A8, block B; and
- table A20.

**Q5.** Does Ofwat expect companies to use the RPI assumptions per the risk and reward guidance or their own assumptions on RPI inflation?

Companies should set out the RPI inflation assumptions they have used in their financial modelling in table A9. Companies should use their table A9 assumptions to produce financial projections under their actual structure and when modelling their view of notional structure.

Note that the indexation treatment for retail means that no RPI inflation (or deflation) is applied to retail costs and revenues.

**Q6.** Does the financial model apply PAYG to total totex?

PAYG is applied to totex net of pension deficit repair costs and revenue from connections. This has been added to the guidance in tables W3 and S3 of the revised business plan templates where we ask companies to report deficit repair costs in block d for table W3 and block H for table S3.

There may be a consequence for tax, so we have retained tax adjustment items in the financial model.

**Q7.** If there are any fair value amounts included within the interest values in table A23 are these treated as debt bearing?

The revised business plan table and guidance make this clear.

**Q8.** Does the financial model cater for retail to pay dividends?

The updated financial model has functionality to reflect retail dividends however we do not capture these in the business plan templates. Companies would need to enter the percentage distributed in row 121 on the 'input nominal' sheet and provide supporting commentary.

**Q9.** Is the tax element in the revenue requirement building blocks intended to be the tax charge for the year rather than tax paid which was how Ofwat modelled it in the last price review?

Yes. We are using the tax charge in the revenue requirement, in line with the simplification we have introduced for this price review.

**Q10.** In the first version of the PR14 financial model tax in the revenue requirement was not adjusted when the legacy revenue adjustments were applied. Is this still the case?

No. The tax now reflects the tax impact arising from the legacy revenue adjustments.

**Q11.** Are the terms such as 'revenue requirement' and 'required revenue' and 'allowed revenue' interchangeable?

No. Revenue requirement refers to the sum of the cost recovery building blocks.

Required revenue is the revenue requirement net of other operating income and revenue from connections.

Allowed revenue is the sum of the required revenue and an allowance in respect of revenue from connections and operating income which may have been adjusted by Ofwat.

**Q12.** In the updated financial model there are over a thousand input items on the 'F\_Inputs' sheet. What help can Ofwat give companies populate the 'F\_Inputs' sheet given they do not have the Fountain database to pass data from business plans into the model?

The feeder model process provides the ultimate mapping on how data flows from business plans into the financial model – although, as explained in the workshop, only about 150 of the input lines relate to wholesale items and the majority of these can be easily traced directly back to the business plan tables through the item codes.

We have shared a simplified mapping with companies through the portfolio leads, which should help with populating the F input sheet with revised business plan numbers.

**Q13.** The tax treatment of IRE is not the way the company treats it in its accounts.

The revised business plan tables and the Ofwat financial model are aligned with our discussion with HMRC and are compliant with IFRS reporting standards.