Ofwat webinar: Aligning risk and return

23 July 2019 2pm–3pm

Q and A

Areas covered:

- Aligning risk and return

Webinar slides are available on our website.

Question and answer session

Q. On slide 9, can you confirm whether you are using additive/monte carlo based ranges on ODI RORE ranges? Is that the same for all companies?

A. We will take this question away and provide a response within the Outcomes webinar.

Q. What form of Board assurance are you expecting?

A. As per section 11.2 of our PR19 methodology, we set out our expectations for companies for providing Board assurance that its plan is financeable on both its actual capital structure and on the notional capital structure specific to their circumstances.

As set out in the draft determinations, we expect companies to reconsider Board assurance based on the company circumstances and in relation to maintaining financial resilience in the long term.

Q. We note that you are using the adjusted ACICR ratio excluding the excess fast money (which is different to how rating agencies do this). Different company policies on this can lead to different levels of stress on the ratios you quote. Should this be uniform in the notional company setting?

A. In regard to the adjusted interest cover ratio, our view is firmly that fast money does improve cash flows in the period of the price control that you bring revenue into.

When we present companies financial ratios in summary documents, they do reflect the company circumstances.

For example, different policies on the treatment of infrastructure renewals expenditure (IRE) can lead to differences in the financial ratios that we model. As part of our assessment of company financeability, we did look at financial ratios without IRE to ensure a consistent assessment across companies.

We allow companies to take the lead on their approach, as it is not for us to set each company’s accounting policy.

Q. Have you carried out an assessment that the notional company is financially resilient over the long-term?

A. We take a view on the gearing level for the notional company every five years. When assessing gearing levels for the notional company, we consider gearing levels from the previous price review and market trends in gearing levels. We also consider what the appropriate dividend policy might be for the notional company; but that is not to say the notional company should apply that dividend yield, the actual dividend yield should reflect the performance of the company over time and a notional company might need to adjust its dividend policy (and capital structure) to reflect expectations about the need to maintain financial resilience.