

Document 34D, 'WWU Commentary - RIIO-GD3 BPFM'

Legal Notice

This paper forms part of Wales & West Utilities Limited Regulatory Business Plan. Your attention is specifically drawn to the legal notice relating to the whole of the Business Plan, set out on page 3 of Document 1 of WWU Business Plan Submission. This is applicable in full to this paper, as though set out in full here.

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Subject: WWU Commentary relating to the RIIO-GD3 Business Plan Financial Models ("BPFM") submitted by 11 December 2024

This document represents WWU's BPFM Commentary permitted in accordance with para 1.20 of the BPFM Guidance. The purpose is to provide useful information to Ofgem, in one place, to facilitate its review of WWU's BPFM submissions.

Business Plan Data Templates ("BPDT") Submissions

- 1) The BPDT's provide inputs to the BPFM's.
- 2) WWU submitted two sets of BPDT Finance and Debt tables. One version reflects Ofgem's business planning assumptions (Document 31, 'Business Plan Data Templates (BPDT) Master') and another reflects WWU's Company Specific Plan (Document 33, 'Business Plan Data Templates (BPDT) (WWU Company Specific)'). The only differences between the BPDTs arises in respect of Total net interest expense, excluding principal inflation accretion, Actual dividends, and Total interest on cash, short term deposits and overdrafts, rows 724, 726 and 756 of the "F2.00 BPFM Inputs" tab respectively. Both BPDTs reflect the same Totex, pass through costs and debt datasets.
- 3) In accordance with [GIT192](#), the Finance and Debt tables reflecting Ofgem's business planning assumptions are within WWU's main BPDT submission, including the Cost & Volume (C&V) and Totex tables. WWU's Company Specific Finance and Debt tables have been submitted separately, as a condensed set of tables, excluding the C&V and Totex tables.

BPFM Submissions

- 4) Enclosed are four BPFMs which represent WWU's financial model submission for the RIIO-GD3 Business Plan. A summary of the differences between each BPFM is outlined below:
 - a. **"WWU GD3 BPFM - Base Model"**(Document 34) – This represents the v7b BPFM issued by Ofgem on 1 October 2024 updated for the following by WWU (because Ofgem did not issue any further model versions):
 - i. Ofgem change instructions (see 5) below)
 - ii. WWU Base Case/Scenario Settings (see 6) below)

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- iii. BPFM Inputs (see 8) to 10) below). The BPDT used is the “RIIO_GD3_BPDT”
- b. “**WWU GD3 BPFM - Ofgem Notional**” (Document 34A)– This is the “WWU GD3 BPFM - Base Model” in 4)a. above updated for WWU bespoke model changes (see 5) below)
- c. “**WWU GD3 BPFM - Ofgem Actual**” (Document 34B)– This is the “WWU GD3 BPFM - Ofgem Notional” in 4)b. above updated for:
 - i. AP60 of the “Scenarios” tab ‘Include tax clawback revenue impact?’ changed from “Exclude” to “Include”
 - ii. Included a manual -0.505% adjusted in cell AU283 of the “Scenarios” tab for ‘dividends as % of equity’ to ensure that 2027/28 dividends do not fall below the 3% Assumed dividends as percentage of notional equity portion of RAV
- d. “**WWU GD3 BPFM - Company Specific Plan**” (Document 34C)– This is the “WWU GD3 BPFM - Ofgem Actual” in 4)c. above updated for:
 - i. Removed the manual -0.505% adjustment in 2)c.ii. above
 - ii. Update the “F2.00 BPFM Inputs” to the “RIIO_GD3_BPDT (WWU Company Specific” version of the BPDT (note – no changes to actual debt data in the F3.06 Debt Dataset)
 - iii. Updates, highlighted pink, for WWU Company Specific Inputs for RIIO-GD3 WACC:
 - a) “Wales & West” tab row 856 – updated ‘iBoxx trailing average’ to 4.95%
 - b) “Scenarios” tab row 133 – updated Base ‘CoD single input figures to use’ to 4.95%
 - c) “Scenarios” tab row 140 – updated Base ‘CoE single input figures to use’ to 6.89%
 - d) “Main Inputs” tab row 354 – updated ‘Cost of equity at 60% gearing’ to 6.89%

Ofgem change instructions

- 5) For completeness, Appendix 1 outlines the model updates (representing change instructions by Ofgem) that have been made subsequent to the RIIO-GD3 BPFM (v7b) issued by Ofgem to licensees on 1 October 2024.

WWU Base Case/Scenario Settings

- 6) For ease of reference, we set out in Appendix 2 the changes to the Base Case/Scenario settings that have been made by WWU to the Ofgem issued BPFM and permitted by Ofgem.

WWU bespoke model changes

- 7) In line with [GIT175](#) and Ofgem’s email titled “RE: RIIO-3 PCFM Development Working Group 17 [OFFICIAL]” dated 30 October 2024 at 13:55 WWU have amended certain ratio calculations in the BPFM and highlighted the changes in green. The specific adjustments are:
 - a. AICR – to include derivative accretion in the denominator:
 - i. “FinancialRatios” tab row 120 insert label “Derivative accretion” and formula is “=-SUM('F2a - Financial Summary (TWA)!P93:P95)”
 - ii. “FinancialRatios” tab row 127 amend formula from “=(AU116 + AU117 - AU118) / -AU118” to “=(AU116 + AU117 - AU118) / -(AU118+AU120)”

- b. FFO/Net Debt – to include accretion in the numerator:
 - i. “FinancialRatios” tab row 46 amend formula from “=AP41 / -AP44” to “=(AP41+AP43) / -AP44”
 - ii. “FinancialRatios” tab row 50 amend formula from “=(AP41 + AP18) / -AP44” to “=(AP41 +AP43+ AP18) / -AP44”
 - iii. “FinancialRatios” tab row 150 amend formula from “=AU145 / -AU148” to “=(AU145+AU147) / -AU148”

BPFM Inputs

- 8) In line with paragraph 1.09 and 1.10 of the BPFM Guidance we have included the “F2.00 BPFM Inputs” and “F3.06 Debt Dataset” tabs of the BPDTs as inputs to the BPFM.
- 9) In line with paragraph 1.12 of the BPFM Guidance we have updated the RIIO-GD2 dataset in the ‘RIIO2 Inputs’ section of the BPFM “Wales & West” tab for the final business plan submission.

This provides updated values in line with Dry Run 2 (DR2) of the 2024 AIP as submitted to Ofgem on 29 October 2024. The DR2 PCFM is enclosed for completeness (Document 34E, WWU GD2 PCFM for AIP 2024 - DR2).

- 10) For the avoidance of doubt, the following ‘Other inputs’ have been included in the BPFM:
 - a. RIIO-GD3 ‘Actual Totex’ rows 789-800 of the “Wales & West” tab
 - b. RIIO-GD3 ‘Other revenue allowances’ rows 815-817 of the “Wales & West” tab
 - c. RIIO-GD3 ‘Tax clawback inputs’ rows 882-883 of the “Wales & West” tab
 - d. 2026/27 ‘General/Special Rate Pool Opening Balance Adjustments’ rows 887-888 of the “Wales & West” tab
 - e. RIIO-GD2 and RIIO-GD3 ‘Domestic charges inputs’ rows 972-975 of the “Wales & West” tab
 - f. RIIO-GD3 ‘Deferred Revenue Expenditure capital allowance rate’ row 904 of the “Wales & West” tab as per [GIT166](#)
 - g. 2024/25 and 2025/26 ‘Actual debt requirement adjustment values (recorded by macro): for Wales & West’ row 235 of the “Finance&Tax(actual)” tab as per [GIT168](#). Please note this row has been used to balance back the closing net debt per the “Finance&Tax(actual)” tab to cells N100 and O100 of the “F1 - Debt for BPFM” values for closing Net Debt. This results in the opening net debt for RIIO-GD3 being aligned between the BPFM (cell AU33 of “Finance&Tax(actual)”) and BPDTs (cell AA721 of “F2.00 BPFM Inputs”)

Stress test settings

- 11) Please note the following settings that are applied to run the stress test results quoted in WWU’s Document 58, ‘Finance Annex’. No separate BPFM’s are provided in this respect and therefore the detailed changes to the “Scenarios” tabs of the BPFM are set out below:

- a. Row 52 'Assumed return of capital as % of equity' – for cells AP52 to BD52 (Base Case and Scenarios) changed to "User defined #2" – this removes special dividends from the notional company for the Base Case and Scenarios, to allow gearing to flex beyond the notional rate of 60% and assess underlying gearing/AICR stress test impacts
- b. Cell AP60 (Base Case) 'Include tax clawback revenue impact?' changed to "Exclude" – this removes tax clawback (TCB) for the actual company to assess underlying gearing/AICR stress test impacts excluding TCB
- c. Cell AP86 (Base Case) 'RIIO-2 closing gearing target: BPDT or user defined?' changed to "BPDT" – this allows actual gearing to flex beyond the user defined % and assess underlying gearing/AICR stress test impacts
- d. Cell AP94 and AP97 (Base Case) 'Dividends: BPDT actual or model calculation?' changed to "BPDT actual" and 'If user defined, select dividends as % of equity' changed to "3%" respectively – this removes actual company special dividends, allowing gearing to flex, and underlying gearing/AICR stress test impacts assessed

BPFM Outputs

12) WWU's FBP Outputs has been completed as required and is included in the "15_ FBPOutputs" tab of Document 58A, 'Finance Annex Support Workbook' which accompanies the Finance Annex. Please note the source information for the populated tables:

- a. The values in cells AP27:AY163 of 15_ FBPOutputs have been taken from the "WWU GD3 BPFM - Base Model" BPFM, "FBPOutputs" tab cells AP27:AY163
- b. The values in cells BE27:BI33 of 15_ FBPOutputs have been taken from the "WWU GD3 BPFM - Ofgem Notional" BPFM, "FBPOutputs" tab cells AP27:A33
- c. For the Main BP and Base (actual) tables, cells AZ27:BD33 and BJ27:BN33, these reflect values from the "WWU GD3 BPFM - Company Specific Plan" and "WWU GD3 BPFM - Ofgem Actual" BPFM's respectively:
 - i. 'FFO interest cover ratio (including accretions)' row 27 – taken from "FinancialRatios" tab row 125
 - ii. 'FFO interest cover ratio (cash interest only)' row 28 – taken from "FinancialRatios" tab row 126
 - iii. 'Adjusted interest cover ratio (post-maintenance interest cover ratio)' row 29 – taken from "FinancialRatios" tab row 127
 - iv. 'FFO / Net Debt' row 30 – taken from "FinancialRatios" tab row 150
 - v. 'Net Debt / Closing RAV' row 31 – taken from "FinancialRatios" tab row 162
 - vi. 'Dividends as % of Equity RAV' row 32 – calculation of "Finance&Tax(actual)" row 202 divided "FinancialRatios" tab row 87
 - vii. 'Dividend cover ratio (using statutory depreciation)' row 33 – calculation of "Finance&Tax(actual)" row 202 divided "FinancialRatios" tab row 247

Other points of note

13) Actual gearing - We understand that sub-bullet 3. of paragraph 5.23 of the BPFM Guidance relates to ensuring there is consistency in gearing, between "BPDT derived closing gearing target" and

“Actual closing gearing target (from BPDT mirror table)” (rows 95 and 97 of FinInput) when the RunAllScenarios macro is used.

As the use of the Run the Save All Scenarios macro is not a model requirement and is optional (para 1.24 of the BPFM Guidance and as confirmed in the RIIO-3 PCFM Development Working Group 17 - FBPOutputs [OFFICIAL]" of 22 November 2024 at 14:47) we are not therefore utilising “Actual closing gearing target (from BPDT mirror table)” in our stress tests. Instead our stress tests are calculated exogenously to the BPFM and use consistent “model calculated gearing” across all scenarios to the Base case level. We do not therefore propose actioning para 5.24 of the guidance unnecessarily.

For completeness, please note WWU's checks in row 28 of the BPFM Checks tab highlights the small gearing difference, however, the check does not trigger a BPFM error as the check allows for a 5% tolerance level. Likewise, to the extent User defined closing gearing target (from "Scenarios" tab) is selected, the checks on row 97 of the BPFM FinInput tab are set to zero, acknowledging that a closing gearing target is to be sought.

As outlined in the BPDT Commentary, row 727 of the “Wales & West” tab of the BPFM in respect of ‘Forecast actual gearing’ excludes shareholder loan note interest and swap accretion. Swap accretion has been excluded from forecast actual gearing to exclude swap impacts for simplicity purposes and to avoid risk of a double count of swap accretion given the BPFM method of treating this. However, this does not impact BPFM net debt for gearing purposes for credit ratios and regulatory gearing given that the BPFM assumes swap accretion is paid every year.

- 14) RoRE – the RoRE values being generated by the” FinancialRatios” tab rows 91 and 99 and the “FinRatios RoRE decomposition” tab rows 124 and 143 appear artificially inflated due to the inclusion of accelerated depreciation revenues within EBIT but without taking account of special dividends to return equity and debt reduction from additional cash flows. We have not referenced that RORE output in our Finance Annex.
- 15) Base dividends in the Ofgem Actual Company plan - Cross-referencing footnote 122 of WWU's Finance Annex *“As noted in Section 3.3b, the WWU company “base” (i.e. before return of equity through special dividends) dividend rate is 5% p.a of equity RAV. We have applied a rate of 3% for 2 reasons : (i) equity issuance would be required to ensure gearing does not exceed 60%, even if special dividends were reduced to nil. It is not efficient to issue equity with attendant costs of issuance, when a lower dividend would preclude that cost. And (ii) to simplify analysis. Support in Document 58A Finance Annex Support Workbook, tab # 10, cols L-T rows 56-64.”*

If Ofgem has any queries or would like to discuss this document and accompanying BPFM submissions we would be pleased to assist. Please contact Ian Weldon, Rebecca Band or Stephanie Pratt (ian.weldon@wwutilities.co.uk / Rebecca.band@wwutilities.co.uk / Stephanie.Pratt@wwutilities.co.uk)

Appendix 1 Post-issuance BPFM updates

Summary

A list of post-issuance change instructions were included in Tomo Sanderman's email titled "BPFM change instructions 25/10/24 [OFFICIAL]" of 29 October 2024 at 20:14 and are summarised below:

Summary of all change instructions since v7b (Issued 1st Oct)

1. [GIT160](#) – high and low inflation stress tests (all sectors) (superseded by GIT165)
2. [GIT157](#) – totex out/underperformance stress tests (all sectors)
3. [GIT161](#) – workaround for extension macro (all sectors)
4. [GIT165](#) – financial year phasing of inflation sensitivities (all sectors)
5. [GIT169](#) – Bills tab labelling (all sectors)
6. [GIT171](#) – tax allowance adjustment in revenues (GD and ET)
7. [GIT172](#) – Scenarios gearing parameter (ET)
8. [GIT177](#) – Scenarios RPI divergence scenarios (all sectors)
9. [GIT170](#) – financeability changes
10. [GIT178](#) – PMICR ratio fix (GD)
11. [GIT179](#) – totex cap rate bucket naming (GD)

The issues not relevant to WWU listed above, and therefore not updated in the BPFM, are:

- a) [GIT160](#) – because this is superseded by GIT165
- b) [GIT161](#) – because this is a bug fix for the extension macro only and not relevant to the underlying BPFM submission for WWU's Business Plan
- c) [GIT172](#) – because this is relevant to ET only

[GIT179](#) amends the BPDTs and not the BPFM and the change instructions have been reflected in WWU's BPDT template.

A further change instruction, [GIT188](#), was issued by email from Catriona Bogle titled "BPFM change instructions 14/11/24 [OFFICIAL]" of 14 November 2024 at 16:22. However, this only needs to be implemented if licensees intend to use the additional ten stress tests (in addition the 20 available). WWU will not be utilising these additional scenarios and therefore the change has not been implemented.

[GIT186](#) was issued by email from Catriona Bogle titled "BPFM change instructions 15/11/24 [OFFICIAL]" of 15 November 2024 at 16:14. This relates to amending the presentation (colour) of certain cells in the BPDT's and the change instructions have been reflected in WWU's BPDT template.

Year t has been selected as 31 March 2026 and other licensee input tabs and tabs not utilised in the BPFM have been hidden for ease of use.

GitLab Change Instructions

The remaining GitLab issues in the summary above are addressed in turn below and are highlighted yellow in the BPFM with corresponding updates to the BPFM Changelog tab.

- 2) Ofgem email titled "BPFM change instructions and updates 04/10/24 [OFFICIAL]" of 4 October 2024 at 15:58. Amendment per [GIT157](#) in respect of Totex Out and Underperformance stress tests.
- 3) Ofgem email titled "BPFM change instructions 07/10/24 [OFFICIAL]" of 7 October 2024 at 16:26. [GIT165](#) is to resolve the inflation sensitivities being mis-proportioned due to the financial and calendar years.
- 4) Ofgem email titled "BPFM change instructions 15/10/24 [OFFICIAL]" of 15 October 2024 at 16:40. [GIT169](#) in respect of customer bill labelling.

- 5) Ofgem email titled “BPFM change instructions 17/10/24 [OFFICIAL]” of 17 October 2024 at 17:02. [GIT171](#) in respect of the Tax allowance adjustment being double counted in the RevenueSummary tab.
- 6) Ofgem email titled “BPFM change instructions 25/10/24 [OFFICIAL]” of 25 October 2024 at 17:15. [GIT177](#) in respect of amendments to the RPI divergence stress tests.
- 7) Ofgem email titled “Adjustments to BPFM v7b Rating Simulator & Financial Ratios [OFFICIAL]” of 28 October 2024 at 18:08. [GIT170](#) implementing the adjustments to BPFM v7b Rating Simulator & Financial Ratios for inconsistent treatment of principal inflation accretion and interest on interest.
- 8) Ofgem email titled “BPFM change instructions 25/10/24 [OFFICIAL]” of 29 October 2024 at 20:14. [GIT178](#) Actual Company Nominal PMICR changes to correctly adjust for inflation on RAV.

WWU Specific Change Instructions

Further changes instructed/permitted by Ofgem that relate specifically to WWU have been implemented as follows, and changes have been highlighted in blue in the BPFM with corresponding updates to the BPFM Changelog tab.

- 1) Ofgem email titled “RIIO-3 PCFM Development Working Group 17 [OFFICIAL]” of 30 October 2024 at 13:55 in respect of Directly Remunerated Services (DRS). WWU has reverted to the original DRS algebra in the BPFM, essentially unwinding [GIT156](#) below.

92	Catherine Borjle	Finimp; calculation of DRS costs	user(1143;142)	
			Manipulate 'Identified directly remunerated services costs (as used in revenue calculation)' amended to link up to 'Identified directly remunerated services costs'	GIT156
93			AP53b formula amended from =SUM(AP532:AP534) to =AP529 and copied across to AY33b	

- 2) Ofgem email, from Stefan Blanchard, titled “WWU BPDT accretion calculation formula [OFFICIAL]” of 26 September 2024 at 13:53. This involves making the equivalent BPDT changes per the email for accretion to the BPFM, F5 - Inflation Linked Debt tab.

Specific formula changes to BPFM, F5 - Inflation Linked Debt cell KB12

Change formula from :

```
"=IF($K12 = 0, 0, $K12 * ($I12 >= KB$9) * ($F12 <= KB$10) * (INDEX('Monthly Inflation'!$I$5:$K$385, MATCH(EDATE(MIN(KB$10, $I12),-$O12 + 1), 'Monthly Inflation'!$B$5:$B$385, 1), 1 + ($N12 = "CPIH")*1 + ($N12 = "RPI")*2) - ((JJ12 <> 0) * $Q12 + (JJ12 = 0) * INDEX('Monthly Inflation'!$I$5:$K$385, MATCH(EDATE(KB$9,-$O12 + 1), 'Monthly Inflation'!$B$5:$B$385, 1), 1 + ($N12 = "CPIH")*1 + ($N12 = "RPI")*2)))/ $Q12"
```

To:

```
"=IF($K12 = 0, 0, $K12 * ($I12 >= KB$9) * ($F12 <= KB$10) * (INDEX('Monthly Inflation'!$I$5:$K$385, MATCH(EDATE(MIN(KB$10, $I12),-$O12 + 1), 'Monthly Inflation'!$B$5:$B$385, 1), 1 + ($N12 = "CPIH")*1 + ($N12 = "RPI")*2) - ((JJ12 <> 0) * INDEX('Monthly Inflation'!$I$5:$K$385, MATCH(EDATE($F12,-$O12 + 1), 'Monthly Inflation'!$B$5:$B$385, 1), 1 + ($N12 = "CPIH")*1 + ($N12 = "RPI")*2) + (JJ12 = 0) * INDEX('Monthly
```

Inflation!\$I\$5:\$K\$385, MATCH(EDATE(KB\$9,-\$O12 + 1), 'Monthly Inflation!\$B\$5:\$B\$385, 1), 1 +
(\$N12 = "CPIH")*1 + (\$N12 = "RPI")*2))/ \$Q12)"

And copy this to cover section KB12:KQ461.

Appendix 2 Base Case/Scenario setting updates

For ease of reference, we set out below the changes to the Base Case and/or Scenario settings that have been made to the Ofgem issued BPFM. These changes have been highlighted in purple in the BPFM:

- 1) Base Case and Scenario changes to the settings for Capitalisation Rates from “Natural” to “Licensee inputs” as permitted by [GIT162](#). Scenarios tab – cells AP:BD21 changed to “Natural”
- 2) Tax Clawback to be excluded for Notional Company (Base Case and Scenarios) per Ofgem email titled “RIIO-3 PCFM Development Working Group 17 [OFFICIAL]” of 30 October 2024 at 13:55. Scenarios tab – cells AP:BD60 changed to “Exclude”
- 3) Base Case change for “RIIO-2 closing gearing target: BPDT or user defined?”, Scenarios tab – cell AP86 changed to ‘User defined’ and row 261, columns AS to AY, updated accordingly. As per [GIT173](#)
- 4) Scenario changes for “Equity issuance: BPDT actual or model calculation?” Scenarios tab – cells AQ:BD89 changed to ‘BPDT actual’ to match base case as per [GIT182](#)
- 5) Per para 1.14 of the BPFM Guidance, to maintain a notional capital structure, in row 174 of the scenarios tab (cells AU:AY174) for “Assumed return of capital as % of equity” – User defined #1, a formula has been inserted to back solve the necessary special dividend % to maintain notional gearing at 60%
- 6) For the Base Case Actual Dividends, the following selections have been made in the scenarios tab:
 - a. AP94 “Dividends: BPDT actual or model calculation?” to ‘Model calculation’
 - b. AP95 “If modelled, based on cash flow or user defined %?” to ‘User defined’
 - c. AP97 “If user defined, select dividends as % of equity” to ‘User defined #1’

In addition, a formula has been inserted in row 283 for User Defined #1 “If user defined, select dividends as % of equity” to ensure the total dividends are calculated to maintain specified gearing target