Received by email
Dear Sirs,

I have not performed a detailed analysis on all of your proposals although I know from speaking with some of my equity colleagues at other firms that there are concerns over the credit ratios they are calculating under the RIIO regime, particularly for NGGT.

I take comfort from your statements that you believe an efficient company can maintain a comfortable investment grade rating, but, as a credit analyst (and bearing in mind that the bulk of any financing will come from the credit markets), I would like more clarity on exactly what credit metrics you are targeting for the maintenance of a “comfortable” investment grade rating. It would be extremely helpful if Ofgem could give guidance on the ratios it believes the companies (particularly NGGT) will be able to maintain (not just a very broad range but more along the lines of, say, FFO/Interest not less than 3x). Obviously, for investors in the sector there is a difference between investing in an A3/A- company or a Baa1/BBB+ company, particularly in times of financial market turbulence. I am concerned, with the heavy investments and the higher notional gearing that Ofgem is targeting a BBB rather than an A range sector under these initial proposals.

The other comment I would make is that I would like to see more justification as to your perception of the relative risks of the various transmission (electricity and gas) and gas distribution companies. I was surprised to see the range of gearing assumptions and WACCs in the initial proposals (and their difference from the Scotcos), and as far as I can see from the documents this mainly comes down to your belief that the cash flow risk is different for the different companies. I understand you have performed some kind of monte-carlo analysis to justify this but I would be interested in seeing the methodology and result for this analysis. I also wonder if this perceived lower cash flow risk is sufficient to explain the wide spread of assumptions within the various WACC calculations, particularly when, on the surface, these are all very similar businesses.

As I stated at the top of this (short) comment I have not done exhaustive financial modeling and I realize this is a very high level response. Ofgem has consistently stated that the RIIO process will provide for transparent and stable regulation, but this is a new regulatory regime and I believe you should be giving better guidance for the credit markets to explain some of your decisions.

Yours faithfully,

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