

EBIT allowance review statutory consultation

Investors call



Welcome

Welcome and introductions – *Steven Alcorn*

14:00 – 14:05

Decision & Statutory Consultation

Overview of Announcements

- *Rohan Churm*

14:05 – 14:25

EBIT Allowance Update

- *Marzia Zafar and Shai Hassid*

Price Protection Overview

- *Dan Norton*

Supplier Dividends Practices Letter–

- *Rohan Churm*

Q&A

Q&A – *Steven Alcorn*

14:25 – 14:55

Close

Close – *Rohan Churm*

14:55 – 15:00

Ofgem is committed to developing a retail market that is more **attractive for innovation and investment**.

Our **work on revising EBIT** forms part of a larger programme of work to **deliver stability** to the market.

Three key decisions have been announced today following consultation earlier throughout this year:

- Price cap level update
- Price cap extension final decision
- Publication of our final decision on Typical Domestic Consumption Values

We have also published **Further Consultations** on the below elements of the announcement package:

- Statutory Consultation on a new model for the Earnings Before Interest and Taxes (EBIT) allowance.
- A call for input on Operational Expenditures

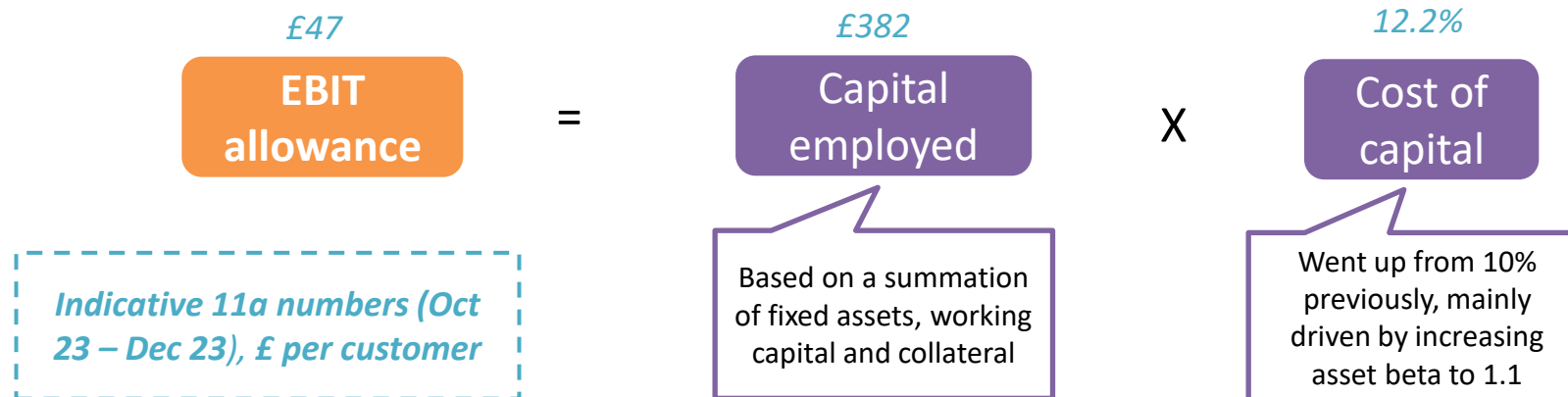
Finally, we have also published an open **letter to Suppliers on Dividend Practices**

Why are we reviewing the EBIT allowance?

- We decided to review the EBIT allowance to reflect that the risk-reward balance has changed since the EBIT allowance was initially introduced in 2018, and to make it more cost reflective by introducing a fixed component

What is the EBIT allowance and how is it derived?

- The EBIT allowance determines the profit a 'notional' supplier serving SVT customers should be making. We use the following components to determine it:



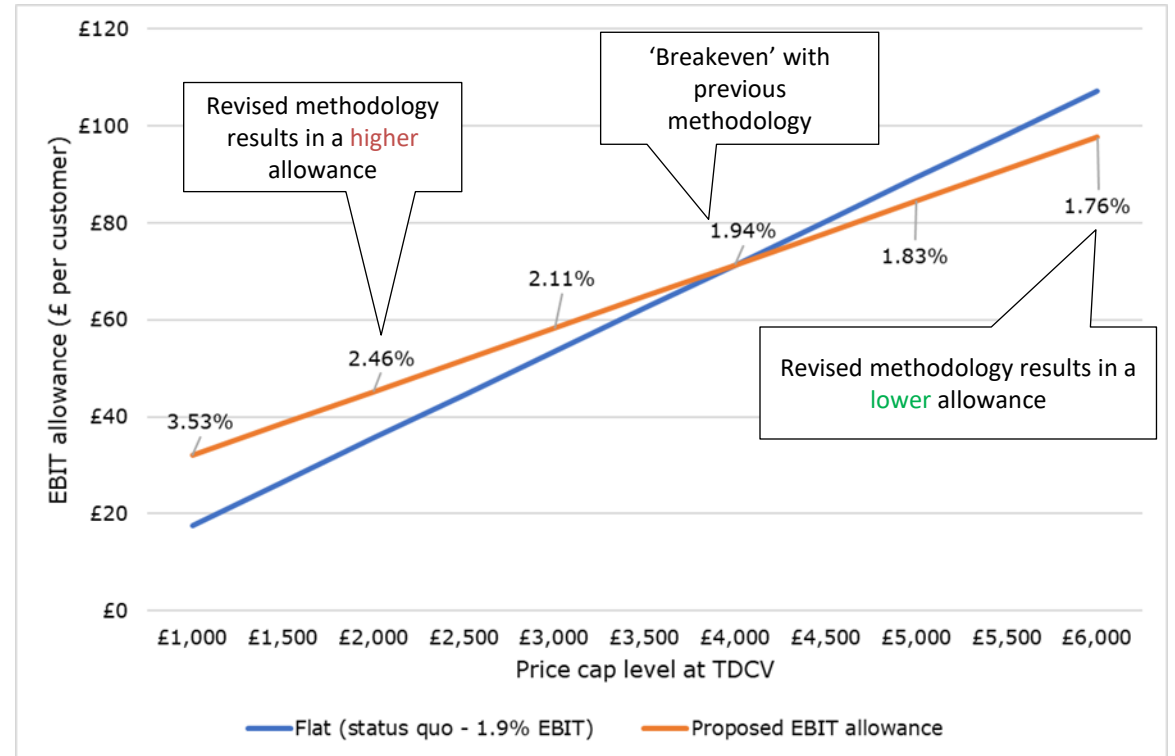
How does the revised allowance compare to the previous one?

- The allowance for 11a is indicatively expected to be **£10 higher** per typical customer than they would have otherwise been under the current 1.9% margin approach
- We are calibrating the allowance based on cap period 11a and scale it thereafter (more in the next page)

Hybrid methodology

- The hybrid methodology for scaling the EBIT allowance introduced a fixed component which reduced its slope – this means **the allowance is less sensitive to the overall cap level**
- Nevertheless, the increase to the cost of capital means consumers would see a lower EBIT allowance than would have otherwise been the case at cap levels of £4000 levels and above
- Unlike the previous approach (the 1.9%), the EBIT margin (%) does not stay fixed – it increases at lower cap levels and vice versa

EBIT allowance and margin under different cap levels for typical consumption



Next steps

- **25 May** - statutory consultation publication, including making the working capital model available
- **28 June** – consultation closes
- **End of August** – decision
- **October** – implementation

Today's Announcements

- Price cap level update
- Call for Input on Operational Expenditure
- EBIT Statutory Consultation
- Price cap extension final decision
- Typical Domestic Consumption Values final decision

Last month:

- Call for Input on the allowances for debt related costs (closed 15 May)
- Call for Evidence: Levelisation of payment types (closed 18 May)

Letter to Suppliers on Dividend Practices

In conjunction with this work on revising the **EBIT Margin**, and noting that suppliers are collectively projecting a return to profitability in 2023, we have also published a letter to suppliers today regarding our expectations on **responsible dividend practices**.

- Responsible distributions are important and necessary for investability
- Suppliers should not make distributions to shareholders if it leaves them with insufficient capital.
- In judging the sufficient capital position the board should take into account the supplier's credible trajectory to meet prospective future capital requirements, including any transition period.
- Suppliers in a negative net asset position should not make distributions and should retain profits to build resilience.

Steven Alcorn to Chair

- To ask a question, please use the hand raise function.
- **If you are joining via phone, please type *5 on your keypad to raise your hand.**
- When it is your turn, your microphone will be activated. You will need to unmute yourself.
- **Please type *6 on your keypad to unmute yourself.**
- Before asking question, please say your name and your institution.

EBIT Timeframe

- **25 May** – *Statutory consultation publication, including making the working capital model available*
- **28 June** – *Consultation closes*
- **Late August** – *EBIT Allowance Final decision*
- **October** – *Implementation Period Begins*

FRC Timeframe

- **31 May** – *Enhanced Financial Responsibility Principle goes live*
- **November** – *First deadline for RO ringfencing credit cover*
- **Summer 2023** – *Planned timing of decision on Common Minimum Capital Requirements and Customer Credit Balance Ringfencing*