

Gas distribution price control review 2008-13

Final Proposals

Analyst presentation

3 December 2007

The conference call, which this presentation accompanies, can be accessed on [+44 208 515 2301](tel:+442085152301).

The call will also be recorded. To access the recording after the call dial [0800 358 9369](tel:08003589369) or [+44 207 190 5901](tel:+442071905901) from overseas and enter the pin [137550#](tel:137550). The recording will be available until close of play on 10 December.

Disclaimer: The information contained in these slides is a summary of the proposals for the gas distribution price control. Full details of GEMA's initial proposals for the price controls are set out in the publication "Gas Distribution Price Control Review Final Proposals". The information contained in these slides is intended to summarise some aspects of the key features of the initial proposals but neither GEMA nor Ofgem represent or warrant that the information contained in these slides constitutes an accurate or complete summary of the proposals.

Note: All figures quoted are in £m 05/06 real, unless otherwise stated.

Abbreviations: FP = final proposals, UP = updated proposals

Key themes

- Rises in our assessment of opex, capex, repex and cost of capital since updated proposals
- GDNs' allowances reflect £5.3bn of investment – of which £1.8bn is funded up-front
- Average increase in allowed revenue of 2% pa across all GDNs
- Full package of supplementary incentives to recognise uncertainties and to promote sustainable development

Operating costs

- Hybrid of top-down/bottom-up benchmark to get balance of relative efficiencies while providing adequate allowances overall
- Average “real price effects” of 1.3% pa
- 2.5% pa productivity improvement
- No change in regional costs allowances
- Small adjustment to NGG’s opex to reflect systematically lower capex over 11 year period
- Material uncertainties over future costs – protection provided by reopener (TMA costs) or revenue driver (loss of meter work)

Operating cost allowances (annual averages)

GDN		Actuals 2002-07	07-08 Allowances	2008-13 UP	2008-13 FP	FP vs. GDN forecast
NGG	East of England	109.0	109.8	93.9	101.4	-17.6%
	London	73.5	71.7	71.2	76.1	-10.5%
	North West	82.6	80.4	76.7	82.7	-10.4%
	West Midlands	60.5	59.9	58.1	62.6	-5.4%
NGN	Northern	77.0	77.3	75.1	79.0	-1.7%
SGN	Scotland	65.8	65.2	63.6	65.3	-7.6%
	Southern	108.5	105.5	113.6	117.8	-2.4%
WWU	Wales & West	79.6	82.7	75.9	78.9	-7.6%
Total		656.5	652.5	628.1	663.8	-8.3%

£m 2005/06 prices. Figures include pensions but exclude shrinkage allowances and impact of loss of metering

Capex/Repex

- Updated demand-driven capex for latest information on availability of capacity from NTS
- Re-balanced Scotia repex between Scotland and Southern GDNs
- Average 2.4% RPEs
- All GDNs gain additional allowances under IQI
- Will review capex requirements if additional reinforcement required as a result of interruptions auctions in July 2008

Capex/repex post-I QI

GDN		Total capex/repex allowances 2008-13	%age reduction from company forecast	Under/over spend incentive rate	Total additional income 2008-13
NGG	East England	715.4	-5.2%	36%	10.9
	London	689.5	-9.1%	36%	8.9
	North West	618.0	-13.6%	36%	9.5
	West Midlands	448.3	-3.0%	36%	7.1
NGN	Northern	637.7	-8.2%	36%	8.4
SGN	Scotland	451.8	-11.8%	33%	3.0
	Southern	1,123.3	-11.3%	33%	7.3
WWU	Wales & West	652.0	-13.6%	33%	4.5
Total		5,335.9	-9.8%		59.7

£m, 2005/06 prices

Indicative RAV

	NGG	NGN	SGN	WWU
Opening RAV 1 April 2008	5,923.4	1,340.1	3,217.7	1,235.0
Capex/repex Additions	2,471.1	637.7	1,575.1	652.0
Less: repex expensed (50%)	-916.2	-207.9	-496.6	-184.3
Depreciation	-1,083.5	-245.7	-587.0	-226.6
Closing RAV 31 March 2013	6,394.9	1,524.2	3,709.1	1,476.1

£m, 2005/06 prices.

Cost of capital

- Cost of debt – continue to take longer-term view, but note that our figure of 3.55% is also consistent with CC/CAA views on current debt costs
- Gearing – see no merit in moving away from 62.5%
- Cost of equity – have sense-checked against CC's methodology, and considered further evidence from respondents. Overall, consider 7.25% post-tax appropriate

Cost of capital

	TPCR Dec 2006	CC: BAA (Heathrow)	GDPCR Dec 2007
Cost of debt (real, pre-tax)	3.75%	3.55%	3.55%
Cost of equity (real, post-tax)	7.0%	7.33%	7.25%
Gearing (% debt/RAV)	60%	60%	62.5%
Vanilla WACC	5.05%	5.06%	4.94%

Other financial issues

- No significant changes since updated proposals:
 - 50% repex expensed
 - 45 year straight-line depreciation on new assets
 - tax allowances benefit as capital allowances changes not yet confirmed in law
 - No revenue profiling
- No adjustments for financeability required

Revenue allowances

GDN		Allowances 2007/08	Average annual Allowances 2008/13	Average annual % change
NGG	East England	427.2	430.5	0.3%
	London	245.1	282.1	4.9%
	North West	285.5	299.0	1.6%
	West Midlands	217.8	231.7	2.1%
NGN	Northern	273.5	290.3	2.0%
SGN	Scotland	194.3	201.5	1.2%
	Southern	432.4	468.1	2.7%
WWU	Wales & West	252.0	267.3	2.0%
Total		2,327.7	2,470.4	2.0%

2005/06 prices

Future issues

- Regulatory reporting for greater transparency between review periods
- Impact of interruption and offtake reform
- Setting allowance for TMA costs
- Structure of charges
- GDNs' role in CO safety



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