



ofgem

RIIO T1 & GD1 Final Proposals

Analyst & Investor Presentation

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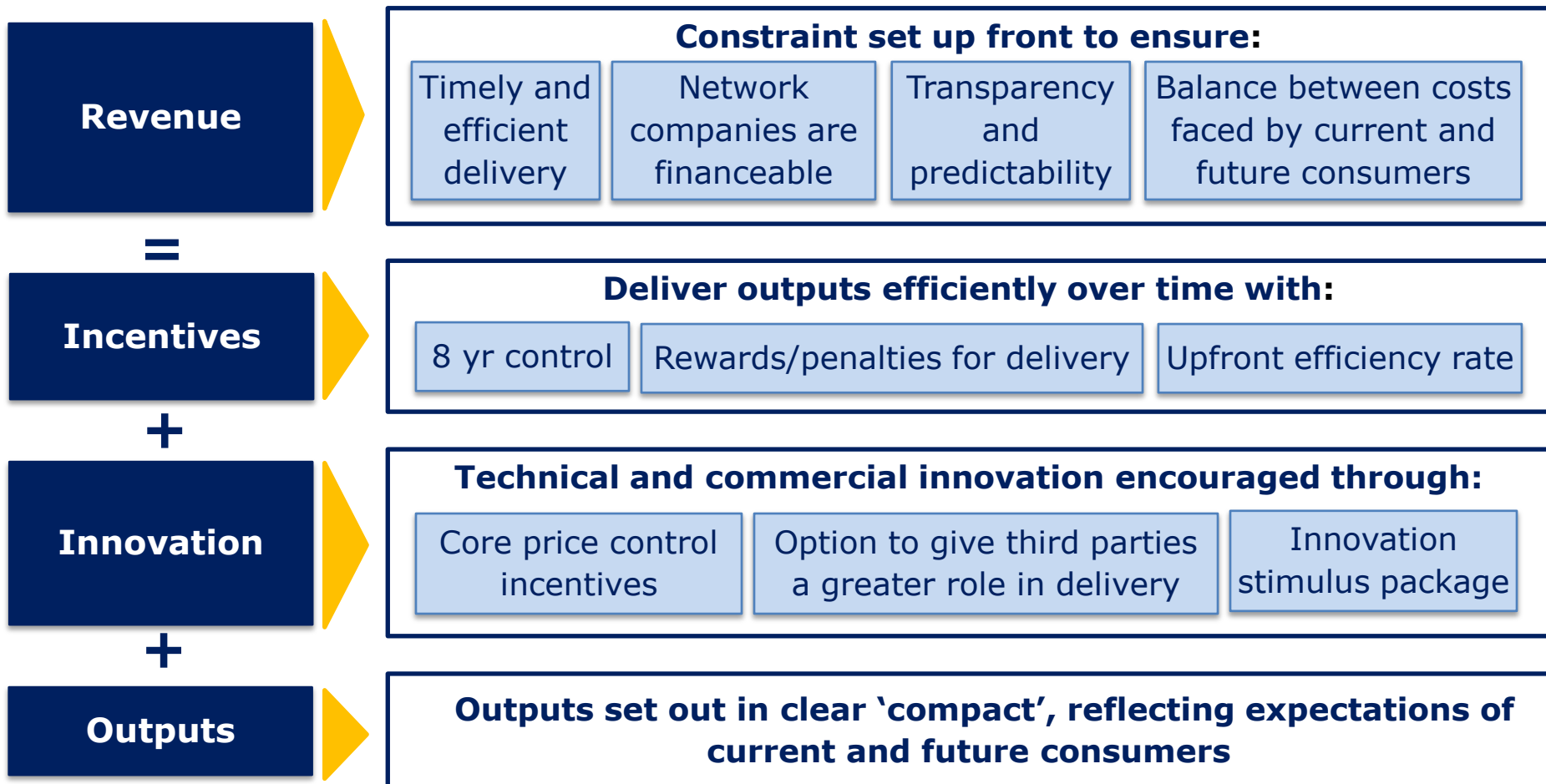
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Ian Marlee

SENIOR PARTNER, TRANSMISSION

RIIO: A new approach to Network Regulation



RIIO – Investors have a role to play

We rely on investors to:

- Keep pressure on management teams not to underperform
- To support management teams to appeal Ofgem’s decisions if they believe them wrong.

You will have:

- Enough regular information to make these judgements
- An awareness that all companies could outperform in theory (ie No “median theory” is in play)

- Investors to be alert: ineffective, lazy or poor management will be found out under RIIO
- GB Network Regulation was never intended to be risk free
- There is now a wider template for risk/reward

Consumers and Investors have common interests

RIIO – So far so good

First price controls under RIIO have achieved:

- ✓ Fundamentally changed behaviour and Board discussions at companies
- ✓ Significant step-up in stakeholder engagement to present well thought-out, detailed and better justified business plans
- ✓ Ofgem staying true to RIIO principles:
 - ✓ Framework and key parameters clearly set out early on
 - ✓ Transparency of approach from early on – No 'black box' dates
 - ✓ Increased stakeholder engagement – including investors
 - ✓ Proportionate treatment
 - ✓ Higher level of scrutiny focused on areas not well justified
 - ✓ Two Scottish TOs fast-tracked
 - ✓ Flexibility in allowed costs ensure customers pay only for necessary expenditure
 - ✓ Financeability not compromised – transition where needed

Balancing huge investment needs and costs to consumers

RIIO-T1 Final Proposals

Summary Proposals

	SHETPLC	SPTL	NGET TO	NGGT TO
	(Fast-tracked)			
Totex Base View	£1bn	£1.6bn	£12.0bn	£2.9bn
Totex Best View	£4.2bn	£2.1bn	£14.5bn	£4.9bn
Cost of Equity	7.0%	7.0%	7.0%	6.8%
Cost of Debt	iBoxx 10yr trailing avg. Bespoke weightings	iBoxx 10yr trailing avg.	iBoxx 10yr trailing avg.	iBoxx 10yr trailing avg.
Gearing	55%	55%	60%	62.5%
Asset lives transition	16 yrs	8 yrs	8 yrs	na
Capitalisation rate	90%	90%	85%	Base: 64% Increment: 90%

RIO-T1 Final Proposals

Financial Parameters

	NGET TO			NGGT TO		
	Business Plan	Ofgem IP	Ofgem FP	Business Plan	Ofgem IP	Ofgem FP
Cost of Equity (real post-tax)	7.5%	7.0%	7.0%	7.5%	6.8%	6.8%
Cost of Debt (real pre-tax)	iBoxx 10 year trailing average					
Notional gearing	55%	60%	60%	55%	62.5%	62.5%
Asset lives transition (20 to 45 yrs)	16 yrs	8 yrs	8 yrs	na	na	na
Capitalisation rate TO	Base: 86% UM: 100%	All: 85%	All: 85%	Base: 57% Incr: 90%	Base: 53% Incr: 90%	Base: 64% Incr: 90%
Revenues growth		25.1%	30.5%		31.4%	28%
RAV growth		63%	69%		45%	42%

RIIO-T1 Final Proposals

Total Expenditure

2009/10 prices (£bn)		First Business Plan		Revised Business Plan		Ofgem IP		Ofgem FP		% Diff. FP v IP (Total)
		Base	Uncertain	Base	Uncertain	Base	Uncertain	Base	Uncertain	
NGET TO	Capex	12.0	1.3	12.0	1.3	9.1	2.6	9.6	2.5	3%
	Opex	2.8	-	2.6	-	2.2	-	2.4	-	9%
	Total Expenditure	14.8	1.3	14.6	1.3	11.3	2.6	12.0	2.5	4%
NGGT TO	Capex	1.7	3.6	1.8	3.7	0.8	2.6	1.4	2.0	0%
	Opex	1.5	-	1.5	-	1.5	-	1.5	-	0%
	Total Expenditure	3.2	3.6	3.3	3.7	2.3	2.6	2.9	2.0	0%

Total RIIO-T1 Capex = £15.5bn

RIIO-T1 Final Proposals

Ofgem Final Proposals v Initial Proposals

NGET

- Financial package unchanged: will allow NGET comfortable investment grade credit rating:
 - CoE 7.0%: in line with TPCR4 and Scottish TOs
 - Gearing 60%: appropriate for size relative to investment programme
- £425m increase in uncertainty mechanisms in order to incur capex in H2 of RIIO-T1 to deliver outputs in RIIO-T2
- Visual amenity: increased expenditure cap to £500m (from £100m)
- Network Innovation Allowance: increased to 0.7% (from 0.6%) of allowed revenues – potential for innovation in SO functions (NGET and NGGT)
- Penalty/reward of up to 2.5% of the value of any over/under delivery of network replacement outputs (NGET and NGGT)

RIIO-T1 Final Proposals

Ofgem Final Proposals v Initial Proposals

NGGT

- Financial package unchanged: comfortable investment grade credit rating
 - CoE 6.8%: lower risk than NGET as a result of lower capex:RAV ratio
 - Gearing 62.5%: can support higher notional gearing than NGET
- £269m compressor capex moved into baseline from uncertainty
- £130m increase in baseline unit cost allowances (c20% from IPs)
 - Compressors £88m, pipelines £42m
- £167m net increase to forecast incremental capex
- £112m reduction from recalculation of RPEs; and £391m reduction resulting from further clarifications from NGGT
- Constraint management collar (£60m) to protect from low probability high impact costs

Hannah Nixon

SENIOR PARTNER, DISTRIBUTION

RIO-GD1 Final Proposals

Financial Parameters

	Business Plans				Ofgem IP	Ofgem FP
	NGGD	NGN	SGN	WWU		
Cost of Equity (real post-tax)	7.2%	7.0%	7.2%	7.2%	6.7%	6.7%
Cost of Debt (real pre-tax)	10yr trailing avg	10yr trailing avg	10 year 'BBB' index	10yr avg +35bps, cap & collar	iBoxx 10yr trailing average	iBoxx 10yr trailing average
Notional gearing	55-60%	62.5%	60%	62.5%	65%	65%
Repex transition (50% to 100%)	8 yrs, 75% all	Applied to totex	Applied to totex	8 yrs, stepped	8 yrs stepped (75% avg)	8 yrs stepped (75% avg)
Totex capitalisation rate	46-53.4%	52.6%	50.7% - 51.5%	45.6-60.2%	Stepped capitalisation ¹ 35-64% (depending on GDN)	Stepped capitalisation¹ 36-66% (depending on GDN)
Revenue growth					3.9%	4.7%
RAV growth					1.0%	6.7%

¹Capitalisation rates varied by year in IP following the repex transition. In FP we have set two rates, one for repex and one for other totex. Using the FP allowances the stepped rates are virtually the same as at IP, but will vary with actual expenditure.

RIIO-GD1 Final Proposals

Totex

2009/10 prices (£bn)	First Business Plan	Revised Business Plan	Ofgem IP	Ofgem FP	% Diff. FP v IP
NGGD	8.7	7.7	6.2	6.9	12%
NGN	2.0	1.8	1.6	1.7	5%
SGN	4.9	4.2	3.7	4.1	12%
WWU	2.1	1.9	1.5	1.7	16%
Total Totex	17.7	15.6	12.9	14.4	12%
Capex + Repex only	10.8	9.6	7.6	8.7	14%

Excluding £4.2bn and £4.7bn of non-controllable costs for IP and FP respectively

RIIO-GD1 Final Proposals

Ofgem Final Proposals v Initial Proposals

- Cost allowances increased by £1.5bn from IPs
 - £1.1bn of increased outputs
 - £750m of repex, disallowed at IPs - included in FPs reflecting better data provided by companies
 - £350m of other outputs (e.g. LTS, pipelines, pressure reduction stations)
 - £0.4bn reflects changes in unit cost assessment methodology, correction of errors and RPE adjustment

RIIO-ED1

Timing

Key Issues:

- Timely & cost-effective connection of new low-carbon technologies
- New types of generation
- New and unusual demand
- Uncertainty of take up of new technologies (e.g. local generation, heat pumps, electric vehicles)
- Consider tools like smart grids



Date	RIIO-ED1
Feb 2012	Launch consultation
Sept 2012	Strategy consultation
Feb 2013	Strategy decision
July 2013	Business Plans
Oct 2013	Initial Assessment; Fast-Track decision (& Initial Proposals)
Feb 2014	Fast-Track Final Proposals
Mar 2014	Non-Fast-Track Business Plans resubmitted
July 2014	Non-Fast-Track Initial Proposals
Nov 2014	Non-Fast-Track Final Proposals
April 2015	Implementation



Key Parameters:

- CoE: 6.0–7.2%
- CoD: Indexed
- Gearing: will be based on assessment of cash flow volatility, business plans, CoE, and RoRE
- Asset lives: 20 to 45 years, transition as required
- RoRE: upside to provide potential for double-digit returns on notional equity; downside at or below CoD

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Hannah Nixon, Senior Partner Distribution
Ian Marlee, Senior Partner Transmission

Q&A

Contact

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The background of the slide is a composite image. On the left, there are rows of solar panels under a bright sun. On the right, a hand is shown holding a white document. In the bottom left corner, a blue gas burner is visible. The overall theme is energy and customer service.

ofgem

Promoting choice and value
for all gas and electricity customers