SP ENERGY NETWORKS

2015-2023 Business Plan

(March 2014 Resubmission)

Price Control Review Forum - 23rd April 2014

Scott Mathieson Regulation & Commercial Director

Jim McOmish Head of RIIO ED1 Programme

Summary, updating our ED1 plan

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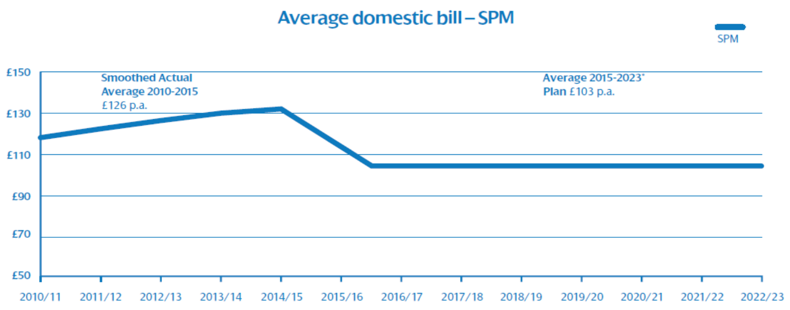
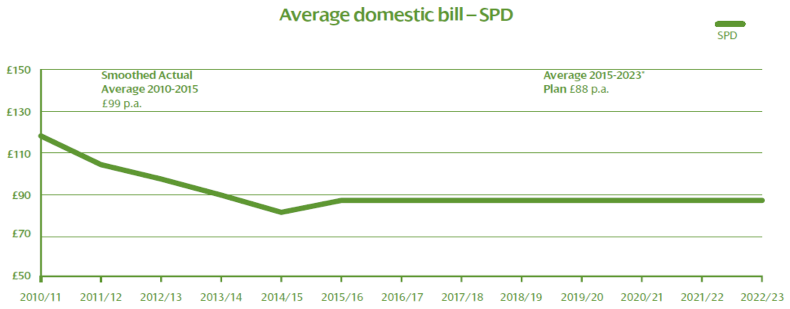
- Our revised plan **maintains >90 original customer commitments**
  - Deliberately ambitious, but based on our track record, achievable
- **Retains incremental investment supported by stakeholders and customers**
  - e.g. storm resilience, flood defence and poorly served customers
- Updated our **costs and volumes** based on latest information:
- Financial Package - **Striking a balance of risk and reward** between stakeholders
- **Real value for money** demonstrated, through benchmarking and analysis

Impact for our customers



Note: allowed revenues follow very similar profile

SPM: The average domestic customer bill **drops 18% from £126 p.a. to £103 p.a. average** (2015-2023).



SPD: The average domestic customer bill **drops 11% from £99 p.a. to £88 p.a. average** (2015-2023).

Note: SPD is only DNO with reducing DR5 bill profile

Bills reducing despite delivering increased volumes of investment

Plus more than 90 customer commitments including:

- Making 25% of our rural HV network resilient to storms by 2023
- Reducing average number of times customers lose power by 7%
- Reducing by 16% the length of time those customers have no power
- Making voluntary commitments to pay additional customer compensation

Changes to Our Plan & Addressing Stakeholder Feedback

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References	Area	What has changed?
Annex ii – Changes to Our Plan - Page 6	**Totex:** Comprehensive bottom up review completed	• Core costs reduced by more than £450m
Main Bus. Plan pages 38, 70, 137 and Annex C6 – Data Assurance Strategy	**Asset Data & Analysis:** All aspects of Ofgem feedback fully addressed	• 70% of investment programme supported by CBA • Asset criticality extended • Separate Losses strategy annex
Main Bus. Plan pages 47, 142, C6 Expenditure and Annex C6 – SP Manweb Company Specific Factors	**SP Manweb Company Specific Factors:** Fully justified special case independently developed	• Special case supplemented with specialist technical and econometric reports

Annex ii – Changes to Our Plan - Page 6 and control sheet loaded to FTP	**Other Strategic Reviews Completed:** >70 detailed annexes included in resubmission	• New annexes including
		  • Expenditure
		  • Cost Assessment, Efficiency & Benchmarking annex
		  • Smart Metering & Smart Grid
		  • Customer Service & Social Obligations
		  • Environment Strategy

Our March '14 Plan address ALL areas of feedback from Ofgem whilst maintaining customer & stakeholder commitments

CLOSING THE GAP TO THE FAST TRACK ASSESSMENT

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Ofgem November decision suggested a gap of £755m versus SPEN £5.2bn plan, we have reviewed all aspects……..

Fast track assessment of plans was 'light touch':

- No account taken of unique SP Manweb Network
- Ofgem had not fully understood detail of investment cases
- Did not recognise differences in DNO investment cycles

We have identified areas where we should deliver greater efficiency or our shareholders can carry a greater share of risk

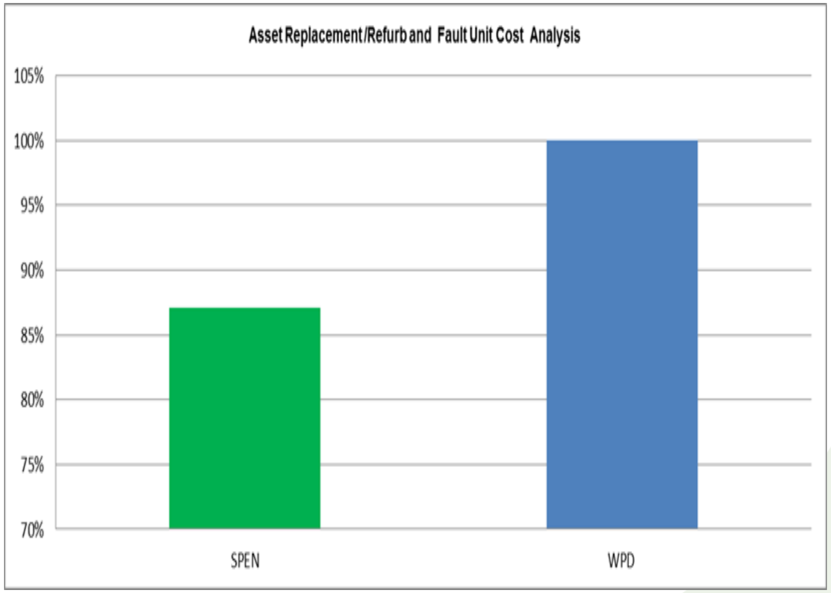
Where appropriate we have stuck to original plan and communicated with Ofgem how benchmarking should be improved

Our ED1 plan has reduced by c£450m to £4.7bn

Benchmarking approach for standard track

Example:

- **SPEN unit costs are 12% less than WPD the fast track company**
- **However, our asset replacement volumes are increasing**
- **Fast track assumed any increased volumes from 2010-13 period were inefficient**



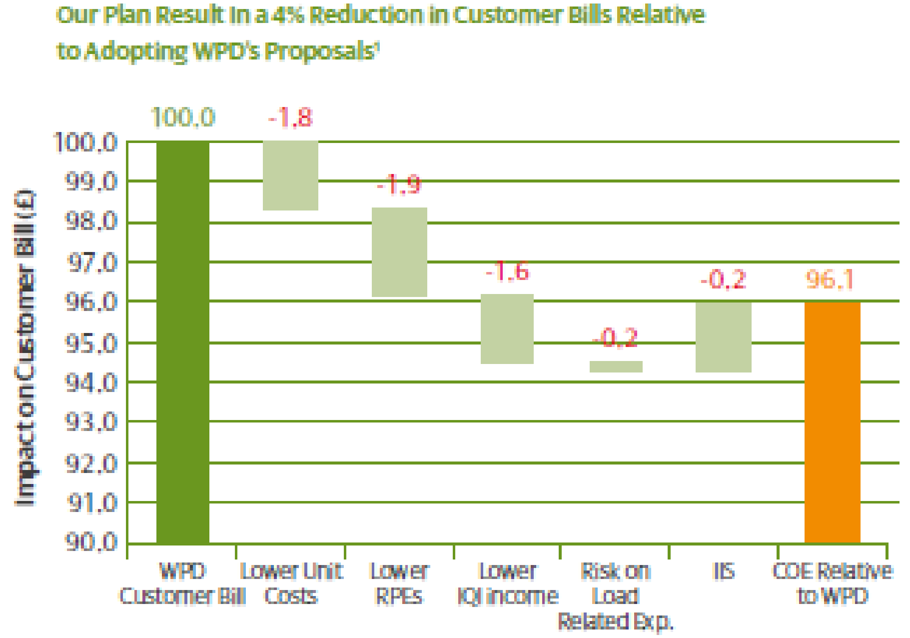
The fast track approach would reduce our 132kV circuit breaker replacement plans from 48 units to 11 units and put at risk the supply to over 710,000 customers

Refinement needed to both engineering and econometric benchmarking, to deliver a fair and correct assessment

Value for Money – Relative Risk

Our plan results in a 4% reduction in customer bills relative to adopting WPDs proposals

- *lower unit costs for key asset activities;*
- *lower real price effects (RPEs);*
- *potential zero IQI income reward; and*
- *greater risk in relation to investment to accommodate changing patterns of demand*



Overall, our package results in greater value-for-money for consumers than WPD since we assume greater risk for a lower return

Financing Our Plan

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Striking a balance of risk and reward between stakeholders

- We propose a **financing plan that is Efficient and adheres to Ofgem policies**
- Our base financial plan gives a **credit rating of Baa1**
  - At **lower end of Ofgem's range**
- Our **financeability demonstrates** that we require:
  - *as a minimum a cost of equity of 6.4%*
  - *a one period transition to longer depreciation lives*

Investors may have to provide a substantial equity injection to maintain an investment grade credit rating

Parameter	DPCR5 (Current)	SPEN July 2013	SPEN March 2014	Comment
Cost of Debt	3.6%	Indexed	Indexed	Reflecting Ofgem's policy decision
Cost of Equity	6.7%	6.7%	At least 6.4%	Considering risk relative to the fast track company
Notional Gearing	65%	65%	65%	Considering risks and opportunities
Dividend Yield	5%	5%	5%	No change
Capitalisation	85%	80%	80%	Reflecting statutory accounts
Asset Lives	20 years	45 years for all new investment	8 year transition to 45 years	Reflecting the loss of fast track reward and financeability relative to the fast track company
Financeability	Investment Grade			Reflecting Ofgem's policy decision