



## Board Assurance Report September 2023



TREASURY & DERIVATIVES



CAPITAL RAISING



FINANCIAL PLANNING & STRATEGY



ASSET MANAGEMENT



London | Dublin

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# Executive Summary

# Board Assurance | Financeability Assessment - Notional Company

Based on Affinity Water's assumed Notional Company, we assess that the business plan has credit metrics commensurate with the target credit rating. Based on that criteria we assess that the Notional Company is financeable

Question	Centrus Assessment
<p>Does the Assumed Notional Company meet Moody's Baa1 rating criteria?</p>	<ul style="list-style-type: none"> <li>▪ Yes, based on our shadow credit rating analysis the Notional Company business plan generates credit metrics which are commensurate with a Baa1 rating</li> <li>▪ Through-out AMP8 the AICR metric is above 1.50x and gearing is below 72% in line with Moody's rating guidance for Baa1 entities</li> <li>▪ We note that the Notional Company does not receive any benefit for any structural features (i.e. securitisation)</li> </ul>
<p>Does the Assumed Notional Company meet S&amp;P's BBB+ rating criteria?</p>	<ul style="list-style-type: none"> <li>▪ Yes, based on our shadow credit rating analysis the Notional Company business plan generates credit metrics which are commensurate with a BBB+ rating</li> <li>▪ Through-out AMP8, the FFO to Debt metric is above the 9% rating downgrade threshold for BBB+ entities</li> <li>▪ We note that the Notional Company does not receive any uplift for any structural features</li> </ul>
<p>Is the Notional Company Financeable?</p>	<ul style="list-style-type: none"> <li>▪ Yes, based on:               <ol style="list-style-type: none"> <li>1. Shadow credit rating analysis of the Notional Company under both Moody's and S&amp;P methodologies as outlined above</li> <li>2. The Affinity Water business plan model and Notional Company assumptions shared by Affinity Water</li> <li>3. The assumption that Ofwat delivers returns in line with expectations</li> </ol> </li> </ul>



## Financeability | Notional Company

# PR24 Notional Company | Capital Structure and Gearing Assumptions

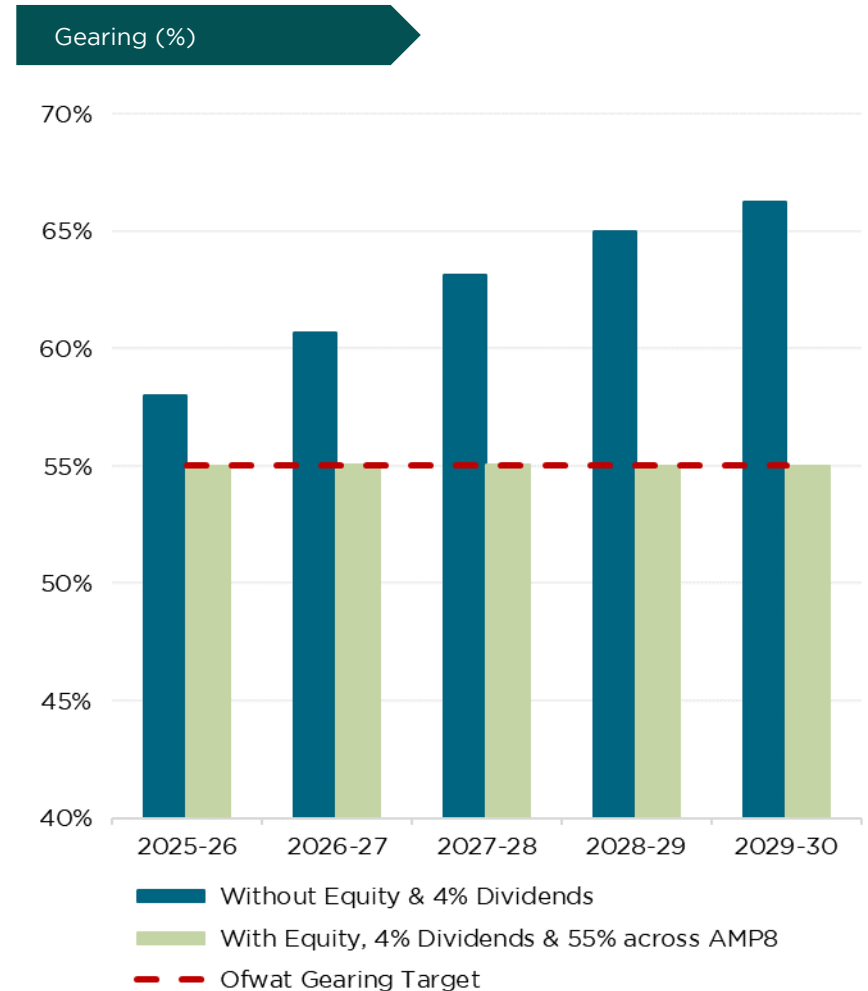
To assess financeability for the Notional Company, a £258m equity injection is assumed over the course of AMP8 and 4% dividends, in order to align gearing to Ofwat's PR24 Notional Company assumption of 55% across AMP8

The PR24 Notional Company is assumed to have a gearing of 55% across AMP8. The regulator has reduced this gearing level by 5% compared to PR19 and noted that is to ensure a company with the notional capital structure has the capacity to continue to raise financing efficiently, whilst taking into account the benefits of high inflation in the current regulatory period.

- With an equity injection of £258m and dividends of 4%, gearing is at c.55% through-out AMP8.
- The table below shows the assumed equity injection timings in AMP8 to align to 55% gearing. **This is the scenario we use as our baseline to assess financeability:**

FY	2025/ 2026	2026/ 2027	2027/ 2028	2028/ 2029	2029/ 2030	AMP 8 Total
c.£m	60	57	60	49	32	258

- With no equity injection and 4% dividends, gearing would be significantly above Ofwat's 55% gearing assumption at 58.02% in 2025/2026 and 62.6% on average.
- Our financeability assessment is based on the assumption that Ofwat delivers on CoE as per AWL business plan, and we also understand equity injections would only be available to AWL on this basis.



# Notional Company | Moody's Scorecard

Centrus' shadow credit rating assessment of the assumed Notional Company utilizing Moody's methodology suggests a Baa1 rating, satisfying the financeability criteria

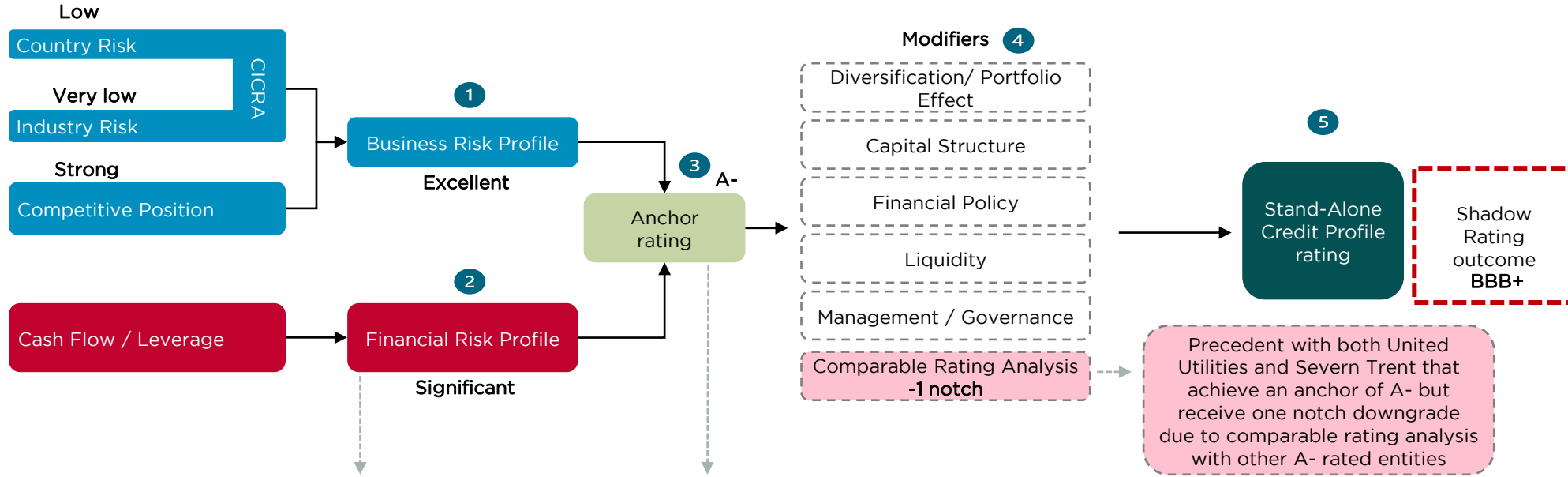
		Moody's Scorecard		Centrus Assessment		
		Weighting	Moody's Guidance	Sub-Factor Outcome Detail		Scorecard-Indicated Outcome
REGULATORY ENVIRONMENT AND ASSET OWNERSHIP MODEL	Stability and Predictability of Regulatory Regime	15.0%	As per the latest Moody's report on AWL Ltd dated 23 <sup>rd</sup> of May	<i>Assumed that these ratings will remain unchanged through-out AMP8 and that the sector will go back to stable in AMP8. However, as of Jan 2023 Moody's have a negative outlook on the UK Water Sector. Moody's have highlighted that this could revert to stable in the event of 1. Lower cost pressures and more favourable Macro environment 2. A more supportive regulatory approach for PR24</i>	-->	Aa*
	Asset Ownership Model	5.0%			-->	Aa
	Cost and Investment Recovery (Ability and Timeliness)	15.0%			-->	A
	Revenue Risk	5.0%			-->	Aa
SCALE AND COMPLEXITY OF CAPITAL PROGRAM	Scale and Complexity of Capital Program	10.0%	Baa: total annual capex 8%-12% of RCV Ba: total annual capex 12%-20% of RCV B: total annual capex 20%-30% of RCV CAA: total annual capex >30% of RCV	9.13% on AMP8 average	-->	Baa
FINANCIAL POLICY	Financial Policy	10.0%	As per the latest Moody's report on AWL Ltd dated 23 <sup>rd</sup> of May	<i>Assumed this will remain unchanged. The additional equity to ensure a low level of gearing is credit positive</i>	-->	Ba
LEVERAGE AND COVERAGE	Adjusted Interest Coverage Ratio (AMP8 average)	12.5%	Baa: 1.5-2.5x Ba: 1.2 -1.5x	1.56x	-->	Baa
	Net Debt / RCV (AMP8 average)	10.0%	A: 40-55% Baa: 55%-70%	55%	-->	A
	FFO / Net Debt (AMP8 average)	12.5%	Baa: 10-15% Ba: 6-10%	10.17%	-->	Baa
	RCF / Net Debt (AMP8 average)	5.0%	Baa: 6-10% Ba: 4-6%	6.78%	-->	Baa
<b>Scorecard-Indicated Outcome Before Notch Lift</b>						<b>Baa1*</b>
Notch Lift:	Structural Considerations and Sources of Notch Uplift From Creditor Protection	Unlike the Actual Company the Notional Company do not benefit from creditor benefits embedded within the covenant and security package such as (1) liquidity facilities, (2) security package, (3) standstill proceedings , (4) cash trapping mechanisms				0
<b>Scorecard-Indicated Outcome</b>						<b>Baa1*</b>

To be in line with Moody's guidance for a Baa1 rating the Notional Company needs to maintain an AICR above 1.5x and a gearing lower than 72%

\*Moody's currently has the sector on negative outlook and if Moody's does downgrade the sector from Aa to A, this would downgrade the scorecard outcome by one notch to Baa2 due to the 15% weighting Moody's applies to the Stability and Predictability of Regulatory Regime. We expect a stable sector outlook from Moody's if higher costs normalise and PR24 is seen as a positive regulatory outcome.

# Notional Company | S&P

Based on Affinity Water Notional Company assumptions, we estimate that the Notional Company would be in line with a BBB+ using S&P corporate methodology



Financial Risk Table		
	Core Ratios	
Risk	FFO/debt (%)	Debt/EBITDA (x)
Minimal	35+	Less than 2
Modest	23-35	Less than 2
Intermediate	13-23	2-3
<b>Significant</b>	<b>9-13</b>	<b>3-4</b>
Aggressive	6-9	4-5
Highly Leveraged	Less than 6	Greater than 6

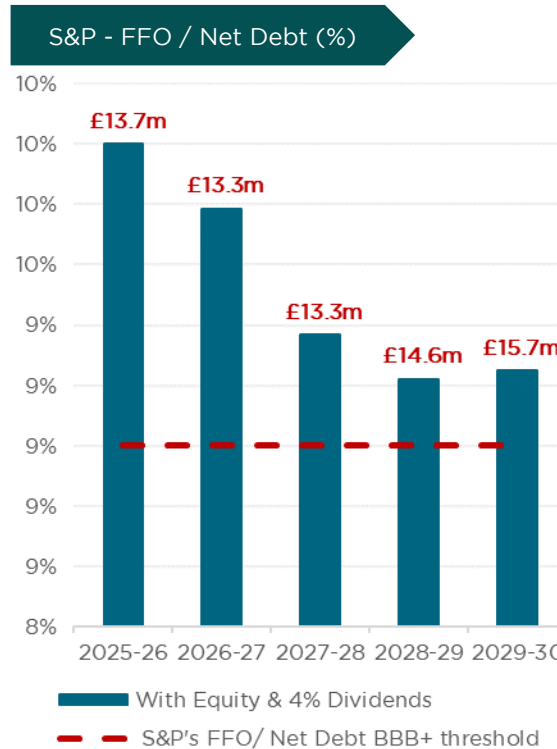
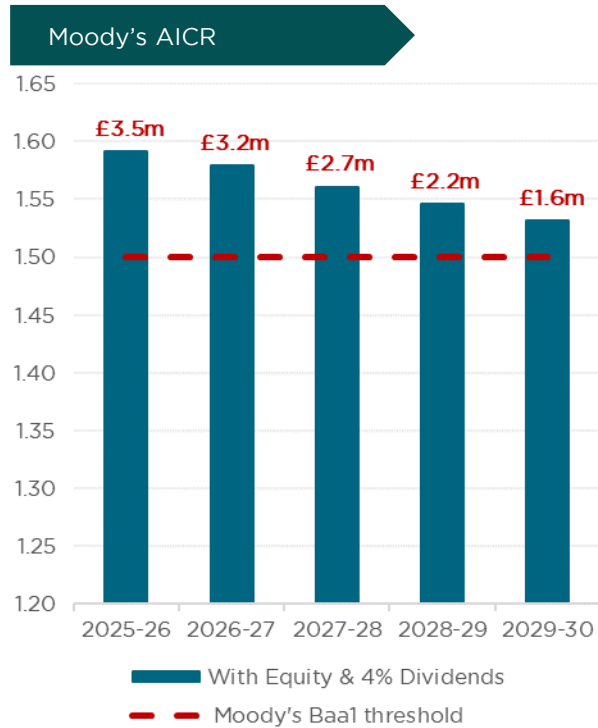
Combining the Business & Financial Risk Profiles to Determine the Anchor						
	Business Risk Profile					
Financial Risk Profile	1 (excellent)	2 (strong)	3 (satisfactory)	4 (fair)	5 (weak)	6 (vulnerable)
1 (minimal)	aaa / aa+	aa / aa-	a / a-	bbb / bbb-	bb+	bb-
2 (modest)	aa	a+ / a	bbb+	bbb-	bb+	bb-
3 (intermediate risk)	a+ / a	a- / bbb+	bbb / bbb-	bb+	bb	bb- / b+
<b>4 (significant)</b>	<b>a-</b>	bbb	bbb- / bb+	bb	bb-	b+
5 (aggressive)	bbb	bb+	bb	bb-	b+	b
6 (highly leveraged)	bbb- / bb+	bb	b+	b	b / b-	b-

To be in line with S&P's guidance for a BBB+ rating the Notional Company needs to maintain an FFO to Net Debt ratio of 9%



# Notional Company Financeability | Ratings Metrics

Affinity Water's assumed Notional Company has financial metrics in line with Moody's AICR Baa1 threshold and S&P FFO/Net Debt BBB+ requirements through-out AMP8



- AICR is above the 1.50x rating guidance of Moody's for a Baa1 company though headroom is limited

- FFO/Net Debt is above the 9.0% rating guidance of S&P for a BBB+ company

- Equity is injected every year to ensure a target gearing of 55% through-out AMP8