Allowed Revenue Breakdown

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Northern Gas Networks

Mod186 reporting…..

NORTHERN GAS NETWORKS				Published:	
	Description	**RIIO License**	**2016-17**	**2017-18**	**2018-19**
ROW REF	**TABLE 1 : TOTAL CHARGE ELEMENTS (ECN + LDZ + CUSTOMER)**				
5	Opening Base Revenue Allowance (09/10 Prices)	PUt	340.2	330.8	333.5
6	Price Control Financial Model Iteration Adjustment (09/10 Prices)	MODt	(6.2)	(11.1)	(17.2)
7	RPI True Up (09/10 Prices)	TRUt	(4.8)	(7.4)	(1.3)
8	Uplift to Nominal Prices using RPIFt		76.6	84.6	98.9
9	**BASE REVENUE**	**BRt**	**405.7**	**396.9**	**414.0**
14	**PASS THROUGH**	**PTt**	**0.6**	**3.5**	**3.5**
17	**NTS EXIT CAPACITY REVENUE ADJUSTMENT**	**EXt**	**(1.4)**	**(0.1)**	**(2.0)**
20	**SHRINKAGE REVENUE ADJUSTMENT**	**SHRt**	**(5.1)**	**(6.7)**	**(6.4)**
21	Broad Measure of Customer Satisfaction Revenue Adjustment	BMt	2.7	3.4	3.4
22	Environmental Emissions Incentive Revenue Adjustment	EEIt	2.8	3.1	5.0
23	Discretionary Reward Scheme Revenue Adjustment	DRSt	0.8		
24	Network Innovation Allowance Revenue Adjustment	NIAt	2.4	2.5	2.6
25	Less Correction Term revenue Adjustment (K added)	-Kt	2.8	6.5	(10.4)
26	**MAXIMUM ALLOWED REVENUE**	**ARt**	**411.3**	**409.2**	**409.6**

- **We discuss in detail the movements each quarter on our Mod186 statements**
- **But what makes up the biggest number on this report…??**
- **This presentation focuses on NGN's Allowed Base Revenue for 18/19 and the building blocks to calculate £333.5m**

12 pieces of the revenue puzzle to fit together.........

£53m / 16% out of £333m

Piece 1

Non Controllable Opex

+ £53m / 16%

An allowance is given to cover the non controllable costs (also known as pass through costs) of :

- Business Rates
- Shrinkage
- Ofgem License Fee
- NTS Pension Deficit Costs
- Exit Capacity costs

Any differences between allowance and actual costs is "trued up" 2 years after so networks always receive full revenue funding for these costs.

Note the methodology relating to NTS Exit Capacity Costs is currently under review and could result in significant differences to current allowances.

Note the £333m is calculated in 09/10 prices – this was the price base used when Ofgem published final proposals in Dec 2012 for the 8 years of RIIO-GD1

12 pieces of the revenue puzzle to fit together......

£60m / 18% out of £333m

Piece 1

Non Controllable Opex

+ £53m / 16%

Piece 2

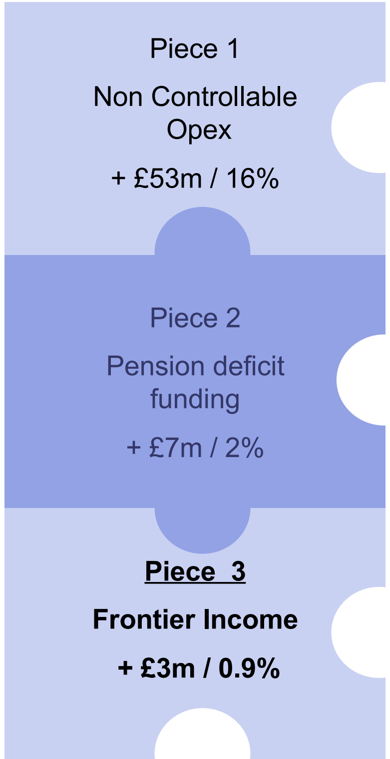
Pension deficit funding

+ £7m / 2%

- We receive an allowance for the amount of money we pay into the NGN pension scheme to cover the deficit.
- It's funded over a 15 year period and re-assessed every 3 years when a new valuation is completed.
- Providing we can demonstrate we are running the scheme efficiently we will receive an allowance to match the cost.

12 pieces of the revenue puzzle to fit together......

£63m / 19% out of £333m



- Bonus income for NGN being the top performing network.
- £3m a year throughout RIIO-GD1.
- Another output of being at the frontier is receiving a strong Totex Incentive rate – so we can keep 64% of any outperformance vs. allowances.

12 pieces of the revenue puzzle to fit together......

£65m / 20% out of £333m

Piece 1

Non Controllable Opex

+ £53m / 16%

Piece 2

Pension deficit funding

+ £7m / 2%

Piece 3

Frontier Income

+ £3m / 0.9%

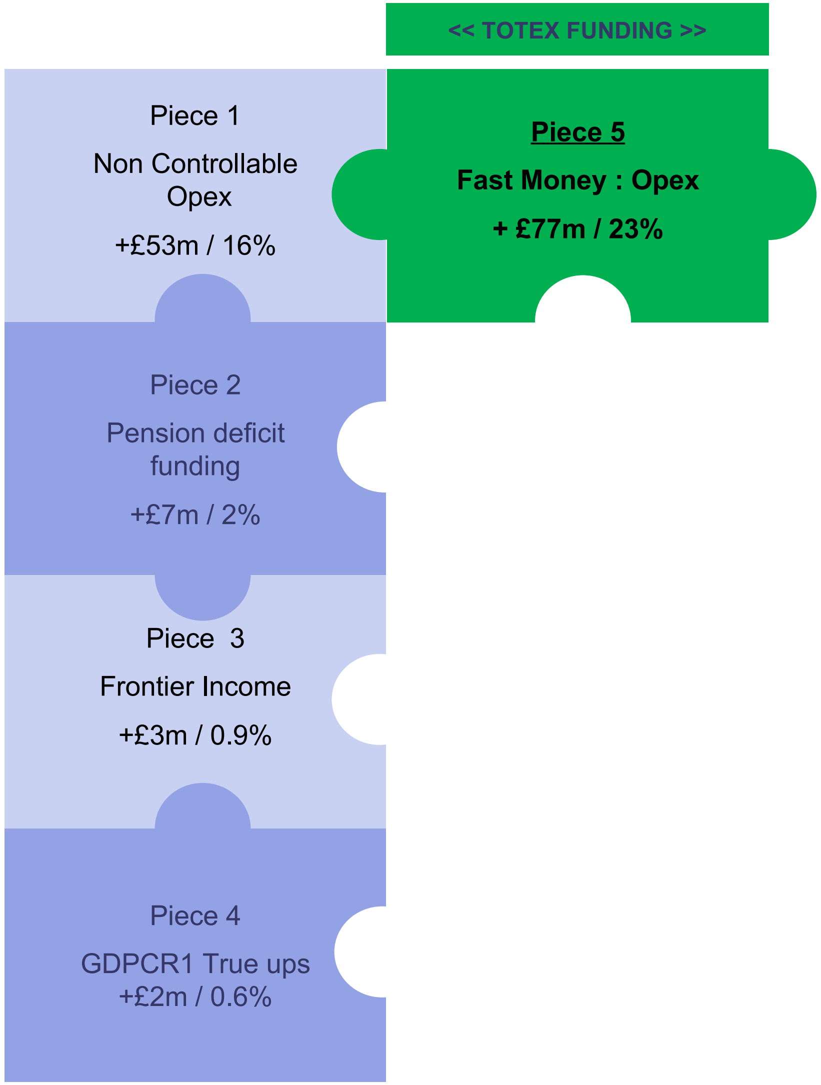
Piece 4

GDPCR1 True ups
+ £2m / 0.6%

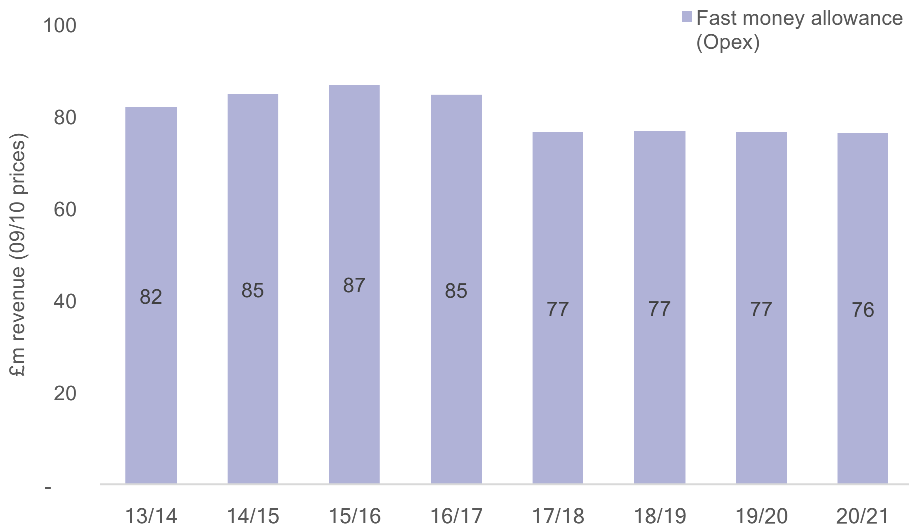
- Finalised incentive performance from the last price control period.
- A pot of money has been spread across all 8 years of RIIO-GD1 c. £2m a year.

12 pieces of the revenue puzzle to fit together......

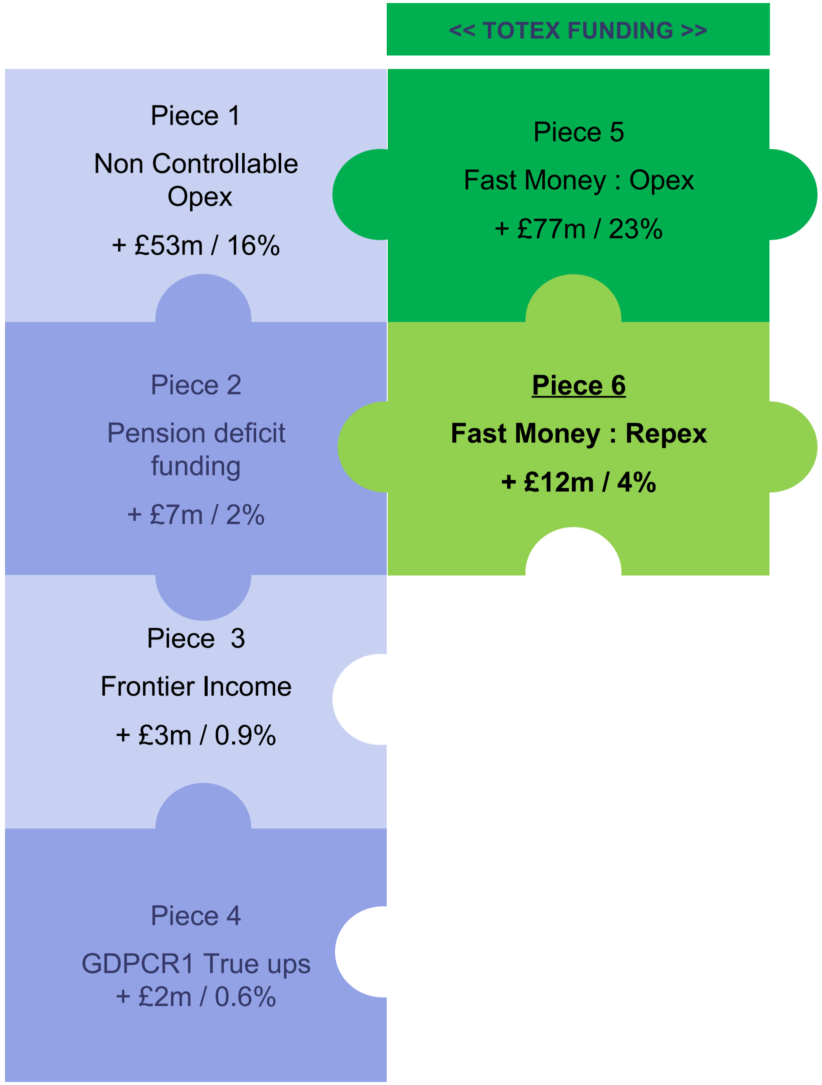
£142m / 43% out of £333m



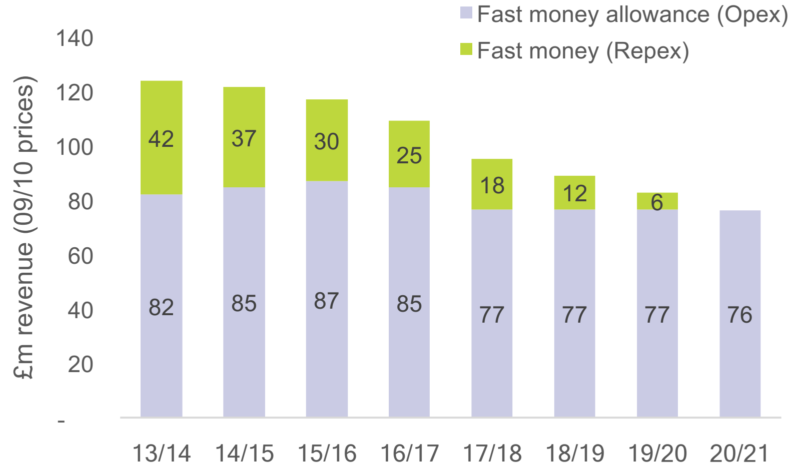
- Opex is classed as “fast money” – i.e. revenue allowance given in the same year as the expenditure is incurred.
- This relates to funding for covering the Operating costs of the business i.e. employee costs, contractor costs, materials, IT, other overheads etc.
- The Totex Incentive Mechanism incentives networks to deliver savings against these allowances - across Opex, Capex and Repex
- NGN can keep 64% of any savings against Totex allowances, but has to return 36% to shippers/end customers



12 pieces of the revenue puzzle to fit together......   £154m / 47% out of £333m

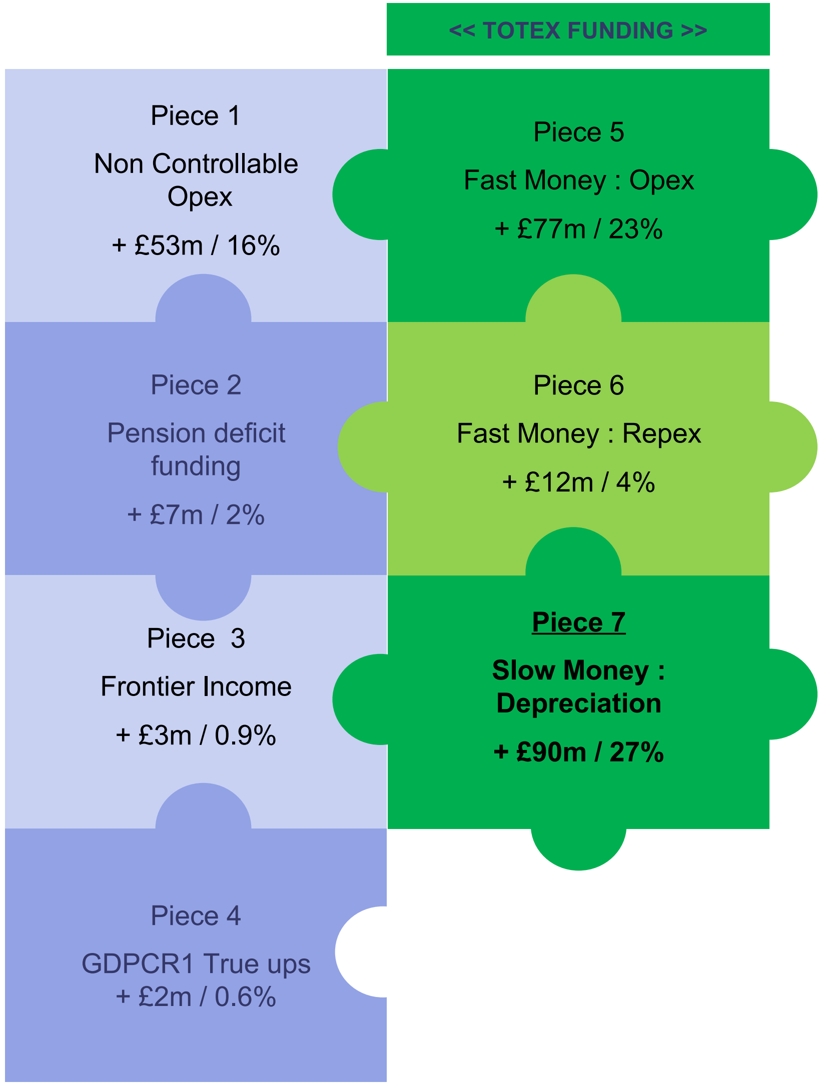


- Some of repex is also classed as “fast money” – but on a reducing basis each year so that by 20/21 it is all capitalised.
- 50% of repex is treated as fast money in 13/14, with a reducing amount every year.
- In 18/19 21% of repex is treated as fast money, by 20/21 this will be nil.

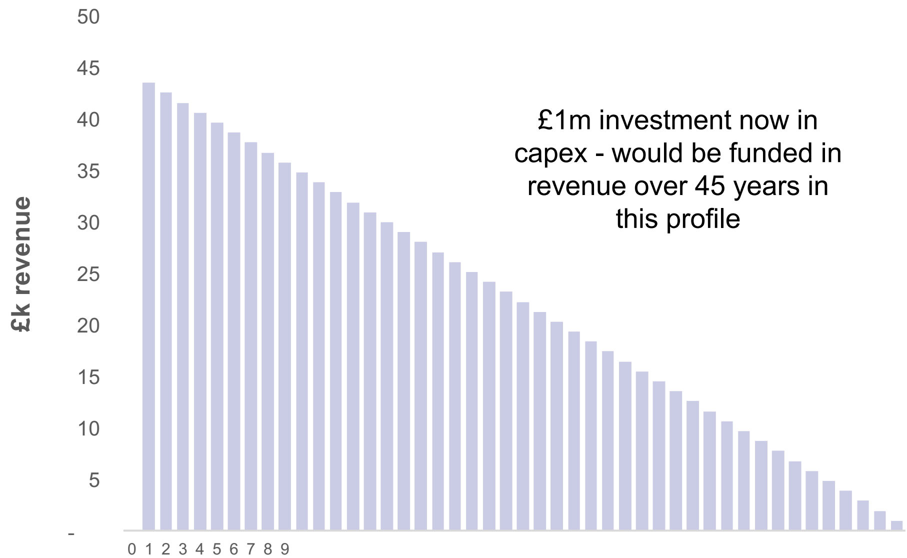


12 pieces of the revenue puzzle to fit together......

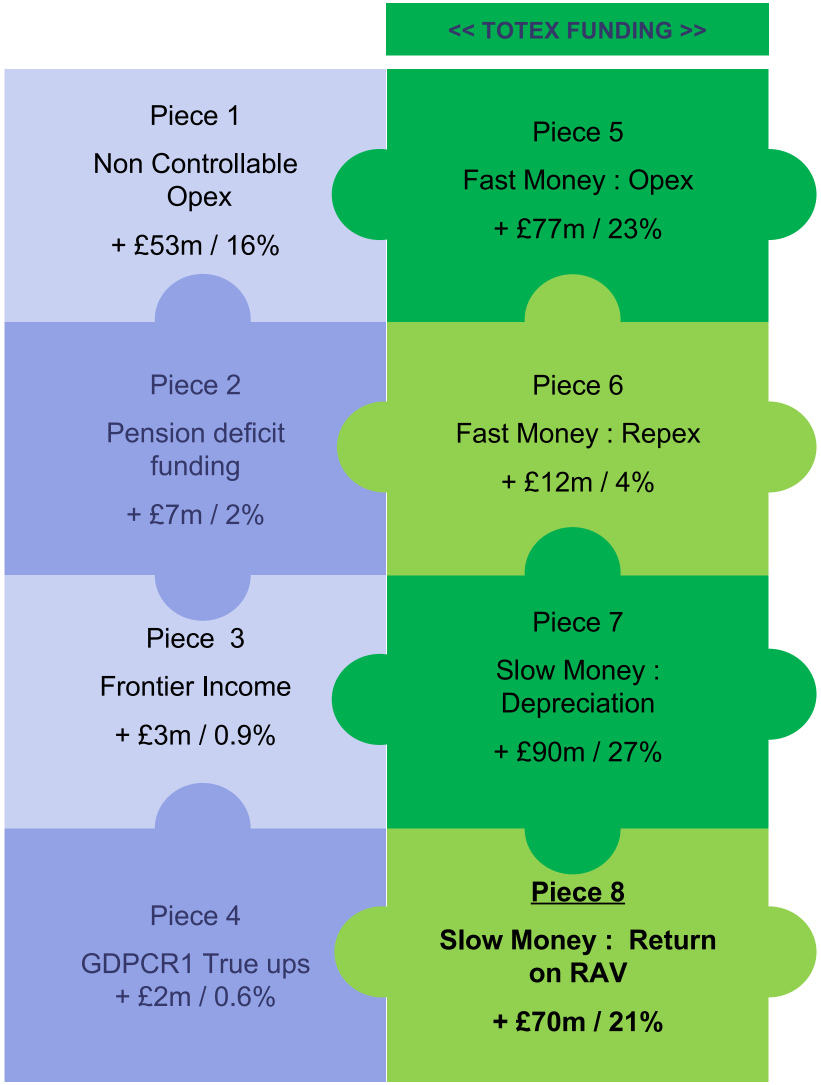
£244m / 74% out of £333m

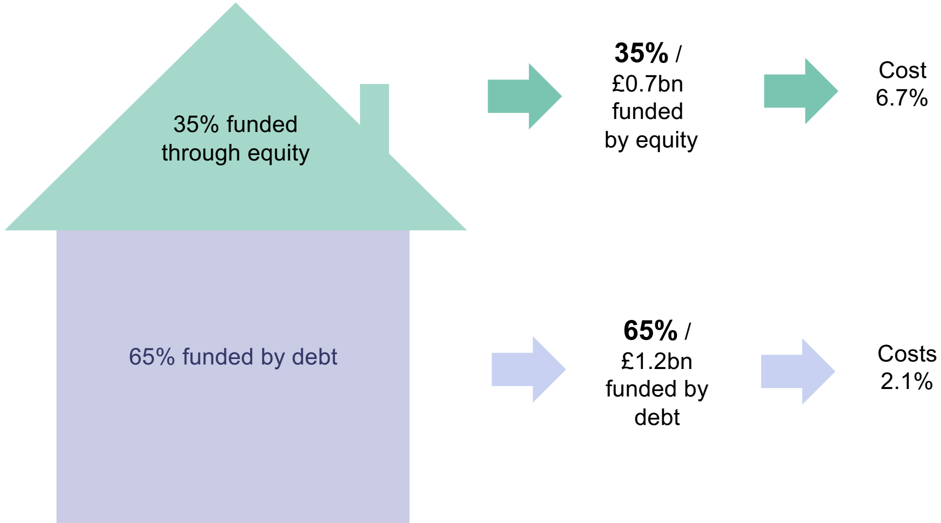


- Slow money (capex) is funded over the life of an asset via the depreciation charge. So if we spend £1m on capex today we get a proportion of revenue each year per the profile below.
- An increasing amount of repex is also being funded this way – all of it by 20/21.



12 pieces of the revenue puzzle to fit together...... £314m / 94% out of £333m





- The NGN house (Regulatory Asset Value) is worth £2.2bn

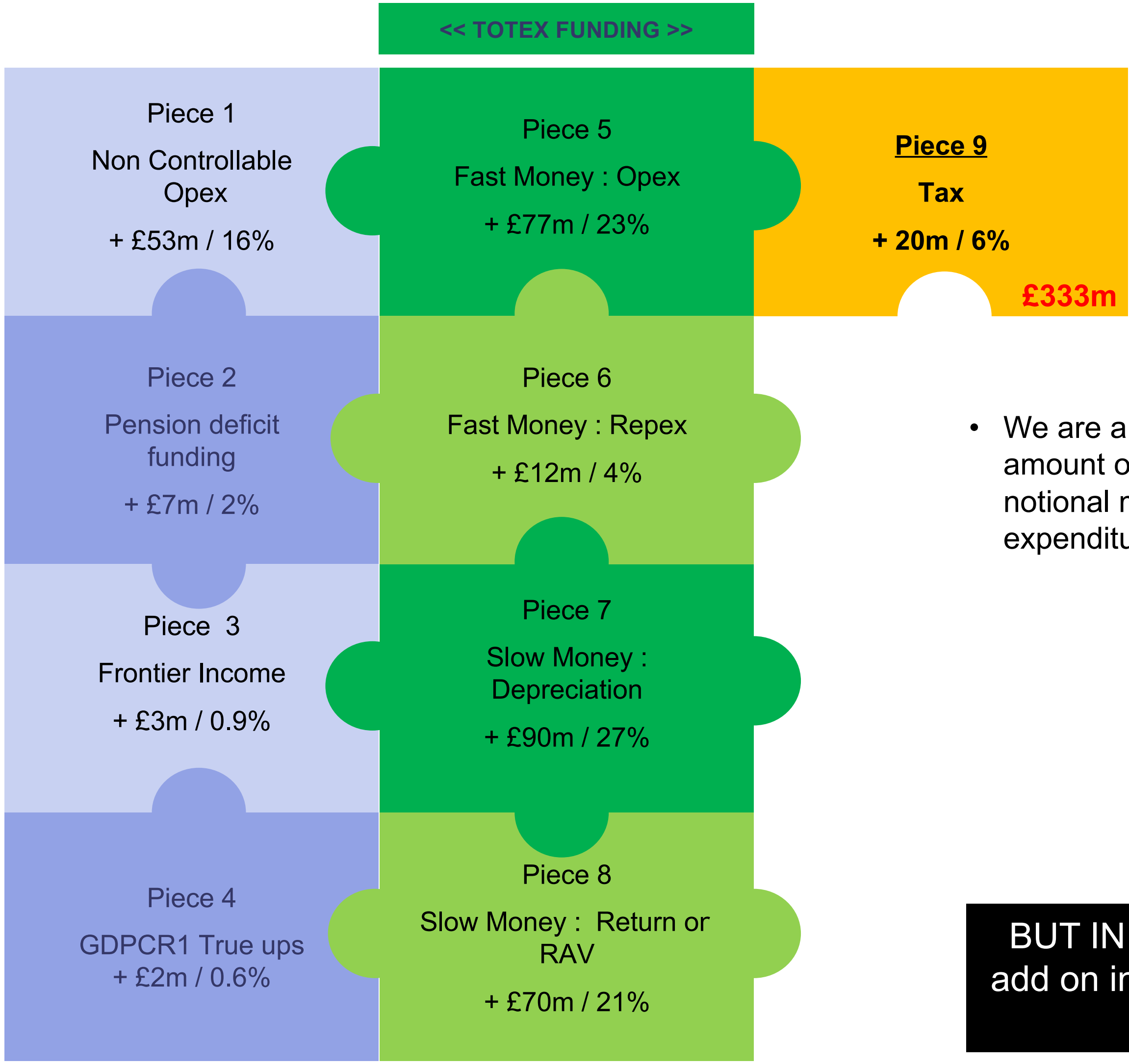
In Ofgem's notional world GDN's capital structure is :

- 65% debt (@ 2.1% cost)
- 35% equity (@ 6.7% cost)

- The costs associated with this are funded by the "Return on RAV" element within Revenue.

- "Loan to Value" or "Debt to RAV" relationship is a key credit metric used to assess the business.

12 pieces of the revenue puzzle to fit together.....£333m / 100% of base allowed revenues

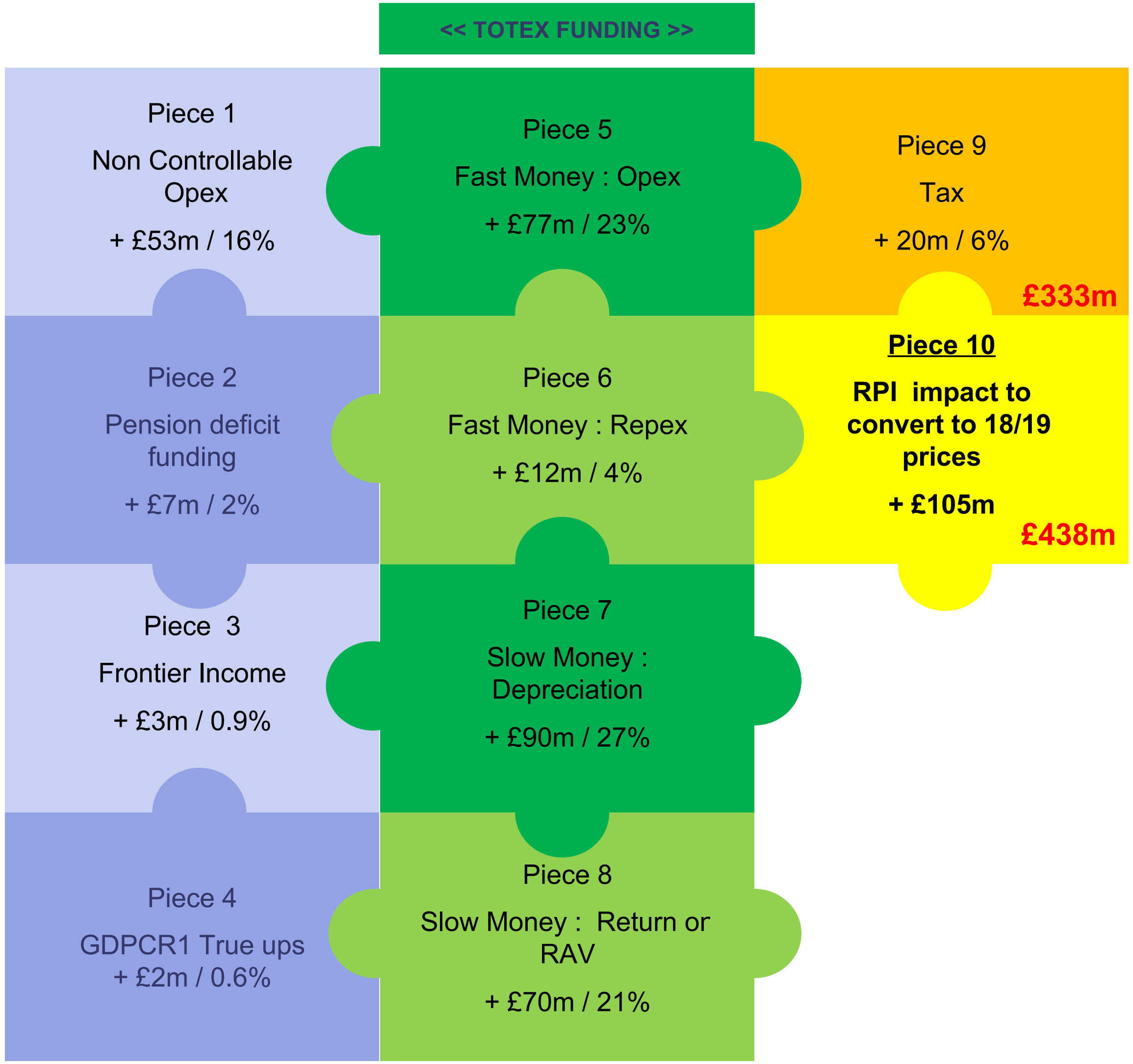


- We are also given an allowance to cover off the amount of tax we will pay – based on Ofgem's notional model and all based on forecasted expenditure levels and costs of capital.

BUT IN 09/10 PRICES – we now need to add on inflation to get to current year prices >>>>>>>>

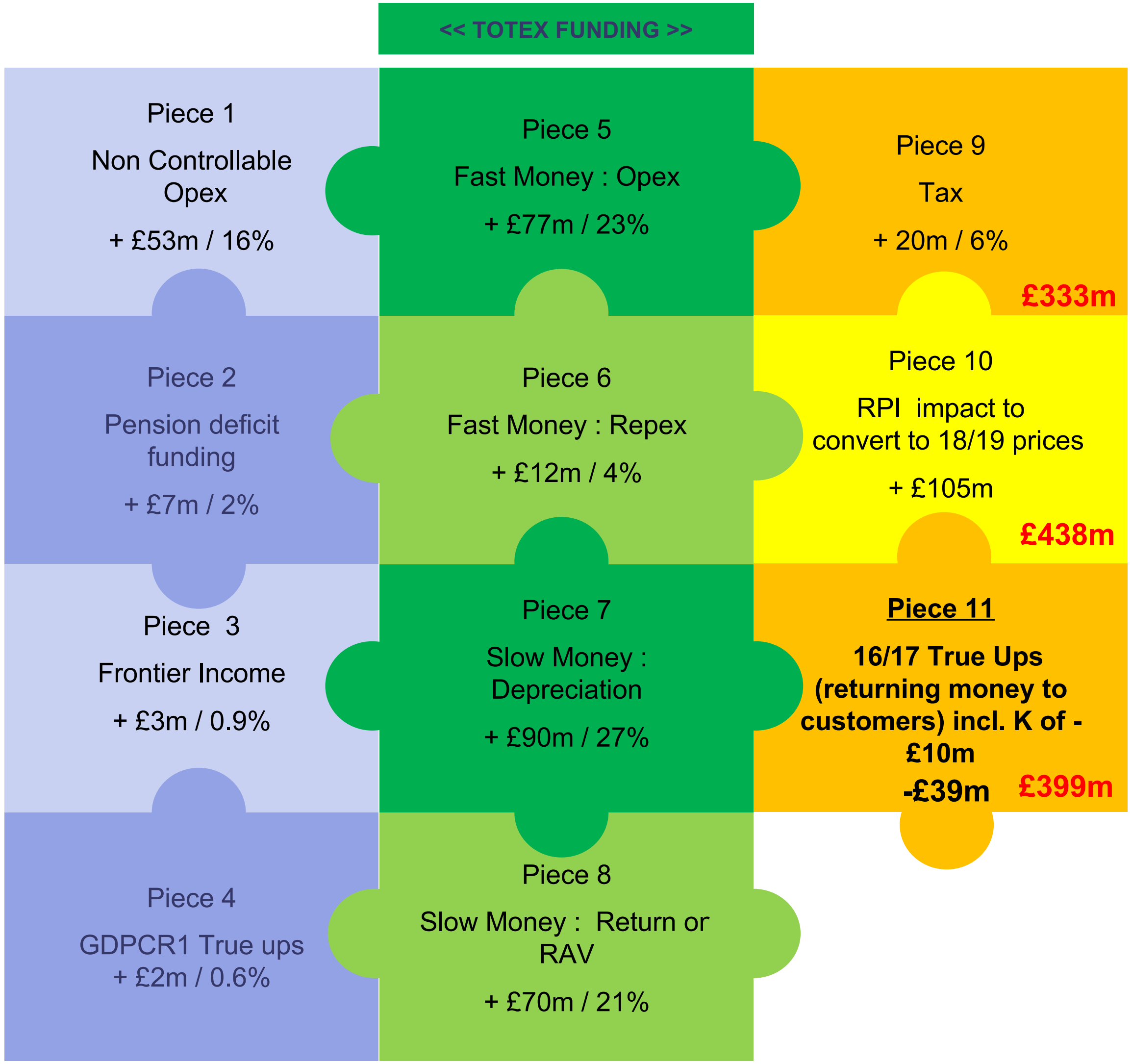
12 pieces of the revenue puzzle to fit together......

Inflation



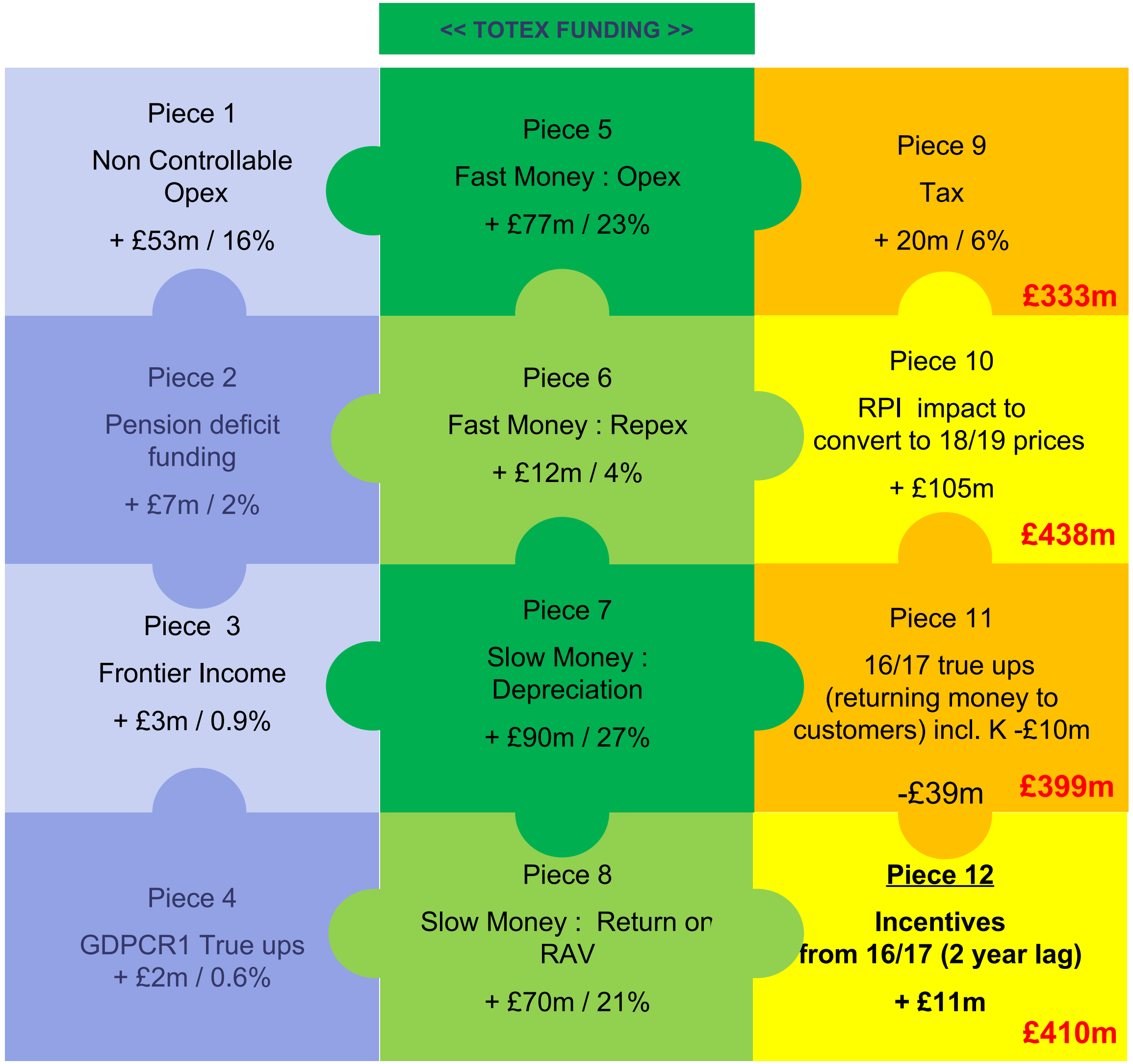
- So far all allowances have been calculated in 09/10 prices. This is so all 8 years of RIIO-GD1 are comparable and exclude the impacts of inflation.
- For income collection we need it to be in 18/19 prices.
- Between years 09/10 and 18/19 RPI growth has been c.31% (avg.3.1% per year).
- Revenue is then uplifted by 31% resulting in £105m being added to revenue.

12 pieces of the revenue puzzle to fit together...... Cost true ups / Totex Incentive / K



- Each year revenue gets adjusted ("trued up") in some areas to reflect actual costs instead of original allowance – main areas being:
- Non Controllable Costs
- Cost of Debt
- Pension Deficit
- Totex Incentive Mechanism (36% give back to customers)
- Note the 2 year lag – so adjustments from 16/17 feed into 18/19 revenue.
- These adjustments are mainly reductions in revenue resulting in money being returned to end customers.

12 pieces of the revenue puzzle to fit together...... Incentives



- Incentives from 16/17 are added into revenue in 18/19:
  - £6m from shrinkage/leakage
  - £3m from customer satisfaction
  - £2m from exit capacity
- The license determines that we are "allowed" to collect £410m.
- We set our unit rates so that we aim to collect £410m from shippers during 18/19 regulatory year.
- Unit rates will be set based on the latest set of data available for AQ / SOQ so that we collect as close as possible to the required number of £410m

Summary

- **Base revenue allowances** are set for all 8 years of RIIO-GD1 when publishing "final proposals" from the RIIO-GD1 price control process. In summary these cover:
    - Non Controllable Costs
    - Operating Expenditure (Fast money)
    - Capex investment (Slow Money)
    - Repex investment (Slow and Fast money)
    - Return on Assets
    - Pension Deficit costs
    - Tax

- **The Annual Iteration Process adjusts for:**
    - Updating allowances to reflect actual Totex expenditure and the sharing mechanism between GDN's/customers
    - Updating Cost of Debt allowances to reflect a rolling 10 year trailing index
    - Updating any pension deficit changes or other allowance changes i.e. shrinkage or fuel poor as directed by Ofgem

- **License terms then further adjust for:**
    - Inflation
    - Updating any differences between original allowances and actuals on non controllable costs
    - Inclusion of incentives earned
    - Adjusting for "K"

- RIIO-GD2 allowances are unknown - and if following the same timetable as RIIO-GD1 would be available a year before in draft for "Initial Proposals" with "final proposals" being published in December 2020.

- Whilst the mechanics *could* follow the same methodology as shown in these slides, Ofgem could change any of the inputs into the methodology (i.e. depreciation profiles as an example) which would materially change revenue profiles.