

WSX33 - Financial resilience and financeability

Business plan
2025-2030



Wessex Water
YTL GROUP

FOR YOU. FOR LIFE.

WSX33 - Financial resilience and financeability

CONTENTS

1. Financeability	1
1.1. Financeability tests – notional company	1
2. Financial resilience	3
2.1. Our approach to LTVS	4
2.2. Detail with RR17	7
2.3. Impact of using the notional company as specified	10
2.4. Analysis over the longer term	10

For annexes, see Supporting Document WSX34 – Annexes – Financial Resilience and Financeability

This supporting document is part of Wessex Water's business plan for 2025-2030.

Please see 'WSX00 – Navigation document' for where this document sits within our business plan submission.

More information can be found at wessexwater.co.uk.

1. Financeability

We explain our key financial assumptions in WSX35 – Financial Assumptions Underpinning the Plan. These, when fed through the published financial model, give the following financeability assessment.

Final methodology notional structure

We have prepared financeability tests for the notional company, as specified in the final methodology, using the early view cost of capital (and assumptions that this would impose). We have used these to undertake the notional assessment of financeability set out in our board assurance statement.

Our view of notional and actual structure

As discussed through our risk and return section, these assumptions are not consistent with the current underlying financial and macroeconomic conditions. Instead, as discussed, we have used the building blocks of the cost of capital set out in our risk and return annexes (WSX32 – Annexes – Risk and Return). We have also prepared a financeability assessment on this basis.

Finally, we have undertaken an assessment of financeability on our actual structure, with consistent assumptions on working capital and raising debt as the Ofwat model for comparability.

1.1. Financeability tests – notional company

We agree with the position set out in the final methodology that the notional company should be targeting a BBB+/Baa1 credit rating. We set out the calculations of the key metrics and the thresholds we consider below:

Gearing = Net debt / RCV < 72%

AICR = (FFO – RCV Run off – Excess fast money) / Interest expensed (exc. indexation) > 1.5x

FFO / Debt = (FFO – indexation of index linked debt) / Net debt

Note, we do not maintain a credit rating with S&P and so place less weight on FFO / debt, as it is not a key indicator for Moody's or Fitch.

For the final methodology's notional company this results in the following metrics:

Table 1: Key Metrics - FM notional company

	2025-26	2026-27	2027-28	2028-29	2029-30
Gearing	57%	60%	62%	64%	67%
AICR	1.9	1.7	1.6	1.5	1.5
FFO / Debt	8.4%	7.8%	7.2%	6.7%	6.3%

These are all consistent with maintaining a BBB+/Baa1 credit rating. However, there is a notable deterioration in the metrics over the period, due to the mismatch in embedded to new debt and increasing financing costs, and significant capital investment. Although this specification passes the tests on paper, we do not think that they represent an overall financially resilient proposition, or an overall balanced picture. As we outline in WSX31 (Risk and return), the WACC needs to be increased, and we do not agree with the 55% notional gearing.

If we correct both, we get the following results, which are not only financeable but also present a much more financial resilient position.

Table 2: Key Metrics - notional company

	2025-26	2026-27	2027-28	2028-29	2029-30
Gearing	61%	62%	63%	64%	65%
AICR	1.9	2.3	2.4	2.1	1.7
FFO / Debt	8.0%	9.4%	9.5%	8.6%	7.1%

Under our actual capital structure, we get the following financial statements:

Table 3: Income statement

£m nominal	2025-26	2026-27	2027-28	2028-29	2029-30
Turnover	696	835	911	952	997
Opex	-335	-359	-369	-385	-433
EBITDA	361	476	542	567	564
Depreciation	-207	-228	-258	-282	-300
EBIT	154	248	284	284	264
Interest	-141	-165	-190	-216	-248
PBT	13	83	94	69	16
Current tax	-1	-13	-12	-5	0
Deferred tax	-65	4	-1	-7	-14
PAT	-53	73	81	57	2
Dividends	0	0	0	0	0
Retained earnings	-53	73	81	57	2

Table 4: Cashflow statement

£m nominal	2025-26	2026-27	2027-28	2028-29	2029-30
EBITDA	361	476	542	567	564
Capex	-624	-705	-766	-891	-891
Working Capital	30	-4	-3	25	-1
Operating Cashflow	-233	-233	-226	-300	-329
Interest paid	-112	-134	-157	-180	-208
tax paid	-1	-13	-12	-5	0
dividend paid	0	0	0	0	0
Net cash outflow	-347	-380	-394	-484	-537
accruals	-29	-31	-33	-36	-39
Gross Cash outflow	-375	-410	-427	-521	-576
Opening debt	-3226	-3572	-3983	-4412	-4933
Closing debt	-3572	-3983	-4412	-4933	-5509
RCV	4958	5548	6190	6948	7699

These result in the following financial metrics which represents a financeable proposition:

Table 5: Key Metrics - actual structure

	2025-26	2026-27	2027-28	2028-29	2029-30
Gearing	72%	72%	71%	71%	72%
AICR	1.6	1.9	1.9	1.7	1.4
FFO / Debt	7.0%	8.3%	8.5%	7.7%	6.5%

Although the AICR dips in the final year, this is due to reprofiling of revenues, which currently rating agencies look through in making their assessment. Adjusting for this results in the following AICR:

Table 6: Key Metrics - actual structure

	2025-26	2026-27	2027-28	2028-29	2029-30
AICR	1.9	1.8	1.7	1.6	1.6

With the full restriction of dividends, included in our plan, our actual structure sets out a financeable proposition. Alongside this, we set out the tests we have applied to ensure that we are also financially resilient in the next section of this document.

2. Financial resilience

Ensuring long term financial resilience is a different test. For this we look over the next ten years and apply the same tests as we do annually in the annual return when preparing our long-term viability statement (LTVS).

That is, we look at the company's ability to maintain an investment grade credit rating, under a range of scenarios designed to test plausible, reasonable, and severe financial shocks.

2.1. Our approach to LTVS

The Company's approach to the assessment and consideration of the full range of risks, including common external risks that affect the water sector as whole as well as specific Company risks is detailed in our annually published Annual Report and Accounts document.

When considering financial viability over a longer time period, we modelled the scenarios set out in the final methodology and we also followed our well-established process for setting out the LTVS that we prepare annually for the annual performance report. Through this process we consider the financial and operational impact if the risks identified in the corporate risk register, including those related to the wider group, were to occur. On top of this the wider economic and regulatory environment was considered, and the impact of any other foreseeable risk was considered. This ensures that all operational, financial, and regulatory risks and liabilities are fully considered. The assumptions to quantify the stress of individual shocks are consistent with the process set out in our LTVS for 2023.

The Corporate risk register is updated annually and reviewed by the Company's risk management group and Audit and Risk Committee to ensure it is a true reflection of the circumstances of the company.

The shocks, scenarios, and levels of sensitivity considered within the financial viability assessment are reviewed and agreed by senior management across the finance, risk and investment, and economic regulation teams. Our full approach to risk identification, management and mitigation is described in document WSX37 – Resilience, Risk Management and Decision Frameworks.

The following table outlines a summary of the individual shocks we have considered and modelled. The levels of financial impact are set having considered historical precedent (both on company performance, that of its peers or analogous risks that have occurred in other sectors), independent expert forecast (for instance forecast ranges published by the Bank of England), and where appropriate guidance within the final PR24 methodology.

Table 7: Summary of financial stress tests

Area	Stress test
Inflation	<p>Sustained lower (up to 2%) than forecast CPIH, reducing allowed revenues and RCV growth,</p> <p>Short-term deflationary scenario with negative CPIH (-1%) over two years, reducing allowed revenues and RCV growth,</p> <p>Short-term higher (up to 8%) than forecast CPIH, increasing costs,</p> <p>Short-term increase in the wedge (up to 2%) between RPI and CPIH on top of current forecasts, increasing accruals on debt without increases in revenues.</p>
Revenues	<p>Sustained lower demand (up to 2% and 8%) for both household and commercial customers respectively, reducing revenues collected,</p> <p>Short-term shock to revenues (i.e. Customer payment strike of up to 10%) reducing revenues recovered,</p> <p>Lower allowed revenues (3% of RoRE ODI penalties) through poor operational performance,</p>

	Decreased collections and an increase in customers' inability to pay, this reduces cash into the business and increases bad debt charge within modelled operational costs.
Capital expenditure	Short-term and sustained input price pressures above (up to 1.5%) CPIH, increasing capital costs, Short-term increases to capital expenditure because of sudden asset failures / environmental incidents / loss of suppliers, Sustained increase (up to 10%) in capital maintenance expenditure, Significant unfunded obligations increasing (up to £100m) capital expenditure.
Operational expenditure	Short-term and sustained input price pressures above CPIH, increasing operational expenditure, Short-term increases (up to £10m) to operational expenditure because of sudden asset failures / environmental incidents / loss of suppliers, Sustained increase (up to 10%) in operational expenditure, Significant regulatory fines (up to 6% of turnover).
Financing	Credit rating downgrade, resulting in higher (up to 0.5%) costs of raising new debt Sustained increase (up to 2%) in cost of raising new debt above the forecast Iboxx indices.

Scenarios were then developed ensuring that the analysis correctly identified linked and compounded risks and were sensitivity tested with reasonable, plausible and extreme levels of severity.

In total we modelled 33 scenarios, including those outlined in the PR24 final methodology, the most severe of which consider multiple concurrent and linked risks as follows.

Table 8: Summary of scenario testing

Scenario	Details and sensitivity testing
Wastewater incident	This might include a major pollution incident or the widespread distribution of unfit water, either driven by catastrophic asset failure, extreme weather events or malicious damage. The base scenarios include the capital costs of rectification and then increases severity by progressively including risks of fines, penalties from regulatory delivery incentives, customer compensation payments and at the most extreme the withholding of customer bill payments.
Water supply incident	
Simultaneous water and wastewater incidents	As above but assumes incidents occur concurrently.
Macroeconomy	This scenario assumes a sustained economic downturn in the UK that increases company input prices and reduces productivity resulting in sustained overspends of regulatory cost allowances while depressing indices of consumer prices and reducing company sales. An accompanying credit squeeze means that the costs of new finance increase.

Combined operational and macroeconomic shock	Assumes operational failure coincides with higher input costs resulting in consistent overspends against regulatory allowances. Alongside this depressed consumer price indices reduce sales and regulatory value. Sensitivity testing increases the severity by assuming demand and sales volumes also decrease and the company suffers higher interest costs through a credit rating downgrade.
New unfunded obligations	This scenario assumes that government or regulators impose new obligations on the Company that create additional costs and diverts management focus leading to operational failure. These are modelled individually and then alongside operational or macroeconomic shocks to fully test the resilience of the company.
Extreme weather event	Extreme weather event (either a 'beast from the east' or a prolonged dry period) causes overspend on operational expenditure and asset failures resulting in ODI penalties.
Climate change	Ongoing climate change causes more uncertain weather, drier summers and wetter winters, leading to additional operational and maintenance expenditure. This was modelled individually and alongside operational and macroeconomic shocks to fully test the resilience of the company.

The PR19 final determination significantly reduced the headroom available which, coupled with extreme global pressures on costs, results in a challenging short-term position. This is further compounded by the significant investment pressures over the 2025-30 period, with expenditure expected to be more than double that previously seen. This creates significant pressure on gearing.

However, this is resolved through the complete restriction of dividends within our base plan. This is acceptable in the short term as we have a long-term shareholder who considers their stewardship in perpetuity and are committed to maintaining the long-term viability of this business. However, this does:

- Reduce the availability of management levers in solving potential future shocks
- The slow down of equity cashflow requires an increase in the underlying WACC (discussed in WSX31)

In many of these scenarios we see further pressure on key credit rating metrics (gearing and interest covers) that may threaten the company's investment grade credit rating, and cause breaches to the financial covenants on our debt facilities. This is of particular note where there is sustained low inflation and significant totex overspends, and on interest covers with sudden reductions in revenue and significant fines.

However, multiple control measures are in place to mitigate or prevent impacts. These include:

1. Insurance against significant one-off shocks such as flooding.

This will help the company recover some of the totex incurred in specific shocks where they are driven by insurable external risks.

2. The suite of regulatory reconciliation mechanisms in place to allocate risk between the company and customers.

These mechanisms will help mitigate the impact of reduced demand on revenues through the RFI and help mitigate the impact of additional expenditure through the totex reconciliation models.

3. Reducing expenditure with limited short or medium-term benefits.

This alongside restriction of bonuses and executive pay can help offset other increases in totex. However, given the scale and uncertainty of the upcoming capital programme we will not have the ability to completely offset increases in costs, and these levers will have lower impact than in previous assessments.

It is imperative to note that if this restriction on expenditure is required over the longer term this will place more stress on the business and reduce its long-term resilience.

4. Equity injections.

To ensure long term viability, the overall package of risk and return needs to be set so that the sector is an attractive proposition to investors. To do this, the WACC needs to be set at an appropriate level. We outline what this is in WSX31.

In almost all cases the first three mitigations outlined were sufficient to restrict the breaches to short-term failures relating to specific shocks, where further action would have limited immediate impact. In these cases, the impact would not affect the underlying viability of the Company as credit rating agencies focus more on the overall trends and sustained failures.

There are also further protections in the regulatory model, which in many of these scenarios, would allow turnover to be adjusted upwards in the event of a substantial adverse effect on the financial position of the Company, where this effect would not have been avoided by prudent management action. It also allows for turnover to be adjusted where a new legal obligation imposed on the Company as a water and sewerage undertaker has led to a material increase in the costs incurred. We have included capacity within our plan to protect against the most uncertain of these.

However, in cases where these protections may not trigger, we would rely on raising equity to maintain long term viability. We have got a shareholder who is focused on the long term, who has been involved in the company for 20 years. They remain committed to the company and understand the potential requirement for equity in severe downside cases. Coupled with recent successful equity issuances and sales across the industry, this gives us sufficient confidence that in these cases the required equity could be raised, if the PR24 determination continues to provide a fair bet for investors.

2.2. Detail with RR17

We present the prescribed scenarios from the final methodology alongside two of our bespoke scenarios that provide a severe downside shock.

We have assumed the following limits to ensure we can maintain an investment grade credit rating, and meet our debt covenants:

- Gearing of 75% consistent with our debt covenants
- AICR of 1.1x over a short period consistent with our view of what is required to maintain investment grade
- FFO / debt – we do not use S&P, and so place less weight on this however, we have assumed a floor of 6%.

2.2.1. Totex underperformance

A 10% totex overspend over 2025-30, as specified in the final methodology.

As set out this scenario stresses our gearing. With the threshold of 75% gearing, we could achieve this by limiting the totex overspend to 5.5%.

Over time, this is partially resolved through totex sharing, where we would expect to recover 50% of these costs, or we would expect systematic risks to trigger a reopening of prices. However, in the short term, with the restrictions on dividends within our plan it poses issues.

As outlined in Section 2.1 if totex costs were increasing, management can restrict spend. There are elements within both opex and capex which, although important in the long run, can be deferred. These include but are not limited to:

- Reducing executive pay and bonuses
- Reducing community engagement
- Reducing proactive maintenance accepting a higher risk appetite for performance

None of these would be sustainable in the long term, but can present a short-term solution until the regulatory mechanisms take effect.

Failing these we would rely on equity issuance, which we would consider a viable mitigation.

2.2.2. ODI underperformance

A 3% of RoRE ODI penalty applied in 2026-27, as specified in the final methodology.

This shock does not pose a risk to financial resilience as specified. However, its severity varies over time. In some years, due to the reprofiling of revenue to achieve an acceptable bill profile, it presents a more serious strain.

In year 2, it could potentially double (to 6% of RoRE) however in both years 1 and 5 as it stands, a 3% penalty would pose a challenge to financial resilience.

2.2.3. Low inflation

Inflation is sustained over the period at 2% under the central assumptions, as specified in the final methodology.

We have assumed that this subdues RCV growth, but also costs and revenues. In this case, it still presents a challenge on gearing. If this were reduced to 1.5% under the assumption, then it would reduce gearing to c75% by the end of the period.

We think that a prolonged low inflation scenario is unlikely, the bank of England will take action to return inflation to its long-term target.

However, as set out in 2.2.1 there are mitigations that are available.

2.2.4. Deflation

Two years of 1% deflation per annum, as specified in the final methodology. We have applied this in years 1 and 2.

As with lower inflation, this puts a pressure on gearing. However, it is less severe than the sustained low inflation scenario and recovers over the period without intervention.

2.2.5. High inflation and RPI/CPIH wedge

10% inflation for a year followed by two years of 5%, with an increased wedge between RPI and CPIH, as specified in the final methodology.

As with other inflation shocks, we have assumed this impacts RCV, costs and revenues.

The main impact here is the significant increase in index linked debt accruals. This has a significant short term impact on profitability, however it has limited impact on ratios, outside of the alternative calculation of FFO, on which we place less weight.

It has a reducing impact on gearing, as we are assuming new index linked debt is raised linked to CPIH.

2.2.6. Increased bad debts

A 20% increase in bad debt costs across the period, as specified in the final methodology.

This shock has a modest increase in opex, and as such doesn't present a financial resilience challenge at an appointee level. It has a much larger impact on retail, which should be considered in the round of the determination in retail prices though.

Overall if more extreme, i.e. bad debt costs triple, it would put a strain on interest cover ratios. However, this would present an extreme case which we consider highly unlikely.

2.2.7. Increased cost of debt

New debt, and re-financed debt raised at 2% more than the central assumption, as specified in the final methodology.

This shock reduces our interest cover ratios with a challenging level in 2029-30. Over the long term this is of concern, although doesn't pose an initial concern over 2025-30, unless it increases to over 2.1% more expensive. This will be corrected through the indexation of the cost of debt, and through revisiting prices at the next determination.

2.2.8. Financial penalty

A 6% of appointee turnover shock, applied in year 2, as specified in the final methodology.

This shock works very similarly and is of similar scale to the ODI penalty shock outlined in 2.2.2.

2.2.9. Severe macroeconomic shock

We have included one of the more testing scenarios from our LTVS modelling where we model:

- sustained low inflation,
- upward pressures on input prices for both opex and capex,
- subdued consumption,
- credit rating downgrade, and
- increased costs of finance

We view this as an extreme scenario, where multiple macroeconomic shocks work against us.

This scenario puts pressure on both gearing and interest covers. As discussed above there are mitigations, however without reopening prices this scenario would require an equity injection to resolve.

As outlined in RR17, it would require <£500m to fully resolve by the end of the period (before any management mitigations), <10% of the RCV. As discussed above, we view the likelihood of raising this scale of equity as credible.

2.2.10. Combined operational and macroeconomic shock

We have included one of the more testing scenarios from our LTVS modelling where we model:

- sustained low inflation,
- upward pressures on input prices for both opex and capex,
- a credit rating downgrade,
- increase in costs due to asset failures, and
- associated fines and penalties.

We view this as an extreme scenario, where multiple macroeconomic shocks work against us, and we experience challenging operational circumstances.

This scenario puts pressure on both gearing and interest covers. As discussed above there are mitigations, however without reopening prices this scenario would require an equity injection to resolve.

As outlined in RR17, it would require <£350m to fully resolve by the end of the period (before any management mitigations), <5% of the RCV. As discussed above, we view the likelihood of raising this scale of equity as credible.

2.3. Impact of using the notional company as specified

The lower WACC, and increase in expenditure used in our “pure” notional company assessment, means that there is significantly less headroom, despite the lower gearing.

Under these assumptions, we do not think we would be financially resilient, due to the increased severity of shocks and the reduction in likelihood that equity would be attracted.

2.4. Analysis over the longer term

We have undertaken this assessment up to 2035, consistent with the inputs in the RR tables. The key assumptions we have made are:

- We have a proposed investment programme of £6bn totex, consistent with our LTDS and proposed level of maintenance.
- There is no material change to the mix of assets, so RCV run off rates / capital allowances remain consistent.
- There is no change to cost of equity or debt, but more weight is placed on the current, higher, cost of debt.

We have made no assumptions around reprofiling revenue beyond 2030, however if a sustained higher level of investment is required, we will ensure that an affordable and acceptable bill profile is used at PR29.

Below we set out the gearing and interest covers for the 3 most stretching scenarios (totex overspend, and the two combined scenarios), before any mitigations, and post mitigations, which include a notional c£0.5bn equity injection, and the continued restriction of dividends to fund the ongoing large capital investment.

Figure 9: Moodys AICR – Pre Mitigations

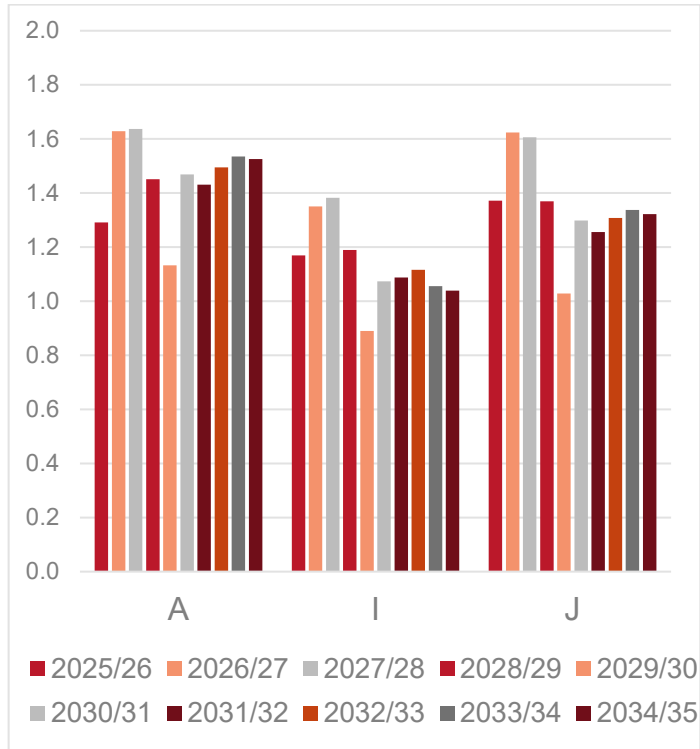


Figure 10: Moodys AICR – Post Mitigations

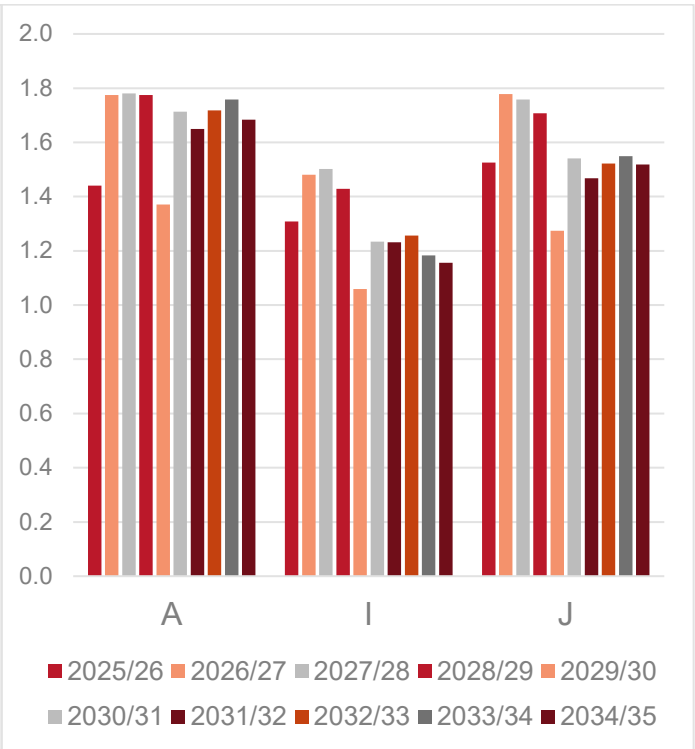


Figure 11: Gearing – Pre Mitigation

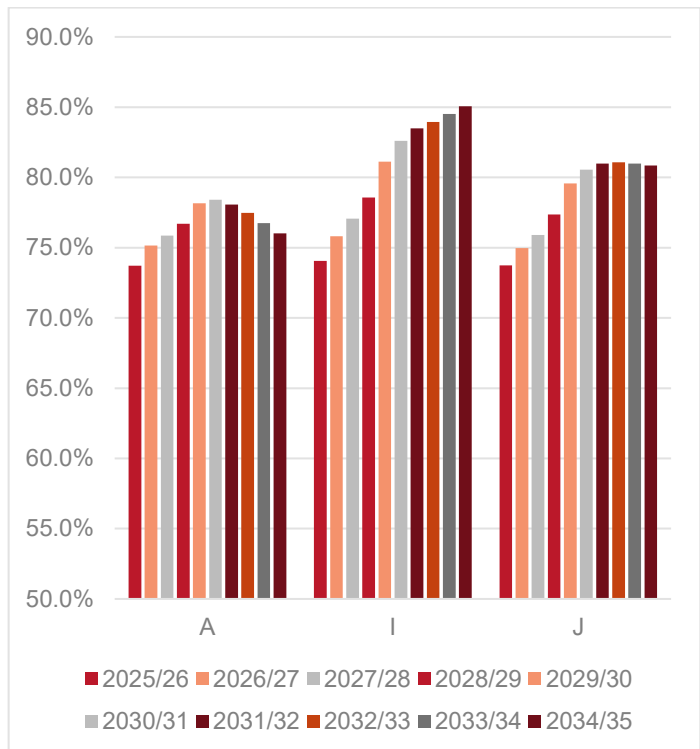
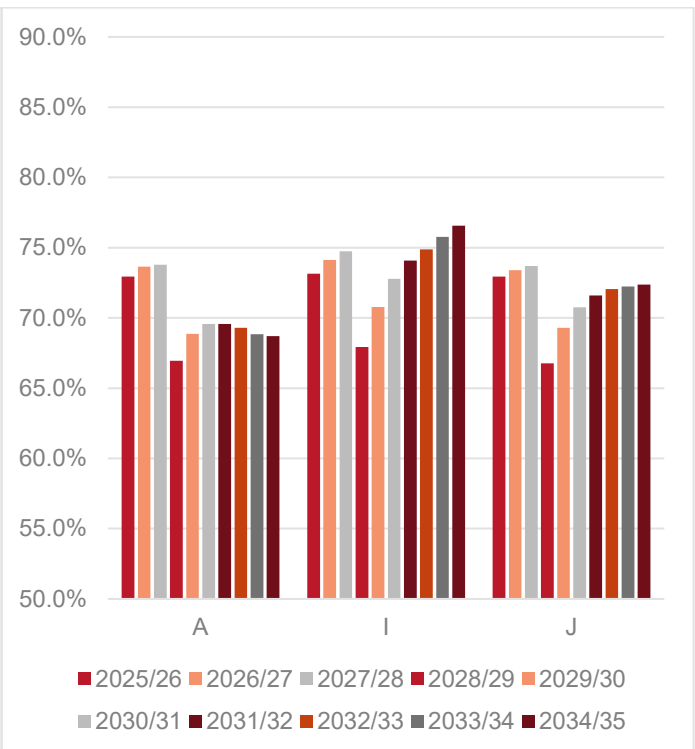


Figure 12: Gearing – Post Mitigation



We can conclude, that as long as the balance of risk and return is set at an acceptable level to attract equity investment, and our efficient costs are funded, then we are financially resilient over the long term. If changes are made to our submitted plan, this analysis will need to be undertaken again, reflecting any potential challenges to cost and varying level of risk and return.