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Paper 3 – Overview of Irish Water's Financial Forecasts

Submission to CSO by

Department of the Environment, Community and Local Government

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1. Overview

Irish Water has prepared draft financial forecasts for the period 2014 to 2021 (the "**Forecast Period**") as part of its business planning process. The forecasts below have not yet been approved by the Ervia Board and are draft until such approval is received. It should be noted that a five year plan is required to be submitted to the relevant Minister by all commercial State bodies on an annual basis under the Code of practice for the Governance of State Bodies. The Forecast Period comprises a number of distinct time periods:

- 2014 – based on expected outturn for the financial year;
- 2015 & 2016 – based on the CER's Interim Price Control ("**IPC1**") determination of allowed revenue, as adjusted by the provisions of the Water Services Act 2014 and modifications to certain assumptions as better data has become available;
- 2017 & 2018 – based on the expected domestic revenue as per the provisions of the Water Services Act 2014 and Irish Water's estimation of other components of revenue and costs, noting that such elements of revenue and cost are subject to future review and determination by the CER and Government budgetary decisions.
- 2019, 2020 & 2021 – extrapolation by Irish of 2017 & 2018 forecasts, noting that there is a higher degree of uncertainty relating to the forecasts for these years as, in addition to being subject to CER review/determination and Government budgetary decisions the provisions re domestic charges set out in the Water Services Bill 2014 only apply to charges up to 2018..

All financial information is forecast (nominal) and is based on IFRS accounting standards.

2. Income Statement

€m	**2014e**	**2015f**	**2016f**	**2017f**	**2018f**	**2019f**	**2020f**	**2021f**
Revenue	687	899	993	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Opex	(768)	(789)	(775)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Provision for delayed collection	(27)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total Costs	(795)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
EBITDA	(108)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Depreciation	(21)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
EBIT	**(129)**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Interest	1	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Profit Before Tax	(128)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Taxation	-	-	-	-	-	-	-	-
Profit After Tax	**(128)**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Dividends	0	0	0	0	0	0	0	0

Source: Irish Water

Set out below is further commentary and analysis of key components of the income statement.

Revenue

€m	2014e	2015f	2016f	2017f	2018f	2019f	2020f	2021f
Domestic Tariff	-	271	274	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Non Dom Tariff	180	185	190	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Connections	68	44	50	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Subvention	439	399	479	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total	**687**	**899**	**993**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

- Revenue increases from €899m in 2015 to €993 in 2016 as part of IPC1 and then is forecast to increase slowly thereafter, to €[redacted] in 2021. The slow expected growth post 2016 reflects the fact that Opex is falling as a result of increased operational efficiencies, offset by higher depreciation, interest and return on equity as a result of high Capex (as a reminder, allowed regulated revenue is set as the total of opex + depreciation + interest + return on equity).

Opex

Operating Costs are projected to decrease by [redacted]% from €768m in 2014 to €[redacted]m in 2021. There are two factors driving this change:

[redacted] Efficiencies in underlying Opex are projected to grow from €13m in 2014 to €[redacted]m in 2021, totalling €1.1bn over the period, representing a [redacted]% year on year reduction [redacted]

- Partly offset by Growth Opex which is projected to increase from €14m in 2014 to €[redacted]m in 2021 (growth opex relates to increased spending resulting from the €4.5bn capital programme, addressing non-compliance with EU regulations, historic supressed capital maintenance and general cost increases in line with inflation, i.e. additional assets require additional costs).

Revenue Collection

Government intends to bring forward legislation in 2015 to enhance the collectability of domestic water charges, building on the approach set out in earlier legislation. Under the Water Services Act 2014, late payment fees of €30 (single adult household) and €60 (multi adult household) apply for each year that charges remain unpaid.

The proportion of billed domestic revenue collected within the year billed has been forecast by Irish Water to increase from [redacted]% in 2015 (late payment penalties only accrue after 12 months) to [redacted]% in 2021. [redacted]

[redacted]

[redacted]

For non-domestic customers, the proportion of billed revenue collected when due is assumed to increase from 85% in 2014 to [redacted]% in 2021. Of the revenue not collected when due, [redacted]% is assumed to be recovered in the following year.

In the Irish Water business plan, a general provision is made each year for the total amount of domestic and non-domestic revenue not collected when due. This appears as an expense in the income statement. The recovery of uncollected revenue in subsequent years is reflected in a reduction in the provision.

Depreciation

- Depreciation increases as Irish Water's capex sees its opening gross asset base increase from €146m in 2014 to [redacted] in 2021. Irish Water's asset base will typically approximate its regulated Asset Base (**"RAB"**), with minor adjustments relating to different capitalisation policies between IFRS and regulatory principles. However, in the period 2019-2021 approximately €1bn in capex relating to two Major Projects has been modelled by Irish Water as not entering the RAB until the assets are commissioned post 2021 (which is consistent with the treatment by the CER of the East West electricity interconnector built by EirGrid).
- Depreciation is based on average useful lives of 35 years on the opening assets and c 40 years on Capex additions post 2017. The CER has adopted a slightly different set of asset lives for the purposes of calculating allowed revenue.

Interest

- Interest charges increase year on year as Irish Water raises more debt to fund its capex programme.
- Interest rates are as per individual existing facilities and [redacted] (nominal) for all future loan facilities.

Taxation

- In the forecast period, tax depreciation/capital allowances are greater than accounting depreciation (shorter assumed asset life). This means that Irish Water is unlikely to incur any cash corporation tax in the period. Deferred tax has not been modelled.

Dividends

- While Irish Water will have sufficient distributable reserves in the Forecast Period to pay dividends to Government (noting that under the current share structure dividends only flow to the Ministerial shareholders and not Ervia), Irish Water has not modelled any dividend payments. The Ministerial shareholders are expected to set out for the Board of Ervia in 2015 Government's financial and policy expectation for Ervia/Irish Water including dividend policy. Any dividends paid during the Forecast Period would result in a corresponding increase in equity required. [redacted]

3. Balance Sheet/Statement of Financial Position

€m	2014e	2015f	2016f	2017f	2018f	2019f	2020f	2021f
Tangible Assets	744	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Cash	37	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Current Assets	20	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total Assets	**801**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Long & Short Term Debt	355	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Current Liabilities	313	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total Liabilities	**668**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Shareholders' funds	**133**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: Irish Water

[redacted] Total core capital expenditure over the eight year period is projected to be circa €4.5bn. A further €1 billion will arise on two major national projects. [redacted]

- It is assumed that Irish Water needs to secure a total of c. [redacted] in (a) commercial debt and (b) working capital loans (from Government) by 2021.
- Shareholders' funds grow to [redacted] by 2021.

Key financial metrics

Two key metrics are used by external stakeholders (in particular banks and credit rating agencies) when reviewing Irish Water's Balance sheet – Net Debt/RAB and Cash Flow.

Net Debt/RAB is used by rating agencies as a proxy for the leverage level of the long-term average enterprise value of a regulated business. A lower ratio implies a less indebted, and/or more cash generative capital structure. Rating agencies seek a metric range of 55%-70% for a utility such as Irish Water to achieve investment grade metrics. Irish Water's forecasts target Irish Water being within that range by [redacted]

	2015e	2016f	2017f	2018f	2019f	2020f	2021f
Net Debt/RAB	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Gearing	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

4. Cash Flow Statement

€m	2014e	2015f	2016f	2017f	2018f	2019f	2020f	2021f
Cash Flow from Ops	1	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Financing Costs	(12)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Purchase of LA WC		[redacted]						
Capital Expenditure	(591)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Loan Drawdown/Repay'	195	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Equity/Capital Cont'n	407	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Net Cash Flow	-	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Opening Cash	37	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Closing Cash	**37**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Note: WC –working capital

Source: Irish Water

- The table below sets out the calculation of Cash flow from Operations.

€m	2014e	2015f	2016f	2017f	2018f	2019f	2020f	2021f
EBITDA	(108)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Working capital movement	109	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Cash Flow from Ops	1	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

- Cash flow from Operations increases significantly over the period as the RAB grows which (a) generates a regulated return thereon, and (b) generates free cash flow as allowable depreciation (non-cash) increases.
- Financing costs increase as debt increases over the period. €5.5bn of Capex is spent in cash terms (from 2014). €[redacted] of external debt is drawn down to fund this Capex.
- Government support includes [redacted] of capital contributions/equity and [redacted] in working capital loans.
- Purchase of Local Authority working capital represents Irish Water buying the net Local Authority financial assets and liabilities balance sheet.
- Cash balance of €50m maintained over the Forecast Period.