Financial Resilience

Assessment Framework Summary

Based on Financial Resilience Statement v1.0 published 14 March 2023

14 March 2023

Scottish Water
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Contents

This slide pack summarises the scoring methodology for Financial Resilience as formally defined in the Financial Resilience Statement published on Scottish Water's website

Scoring approach (v3.0 – 31 October 2022)

- For following 5 metrics, score of 1-5 awarded (1 bad/5 good) based on parameters:
  - RCF/Net Debt
  - Credit Period Given (a.k.a. Debtor Days)
  - Available Liquidity
  - Interest Cover
  - Payment history (primary charges only and minimum 12 month trading history before points accrued)
- If insufficient information available (e.g. no full audited accounts available), 0 points awarded
- Overall score based on sum of individual metric scores – gives total out of possible 25
- 3 months prepayment applies if market share (by value) >30%
- Risk category assigned based on overall score:
  - 1-5: E 3 Months prepayment
  - 6-10: D 3 Months prepayment
  - 11-15: C 2 Months prepayment
  - 16-20: B 2 Months prepayment
  - 21-25: A 1.5 Months prepayment
- **If LP is not participating in Market Health Check, total score reverts to 0**
- **If accounts are overdue, total score reverts to 0**
- **If any cross guarantees or contingent liabilities exist, raw score discounted by 25%**

Scoring and Prepayment Period (v3.0 – 31 October 22)

1. Score of 0-5 awarded against each of the 4 financial ratios and based on payment history

Score	RCF/Net Debt	Credit Period Given	Available Liquidity	Interest Cover	No. of late primary payments in last 12 months
5	> 40%	< 30 days	> 50 days	> 5	0
4	25-40%	30 - 60 days	40 - 50 days	3.5 - 5	1
3	15-25%	60 - 80 days	30 - 40 days	2 - 3.5	2
2	7.5-15%	80 - 100 days	20 - 30 days	1 - 2	3
1	< 7.5%	> 100 days	< 20 days	< 1	4-5
0	No data available				>5
Notes	If net debt negative, score 5 (as more cash than debt)	If no turnover data available score zero	If no turnover data available score zero	If no EBIT data available score zero	Score of 0 until 12 months trading history established

2. Total score adjusted based on market share, participation in MHC and contingent guarantees

3. Risk category based on adjusted score

Overall Risk Category	Total Score across all 5 measures and after Market Share adjustment
A	21-25
B	16-20
C	11-15
D	6-10
E	0-5

4. Prepayment based on Risk Category

Prepayment/Credit Security Period	Financial Resilience Risk Category
1.5 Months	A
2 Months	B
	C
3 Months	D
	E

Process for review of Financial Resilience Scoring

Triggers for a review of scoring

- Scoring may change in response to:
  - New financial accounts
  - Change in late payment scoring
  - Change in market share above/below 30% - propose triggered by either:
    - a movement in market share (by value) of 2% or more in one month (e.g. 29% > 31%)
    - 3 consecutive months' R1s above/below 30%
  - Participation in Market Health Check – process for identifying LP signing up to/dropping out of MHC to be defined

Review process

- Scoring reviewed monthly based on latest available data on 20th (or next business day) of month X (e.g. April)
- Any resulting change in scoring notified to LP by 5th business day of the following month X+1 (e.g. May)
- New payment terms take effect in month after notification – month X+2 (e.g. June)
- Change in payment terms would result in:
  - One month with double prepayment (if increasing prepayment)
  - One month with no P1 invoice (if decreasing prepayment)

Next Steps and Key Milestones

- Last date for publication of audited accounts to inform May 23 go-live scoring – 20th March 23
- WICS Directions to LPs for WSA changes – Apr 23
- Central Systems changes MCCP284 – Mar 23 Release (subject to TP approval)
- Notice of financial resilience score and prepayment level for May 23 go-live issued to each LP – 10 April 23
- New prepayment periods take effect – May 23
  - LPs moving to 3 months prepayment – double provisional payment in May 23
  - LPs on 2 months prepayment – no change to usual payment schedule in May 23
  - LPs moving to 1.5 months prepayment – delayed provisional payment in May 23

Annex – worked examples

Review of Financial Resilience Scoring – worked examples

1. Increase in scoring due to improved financial ratios
   - 8 June – new financial accounts published
   - 20 June – monthly review of Financial Resilience scoring commences
   - 7 July – LP notified of improved Financial Resilience score, resulting in move from 3 months to 2 months prepayment
   - Change takes effect in August so:
     - October P1 invoiced and paid as usual in July (3 months ahead)
     - No P1 invoice in August (as LP transitions from 3 months to 2 months prepayment)
     - November P1 invoiced and paid in September (2 months ahead)

2. Decrease in scoring due to late payment
   - 15 February – P1 invoice paid late
   - 20 February – monthly review of Financial Resilience scoring commences
   - 7 March – LP notified of reduced Financial Resilience score, resulting in move from 2 months to 3 months prepayment
   - Change takes effect in April so:
     - May P1 invoiced and paid as usual in March (2 months ahead)
     - June P1 and July P1 both invoiced and paid in April (as LP transitions from 2 months to 3 months prepayment)

NB: Examples above relate to scenarios where the change in financial resilience score is sufficient to result in a change of risk category and prepayment period (e.g. increase in score from 9 to 11). Not all changes in financial resilience score will result in a change in prepayment period.

Review of Financial Resilience Scoring – worked examples

3. Decrease in scoring due to change in market share
   - Aug R1 published in Sep – market share (by value) of 29%
   - Sep R1 published in Oct – market share (by value) of 30.5% (no change in scoring as less than 2% swing)
   - Oct R1 published in Nov – market share (by value) of 31%
   - Nov R1 published in Dec – market share (by value) of 31% (triggers change in scoring as 3 consecutive months above 30%)
   - 20 Dec – monthly review of Financial Resilience scoring commences
   - 9 Jan (business day 5) – LP notified of reduced Financial Resilience score, resulting in move from 2 months to 3 months prepayment
   - Change takes effect in February so:
     - March P1 invoiced and paid as usual in January (2 months ahead)
     - April P1 and May P1 both invoiced and paid in February (as LP transitions from 2 months to 3 months prepayment)

4. Increase in scoring due to change of payment history score
   - 20 January – monthly review of Financial Resilience scoring commences – 5 late payments in previous 12 months
   - 20 February – monthly review of Financial Resilience scoring commences – 3 late payments in previous 12 months
   - 7 March – LP notified of improved Financial Resilience score, resulting in move from 3 months to 2 months prepayment
   - Change takes effect in April so:
     - June P1 invoiced and paid as usual in March (3 months ahead)
     - No P1 invoice in April (as LP transitions from 3 months to 2 months prepayment)
     - July P1 invoiced and paid in May (2 months ahead)

NB: Examples above relate to scenarios where the change in financial resilience score is sufficient to result in a change of risk category and prepayment period (e.g. increase in score from 9 to 11). Not all changes in financial resilience score will result in a change in prepayment period.