MOODY'S INVESTORS SERVICE

CREDIT OPINION
14 February 2019

Update

Rate this Research

RATINGS

**Southern Gas Networks plc**

| | |
|---|---|
| Domicile | United Kingdom |
| Long Term Rating | Baa1 |
| Type | LT Issuer Rating - Dom Curr |
| Outlook | Negative |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*


Analyst Contacts

Graham W Taylor +44.20.7772.5206
*VP-Sr Credit Officer*
graham.taylor@moodys.com

Matthew Brown +44.20.7772.1043
*Associate Analyst*
matthew.brown@moodys.com

Neil Griffiths-Lambeth +44.20.7772.5543
*Associate Managing Director*
neil.griffiths-lambeth@moodys.com


CLIENT SERVICES

| | |
|---|---|
| Americas | 1-212-553-1653 |
| Asia Pacific | 852-3551-3077 |
| Japan | 81-3-5408-4100 |
| EMEA | 44-20-7772-5454 |

# Southern Gas Networks plc

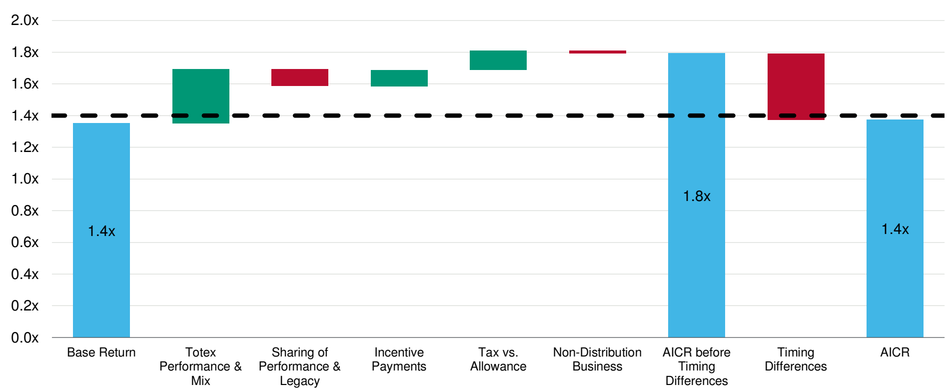
## Update following negative outlook

## Summary


The credit quality of Southern Gas Networks plc (Southern GN, Baa1 negative) is supported by the company's natural monopoly position as the licensed provider of gas distribution services in the South of England, the low business risk of those activities, the well-established and transparent regulatory regime in Great Britain, which underpins stable and predictable cash flow, and strong performance in relation to regulatory outputs in the first five years of RIIO-GD1 through March 2018. However, the company's credit quality is constrained by (1) its policy of maintaining relatively high financial leverage, as measured by its net debt/regulated asset value (RAV) of 70%-75%; and (2) the scope for additional leverage at Southern GN's parent company, SGN MidCo Limited (SGN MidCo), which under its financing structure can increase consolidated leverage to 85% of RAV, excluding our adjustments.

Southern GN's adjusted interest coverage ratio (AICR) of 1.4x in 2017-18 has been negatively impacted by temporary timing differences, primarily because of increased property taxes (known as business rates). While the regulatory framework allows networks to fully recover the higher business rates, the mechanism operates under a two-year lag that creates significant annual volatility in the AICR. We therefore estimate the AICR to be 1.2x in FY19, before recovering to 1.5x in FY20.


Exhibit 1
**The impact of totex outperformance on AICR was offset by temporary timing differences**
**Moody's-adjusted AICR for financial year ending March 2018**




*Source: Moody's Investors Service*

The negative outlook reflects the risk that the AICR will fall below our guidance for the current rating level in the RIIO-GD2 period that starts in April 2021, given the reduction in returns and opportunities for outperformance signalled by the regulator.

## Credit strengths

» Well-established and transparent regulatory framework, underpinning stable and predictable cash flow, with three years of visibility

» Strong delivery on required outputs

» Significant outperformance of cost allowances in the first five years of the 2013-21 regulatory period, which is expected to continue

## Credit challenges

» High leverage at the consolidated SGN MidCo group level

» Downward pressure on interest coverage from anticipated reductions in allowed returns from FY22, only partially offset by the move to CPIH indexation

## Rating outlook

The negative outlook reflects the risk that, absent offsetting measures or operational outperformance, the AICR will fall below our guidance for the current rating of at least 1.4x at Southern GN and 1.2x at the consolidated SGN MidCo group, in the RIIO-GD2 regulatory period that starts in April 2021.

## Factors that could lead to an upgrade

» Given the negative outlook, we currently see little potential for upward pressure

» The outlook could be stabilised if further regulatory decisions make it likely that expected returns, including reasonably probable operational outperformance, will support interest coverage metrics consistent with the assigned rating

» The outlook could also be stabilised if the SGN group took measures to strengthen its balance sheet and/or materially reduce financing costs

## Factors that could lead to a downgrade

» Announcements by Ofgem that would further increase the likelihood that the company will receive a regulatory settlement that will not support AICRs of at least 1.4x at Southern GN and 1.2x at SGN MidCo

» Reduction in allowed returns is not offset by management action

» Poor operating performance

» Net debt/RAV above 75% for Southern GN or over 85% for the consolidated SGN MidCo group

## Key indicators

Exhibit 2
**Southern Gas Networks plc**

| | Mar-14 | Mar-15 | Mar-16 | Mar-17 | Mar-18 | 2019-proj. | 2020-proj. | 2021-proj. |
|---|---|---|---|---|---|---|---|---|
| Adjusted Interest Coverage Ratio | 1.9x | 2.8x | 1.4x | 1.9x | 1.4x | 1.2x | 1.5x | 1.3x |
| Net Debt / RAV | 71.7% | 80.4% | 72.1% | 72.4% | 73.4% | 73.9% | 74.7% | 74.8% |
| FFO / Net Debt | 14.7% | 17.3% | 11.3% | 12.1% | 10.1% | 9.3% | 9.9% | 9.7% |
| RCF / Net Debt | 14.7% | 17.3% | 11.3% | 6.9% | 5.9% | 4.7% | 5.5% | 5.3% |

All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Projections (proj.) are our opinion and do not represent the views of the issuer.
*Source: Moody's Financial Metrics™*

Following the implementation of the MidCo structure, SGN's established policy is to pool cash between the regulated entities within the MidCo group. Prior to the restructuring, excess funds from the operating companies were instead lent to the parent. Southern GN's net debt/RAV temporarily increased in 2015 as the company issued bonds to partially pre-fund maturities in 2016, while the intercompany loan receivables were *not* netted against debt, resulting in a higher leverage calculation than it would have been if excess cash was held at the operating companies.

## Profile

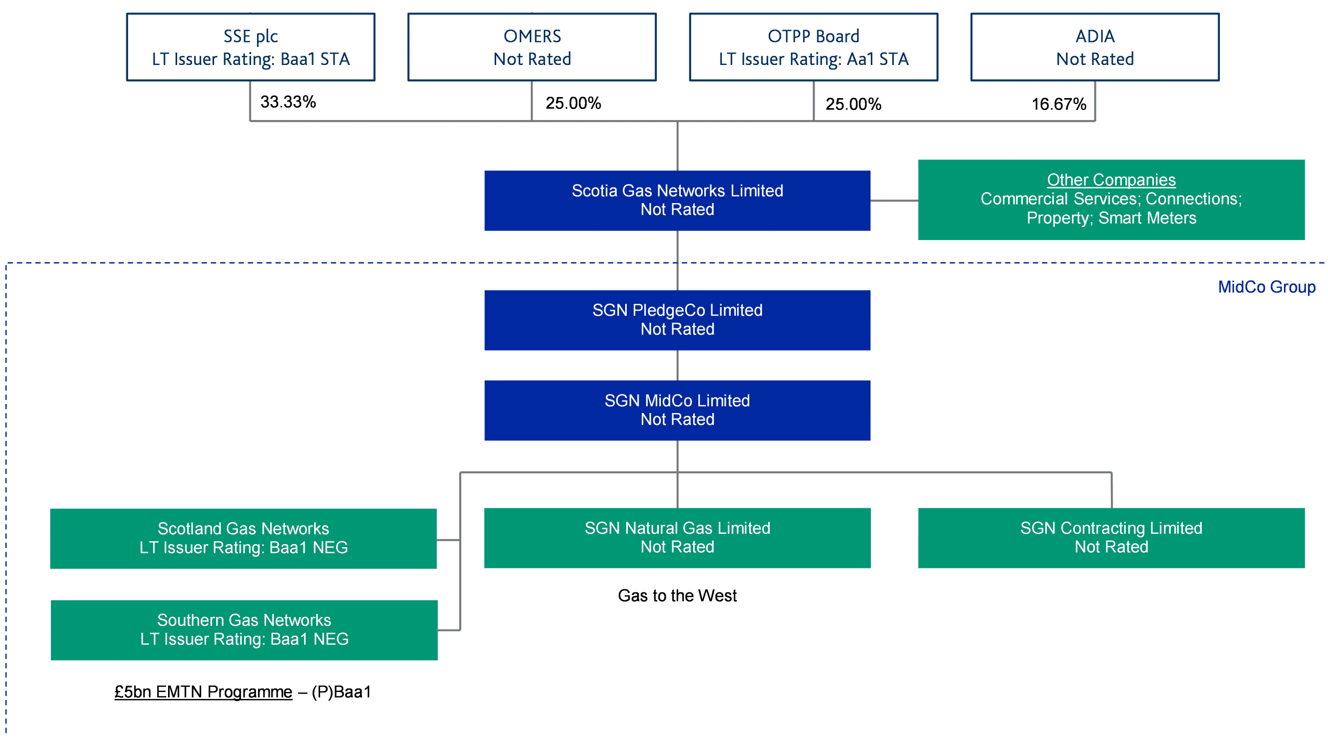
Southern GN is the largest of the eight gas distribution networks (GDNs) in England, Wales and Scotland by Regulated Asset Value. It provides gas distribution services to around 4.0 million customers through about 49,000 kilometres of gas pipelines in the South of England, including the cities of Milton Keynes and Dover, and London boroughs south of the River Thames.

Southern GN is a wholly owned subsidiary of Scotia Gas Networks Limited (SGN HoldCo) via the intermediate holding companies SGN MidCo Limited (SGN MidCo) and SGN PledgeCo Limited. SGN HoldCo is, in turn, owned by a consortium including SSE plc (Baa1/P-2 stable), OMERS, Ontario Teachers' Pension Plan Board (Aa1 stable) and the Abu Dhabi Investment Authority.

SGN also owns another gas distribution network in Great Britain, Scotland Gas Networks plc (Scotland GN, Baa1 negative). The two networks are operationally managed as one entity, although for regulatory reasons they remain legally separate and independent of each other and their respective performances are judged on a standalone basis. In August 2014, it was announced that an alliance of SGN and Mutual Energy had been appointed as the preferred bidder for the Gas to the West project, which has now started to connect around 40,000 new customers to the gas grid in the west of Northern Ireland. SGN's share in the project is being carried out through a separate legal entity, SGN Natural Gas Limited.

As of 31 March 2018, Southern GN had a RAV of £3.8 billion. In the regulatory year to that date — the fifth year of the RIIO-GD1 regulatory period — the company earned revenue of £746 million and operating profit of just over £316 million.

Exhibit 3
**Simplified organisational structure**




*Source: Moody's Investors Service*

## Detailed credit considerations

### Well-established and transparent regulatory framework underpins stable and predictable cash flow; good visibility until March 2021

The GDNs in Great Britain benefit from a very transparent, stable and predictable regulatory regime based on clearly defined risk and reward principles. It is overseen by an experienced regulator, the Office of Gas and Electricity Markets (Ofgem), with a long track record of consistent decision making. Ofgem has consulted widely with a variety of stakeholders whenever changes to the regulatory framework have been made in the past. Southern GN has significant visibility in relation to future cash flow under the current price control for gas distribution (RIIO-GD1), which began on 1 April 2013 and runs until 31 March 2021.

Exhibit 4
**Southern GN service area**

*Source: Energy Networks Association*

Exhibit 5
**Price control overview**

| | GB Gas Distribution |
|---|---|
| Regulator/ Price Control | Ofgem / RIIO-GD1 |
| Regulated Business | Southern Gas Networks |
| Term of price control | 2013-21 |
| Allowed return on RAV (vanilla real) | 3.59% (2018-19), 3.37% (2019-20) |
| Company's forecast eight-year Return on Regulatory Equity | 12% vs 6.7% assumed cost of equity |
| Regulated Asset Value (March 2018) | £3.8 billion |

*Source: Ofgem*

The RIIO regulatory framework included provisions for a mid-period review in 2017 that was intended to deal with clear changes in government policy or consumers' and network users' needs. On the basis of the stated, limited purpose of the mid-period review, Ofgem determined that no review was needed for gas distribution.

However, following the decision, several GDNs made what were described as "voluntary contributions to reduce customer bills. The companies explained their decisions in terms of allowances that were no longer required or reopeners that they would not claim despite being entitled to do so. SGN, across both of its networks, returned a package of £145 million to customers, including returning £50 million of repex allowances, not claiming additional allowance through a reopener, and additional unfunded resilience and fuel poor work during RIIO-GD1.

We believe the payments evidence the difficult environment in which the sector now operates, with affordability of utility bills high on the political agenda. The impact of the lost revenue will be relatively modest for the companies that chose to make contributions. However, if political pressure leads to further interventions, it could, over time, weaken our assessment of the transparency, stability and predictability of the regime.

### Strong results since the beginning of the regulatory period imply significant potential for outperformance and incentives

Ofgem assesses companies against a number of output measures that are intended to reflect the minimum that customers require of a GDN, including in relation to customer service, shrinkage/leakage volume, fuel poverty and other social outputs, asset health and reliability (including interruptions to supply). Southern GN has exceeded the required standards for all the outputs during the first five years of RIIO-GD1. Currently, Southern GN forecasts that its eight-year target for fuel poor connections is at risk but is investing additional resources to address this.

In RIIO-GD1, the financial incentives attached to these outputs are small. In 2017-18, Scotland GN and Southern GN together earned £19.4 million in incentives revenue, to be collected in 2019-20. The main scope for outperformance is in cost efficiency. Southern GN achieved totex savings of £62 million (13.8%) during the fifth year of RIIO-GD1, compared with the industry average of 17.1%. Of the £62 million savings, around £22 million will ultimately be shared with customers. Over the first five years of RIIO-GD1, Southern GN's expenditure has been 17.8% lower than the adjusted allowance, with most savings achieved on opex.

Exhibit 6

**Southern GN has spent less than allowances in all categories of expenditure**

**Five-year cumulative over-/underspend against allowances by GDN**


*Sources: Ofgem, company reports*

Ofgem notes that milder-than-expected winters and slower economic recovery may have reduced investment requirements across the industry, and that lower-than-expected inflation in relevant input costs (real price effects) may also have contributed to lower costs.

### The RIIO totex framework

For RIIO-GD1, like other RIIO price controls in gas and electricity, allowed expenditure is determined and performance is assessed on a totex basis, which combines all controllable capital and operational costs. The share of any outperformance or underperformance, which is retained by the company, is determined using the Information Quality Incentive mechanism. This is intended to reward companies that apply levels of allowed expenditure that align with the regulator's view of efficient costs.

For Southern GN, the incentive rate (that is, the percentage of any efficient under- or overspending on totex that the company retains or is exposed to) is 64% for RIIO-GD1. Southern GN's incentive rate is one of the highest among the eight GDNs, reflecting a business plan that included forecast costs close to that of Ofgem's own assessment.

While part of the underspend in these years may be a result of a different phasing of spending than assumed by Ofgem, we expect Southern GN to outperform materially on totex over the period as a whole, given the structural nature of the changes implemented since the beginning of RIIO and the SGN group's frontier performance on cost efficiency in the previous regulatory period (GDPCR1). Southern GN expects to underspend the eight-year totex allowance by 14% in total.

## Sustained low real interest rates will reduce future allowed returns over remainder of RIIO-GD1 period

### Cost of debt indexation under RIIO-1

With the introduction of RIIO, Ofgem introduced an indexed cost of debt allowance, which changes annually through the regulatory period. The index is based on specific iBoxx indices and the breakeven yield on UK government bonds. For transmission and gas distribution companies, the allowance is currently based on a 10-year average of the index.

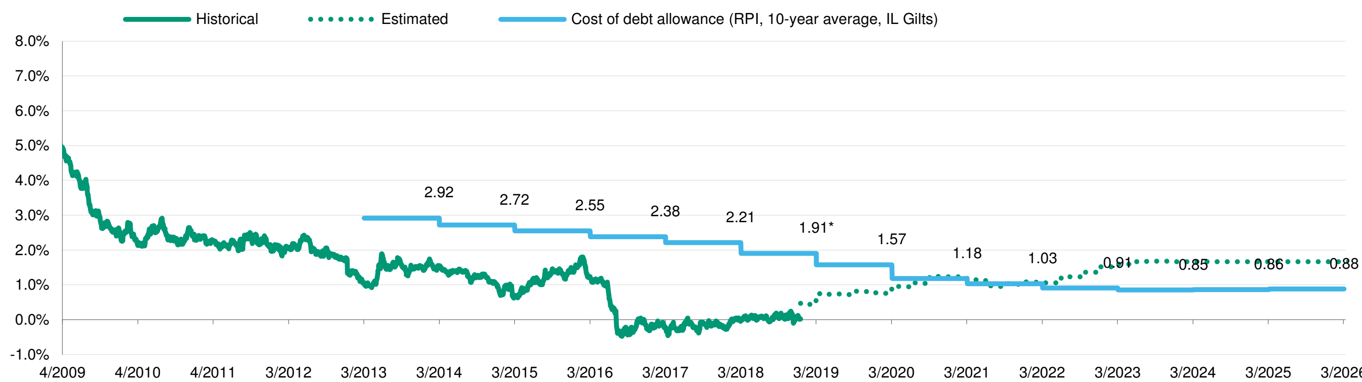
Because of the low real interest rate environment since the global financial crisis, the calculated value of the allowed return on debt has fallen to 1.91% in 2018-19 from 2.92% (pretax, real) at the start of the RIIO-GD1 and RIIO-T1 controls. Our central case is that market interest rates will rise over time, and under this scenario, the allowed cost of debt would still fall to around 1.18% in 2020-21.

Declining allowed returns will impact returns for the whole GB regulated energy sector. However, with a weighted average maturity of eight years for its fixed and index-linked debt, in line with the regulator's index, Southern GN's cost of debt should decline broadly in line with the regulatory allowance, over time.

Exhibit 7

**Ofgem's cost of debt index will reduce allowed returns over the remainder of RIIO-GD1**

**Cost of debt index and allowed cost of debt for GDNs, RPI basis**




Note: For comparability, the allowed cost of debt is shown in RPI-stripped terms for all years. Ofgem has signalled that the allowance will be set in CPIH terms from April 2021, which will increase the allowance by around 1 percentage point.
The cost of debt allowance was set at 2.03% for 2018-19 because of the temporary unavailability of a data series (see Regulated Transmission and Gas Distribution Networks – GB: Statistical change will boost revenues in 2018-19, 31 October 2017). Following the publication of the series, the cost of debt was updated to 1.91% in November 2018.
*Source: Moody's Investors Service*

Southern GN has 16% of its debt indexed to RPI, which reduces its cash interest costs and results in stronger cash interest coverage metrics than if the company was funded entirely with nominal debt.

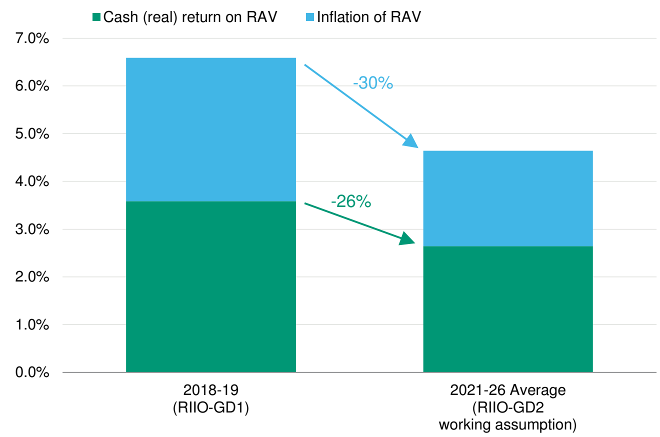
Our base case is that Ofgem will continue to use the current index for gas distribution companies in RIIO-GD2, although translated into CPIH terms, although changes are possible.

## Regulatory consultation suggests significantly lower returns from April 2021

Ofgem's methodology consultation proposes, as a "working assumption", that companies should be allowed to earn a cash return of 2.64%, in addition to inflation of their Regulatory Asset Value (RAV) based on the Consumer Prices Index including owner occupiers' housing costs (CPIH). This compares to a cash return of 3.59% before Retail Prices Index (RPI) inflation in the current period. Because RPI is structurally higher than CPIH by around 1 percentage point, this represents a reduction in total (nominal) returns of around 30%, to around 4.6% from around 6.6%.

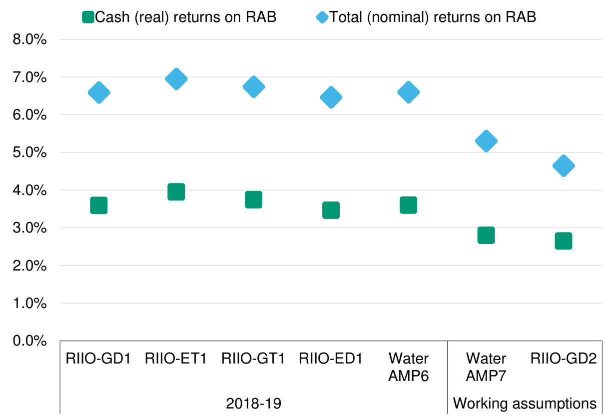
The allowed return is at the bottom end of the range that Ofgem signalled in July 2017 and is also well below the total return (including indexation of the regulatory asset base) proposed for UK water companies in their price review process currently underway.

Exhibit 8
**Ofgem's methodology suggests a 26% cut in cash return and 30% cut in total allowed return**
**RIIO-GD2 average vs 2018-19**




*Source: Ofgem*

Exhibit 9
**Ofgem's working assumption on returns is lower than proposed for water**
**Current and proposed allowed returns on Regulatory Asset Base (RAB)**




*Source: Ofgem, Ofwat*

Although the cut in allowed returns largely reflects the persistent low yield environment and companies will continue to benefit from low rates as they refinance, we expect interest cover metrics to decline during the RIIO-GD2 period (See Regulated Gas Networks – Great Britain: Credit quality likely to weaken in RIIO-GD2 regulatory period, 14 February 2019).

During the first five years of RIIO-1, Southern GN has been outperforming regulatory allowances and has benefited from operational incentives, which has supported its AICR. However, the RIIO-2 Framework decision[1] published in July 2018 and sector-specific consultations [2]published in December 2018 set out Ofgem's approach, which should make systemic outperformance less likely.

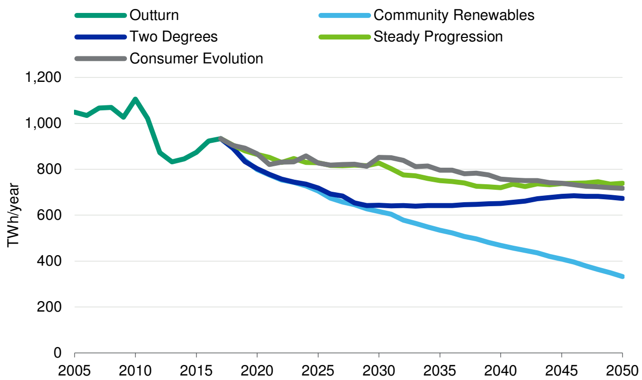
We estimate that Southern GN and SGN MidCo would both have an average AICR of around 1.1x over the RIIO-GD2 period if they perform operationally in line with the regulator's determination.

We expect Ofgem to give more information on remaining uncertainties in its May 2019 methodology decision. Companies are required to formally submit business plans in December 2019 and draft determinations are due in Q2 2020.

## Long-term decline in gas demand

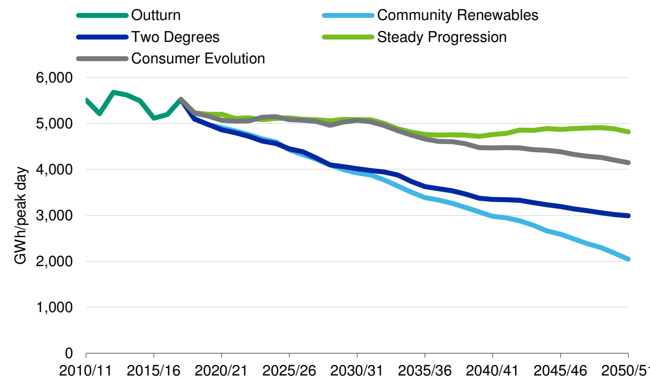
Although SGN continues to make significant investments in its network to maintain reliability and safety, underlying average gas demand is falling sharply. Gas consumption in Great Britain fell 11% between 2005 and 2017 to 933 terawatt hours equivalent from 1,048 terawatt hours equivalent. National Grid's latest Future Energy Scenarios exercise considers future pathways, under which demand falls further by 8%-17% by 2021 and 8%-34% by 2030, driven largely by lower demand from residential heating. National Grid's estimate of 1-in-20 years peak demand has been more stable in recent years but is also assumed to fall 8%-28% by 2030.

Exhibit 10
**Gas demand is expected to decline further in all scenarios...**
**National Grid Future Energy Scenarios 2018**




Shown in calendar years.
*Source: National Grid*

Exhibit 11
**...and peak demand will also fall**
**National Grid Future Energy Scenarios 2018**




Represents 1-in-20 peak demand; shown in gas years ending September.
*Source: National Grid*

The UK's 2050 climate targets mandate an 80% reduction in carbon emissions from the 1990 levels. The UK's Committee on Climate Change has stated that achieving this target will require the near-complete decarbonisation of heat. However, the committee's recent research shows that a hybrid approach utilising both electric and gas solutions may be the most cost-effective way to achieve this objective.

In the short term, SGN has limited volume exposure, as any revenue shortfalls because of faster-than-expected declines in demand can be recovered from customers with a two-year lag. In the longer term, Ofgem has a statutory obligation to ensure that gas transportation companies are able to finance the provision of gas supply services. However, a continued decline in demand for SGN's core service may create challenges for the business, which are currently difficult to foresee.

## Structural considerations

Our assessment of Southern GN factors in the weaker credit quality of the SGN MidCo group it belongs to. Although SGN MidCo's financing structure includes trigger events, which will restrict dividends and other payments, if consolidated gearing exceeds 85%, the group is likely to have very significant headroom in its interest coverage financial covenant. As a result, although the financing structure limits gearing to levels commensurate with a mid-Baa credit quality for the consolidated SGN MidCo group, it would be possible for cost allowances to decline significantly compared with the company's operating and financing costs, including to levels not consistent with the assigned ratings, without triggering this covenant. Despite this risk, we currently regard the credit quality of the SGN MidCo group to be in the mid-Baa range.

Although this would normally act as a cap on Southern GN's credit quality, the operating company benefits from regulatory ring-fencing provisions, which partly insulates it from the credit quality of SGN MidCo at the current rating level (described in Appendix C [Considerations for ratings within a corporate family] of the Regulated Electric and Gas Networks rating methodology). As a result, the credit quality of Southern GN is able to pierce that of the SGN MidCo group by one notch.

We consider that the covenant package in the SGN MidCo financing structure insulates the operating companies from shareholder loans at the ultimate holding company, SGN HoldCo. As a result, the debt at SGN HoldCo does not constrain the credit quality of the operating companies.

## Liquidity analysis

We view Southern GN's liquidity as excellent, reflecting the stable and predictable cash flow generated by its regulated gas distribution business that allows it to fund the bulk of its capex and repex requirements, cash and cash equivalents of £346 million as of 30 September 2018 (including some cash pooled from Scotland GN), and access to a £240 million revolving credit facility maturing in March 2023. As of 30 September 2018, the facility was fully undrawn.

Following the maturity of a £300 million bond in November 2018, the next significant maturity is £215 million in December 2020.

## Rating methodology and scorecard factors

Our assessment of Southern GN's credit quality is based on the rating methodology for Regulated Electric and Gas Networks, published in March 2017. The grid-implied rating based on three years of historical financial metrics is A3, and is Baa1 in our forward view. The assigned Baa1 rating is constrained by the weaker credit quality of the consolidated SGN MidCo group.

Exhibit 12

**Rating factors**

**Southern Gas Networks plc**

| Regulated Electric and Gas Networks Industry Grid [1][2] | Current FY 31/03/2018 | | Moody's 12-18 Month Forward View As of January 2019 [3] | |
|---|---|---|---|---|
| **Factor 1 : Regulatory Environment and Asset Ownership Model (40%)** | **Measure** | **Score** | **Measure** | **Score** |
| a) Stability and Predictability of Regulatory Regime | Aaa | Aaa | Aaa | Aaa |
| b) Asset Ownership Model | Aa | Aa | Aa | Aa |
| c) Cost and Investment Recovery (Ability and Timeliness) | A | A | A | A |
| d) Revenue Risk | Aa | Aa | Aa | Aa |
| **Factor 2 : Scale and Complexity of Capital Program (10%)** | | | | |
| a) Scale and Complexity of Capital Program | A | A | A | A |
| **Factor 3 : Financial Policy (10%)** | | | | |
| a) Financial Policy | Ba | Ba | Ba | Ba |
| **Factor 4 : Leverage and Coverage (40%)** | | | | |
| a) Adjusted Interest Coverage Ratio (3 Year Avg) | 1.6x | Baa | 1.2x - 1.6x | Baa |
| b) Net Debt / RAB (3 Year Avg) | 72.7% | Baa | 70% - 75% | Baa |
| c) FFO / Net Debt (3 Year Avg) | 11.1% | Baa | 8% - 11% | Ba |
| d) RCF / Net Debt (3 Year Avg) | 8.0% | Baa | 4% - 6% | Ba |
| **Rating:** | | | | |
| Indicated Rating from Grid Factors 1-4 | | A3 | | Baa1 |
| **Rating Lift** | **0.5** | **0.5** | **0.5** | **0.5** |
| a) Indicated Rating from Grid | | A3 | | Baa1 |
| b) Actual Rating Assigned | | | | Baa1 |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 31/03/2018.
[3] This represents Moody's forward view, not the view of the issuer, and unless noted in the text, does not incorporate significant acquisitions and divestitures.
*Source: Moody's Financial Metrics™*

## Ratings

Exhibit 13

| Category | Moody's Rating |
|---|---|
| **SOUTHERN GAS NETWORKS PLC** | |
| Outlook | Negative |
| Issuer Rating -Dom Curr | Baa1 |
| Senior Unsecured -Dom Curr | Baa1 |

*Source: Moody's Investors Service*

## Appendix

Exhibit 14

### Southern Gas Networks plc

Peer Comparison Table

| in GBP millions | Southern Gas Networks PLC Baa1 NEG | | | Electricity North West Limited Baa1 NEG | | | Wales & West Utilities Limited Senior Secured - Baa2 NEG | | |
|---|---|---|---|---|---|---|---|---|---|
| | FYE Mar-16 | FYE Mar-17 | FYE Mar-18 | FYE Mar-16 | FYE Mar-17 | FYE Mar-18 | FYE Mar-16 | FYE Mar-17 | FYE Mar-18 |
| Revenue | 737 | 758 | 746 | 451 | 486 | 430 | 530 | 434 | 425 |
| EBITDA | 461 | 475 | 441 | 315 | 363 | 291 | 347 | 101 | 311 |
| Regulated Asset Base | 3,490 | 3,622 | 3,802 | 1,671 | 1,756 | 1,785 | 2,076 | 2,120 | 2,163 |
| Total Debt | 2,518 | 2,630 | 3,066 | 1,171 | 1,208 | 1,184 | 1,614 | 1,574 | 1,567 |
| Cash & Cash Equiv. | 3 | 7 | 277 | 143 | 153 | 87 | 138 | 71 | 37 |
| EBITDA Margin % | 62.6% | 62.7% | 59.1% | 69.9% | 74.8% | 67.6% | 65.4% | 23.3% | 73.2% |
| Adjusted Interest Coverage Ratio | 1.4x | 1.9x | 1.4x | 1.9x | 2.0x | 1.0x | 1.6x | 1.4x | 0.8x |
| Net Debt / RAB | 72.1% | 72.4% | 73.4% | 61.5% | 60.1% | 61.5% | 71.1% | 70.9% | 70.8% |
| FFO / Net Debt | 11.3% | 12.1% | 10.1% | 19.7% | 23.2% | 15.9% | 15.3% | 11.3% | 7.8% |
| RCF / Net Debt | 11.3% | 6.9% | 5.9% | 16.8% | 15.5% | 9.0% | 11.8% | 7.9% | 4.4% |

*Source: Moody's Financial Metrics™*

Exhibit 15

### Southern Gas Networks plc

Moody's-adjusted net debt breakdown

| in GBP millions | FYE Mar-14 | FYE Mar-15 | FYE Mar-16 | FYE Mar-17 | FYE Mar-18 |
|---|---|---|---|---|---|
| **As Reported Net Debt** | **2,438.3** | **2,745.0** | **2,511.8** | **2,612.3** | **3,043.0** |
| Pensions | 42.1 | 35.7 | 0.0 | 0.0 | 0.0 |
| Operating Leases | 0.8 | 7.0 | 4.0 | 10.6 | 12.6 |
| Non-Standard Adjustments | -6.3 | -7.1 | 0.0 | 0.0 | -266.4 |
| **Moody's Adjusted Net Debt** | **2,474.9** | **2,780.6** | **2,515.8** | **2,622.9** | **2,789.1** |

Non-standard adjustments reflect the netting of short term deposits. All figures are calculated using Moody's estimates and standard adjustments.
*Source: Moody's Financial Metrics™*

Exhibit 16

### Southern Gas Networks plc

Moody's-adjusted funds from operations breakdown

| in GBP millions | FYE Mar-14 | FYE Mar-15 | FYE Mar-16 | FYE Mar-17 | FYE Mar-18 |
|---|---|---|---|---|---|
| **As Reported FFO** | **234.0** | **453.4** | **426.7** | **422.0** | **380.7** |
| Pensions | 8.7 | 9.0 | 6.9 | 9.6 | 7.2 |
| Operating Leases | 0.2 | 0.5 | 0.3 | 0.9 | 1.7 |
| Align FFO | -28.3 | -33.1 | -31.9 | -8.9 | -5.9 |
| Non-Standard Adjustments | 150.1 | 51.7 | -118.8 | -106.4 | -101.5 |
| **Moody's Adjusted FFO** | **364.7** | **481.5** | **283.2** | **317.2** | **282.3** |

All figures are calculated using Moody's estimates and standard adjustments.
*Source: Moody's Financial Metrics™*

Exhibit 17

**Southern Gas Networks plc**

**Selected historical Moody's-adjusted financial data**

| in GBP millions | FYE Mar-14 | FYE Mar-15 | FYE Mar-16 | FYE Mar-17 | FYE Mar-18 |
|---|---|---|---|---|---|
| INCOME STATEMENT | | | | | |
| Revenue | 766 | 739 | 737 | 758 | 746 |
| EBITDA | 498 | 472 | 461 | 475 | 441 |
| EBITDA Margin % | 65.1% | 63.9% | 62.6% | 62.7% | 59.1% |
| EBIT | 265 | 373 | 354 | 362 | 326 |
| EBIT Margin % | 34.6% | 50.4% | 48.0% | 47.8% | 43.7% |
| Interest Expense | 119 | 125 | 110 | 100 | 102 |
| BALANCE SHEET | | | | | |
| Cash & Cash Equivalents | 1 | 5 | 3 | 7 | 277 |
| Total Assets | 3,266 | 5,152 | 5,170 | 5,316 | 4,967 |
| Total Liabilities | 2,972 | 3,854 | 3,548 | 3,621 | 4,070 |
| CASH FLOW | | | | | |
| Funds From Operations (FFO) | 365 | 481 | 283 | 317 | 282 |
| FFO / Net Debt | 15.2% | 17.4% | 11.3% | 12.1% | 10.1% |
| Capital Expenditures | 205 | 391 | 215 | 244 | 268 |
| Dividends | 0 | 0 | 0 | 135 | 117 |
| Retained Cash Flow (RCF) | 377 | 483 | 283 | 182 | 165 |
| RCF / Net Debt | 15.2% | 17.4% | 11.3% | 6.9% | 5.9% |
| Free Cash Flow (FCF) | 130 | 129 | 91 | -99 | 794 |
| FCF / Net Debt | 5.3% | 4.6% | 3.6% | -3.8% | 28.4% |
| INTEREST COVERAGE | | | | | |
| EBITDA/Interest Expense (exc. Indexation) | 4.2x | 3.8x | 4.2x | 4.8x | 4.3x |
| Adjusted Interest Coverage Ratio | 1.9x | 2.8x | 1.4x | 1.9x | 1.4x |
| LEVERAGE | | | | | |
| Debt / EBITDA | 5.0x | 4.4x | 4.1x | 4.0x | 4.8x |
| Net Debt / EBITDA | 5.0x | 4.4x | 4.1x | 4.0x | 4.3x |
| Debt / Book Capitalization | 89.4% | 68.2% | 60.8% | 60.8% | 77.3% |
| Regulated Asset Base | 3,450 | 3,461 | 3,490 | 3,622 | 3,802 |
| Net Debt / Regulated Asset Base | 71.7% | 80.4% | 72.1% | 72.4% | 73.4% |

All figures are calculated using Moody's estimates and standard adjustments.
*Source: Moody's Financial Metrics™*

## Endnotes

1 RIIO-2 Framework Decision, Ofgem.

2 RIIO-2 Sector Specific Methodology Consultation

REPORT NUMBER 1158070