

WESTERN POWER DISTRIBUTION PLC GROUP

Management Narrative Analysis of Results

For the year to 31 March 2016

Western Power Distribution plc ("WPD") heads the WPD Group whose principal activity is the distribution of electricity in the South West, East and West Midlands areas of England and in South Wales. This activity is conducted by its subsidiaries Western Power Distribution (South West) plc ("WPD South West"), Western Power Distribution (East Midlands) plc ("WPD East Midlands"), Western Power Distribution (West Midlands) plc ("WPD West Midlands") and Western Power Distribution (South Wales) plc ("WPD South Wales").

	2016	2015	Variance	Variance
	£m	£m	£m	Favourable/ (adverse) %
Revenue	1,480.6	1,620.1	(139.5)	(8.6)
Operating costs	(598.1)	(576.9)	(21.2)	(3.7)
Other operating income	2.9	2.2	0.7	31.8
Other operating expense	(2.3)	(0.7)	(1.6)	(228.6)
Impairment of intangible assets	-	(72.0)	72.0	100.0
Operating profit	883.1	972.7	(89.6)	(9.2)
Finance income	8.6	7.8	0.8	10.3
Finance costs	(266.9)	(259.9)	(7.0)	(2.7)
Net finance expense relating to pensions and other post-retirement benefits	(20.3)	(24.3)	4.0	16.5
Profit before income tax	604.5	696.3	(91.8)	(13.2)
Tax expense	(47.6)	(144.4)	96.8	67.0
Profit for the year	556.9	551.9	5.0	0.9

Revenue

Revenue for 2016 was £1,480.6m compared to £1,620.1m for the previous year, a decrease of £139.5m (8.6%). This was principally due to an average tariff decrease of 12.2% in WPD South West, 20.8% in WPD South Wales, 4.1% in WPD West Midlands and 2.6% in WPD East Midlands, effective 1 April 2015. This tariff decrease was from the commencement of the new eight year price control period, known as RII0-ED1.

Operating costs

Operating costs were broadly in line with the previous year increasing by £21.2m (3.7%) from £576.9m in 2015 to £598.1m in 2016.

Other operating expense

Other operating expenses were £2.3m for 2016 compared to £0.7m for the previous year. The movement has arisen due to a higher decrease in the fair value of investment properties.

Impairment of intangible assets

In 2015, the WPD Group recognised an impairment loss in respect of goodwill of £72.0m allocated to the WPD West Midlands cash generating unit. No impairment has been recognised in the current year.

The impairment in the previous year largely arose as a result of changes to the short-term inflation assumption which had reduced both the operating cash flows and the terminal value used in the discounted cash flow model, and the growth in the carrying amount of the cash generating unit in the year exceeded the underlying growth in its recoverable amount. These factors were partly offset by higher than previously anticipated levels of capital expenditure in the year which had increased both the future operating cash flows and terminal value used in the discounted cash flow model, and a reduction to the discount rate.

Finance costs

Finance costs for 2016 were £266.9m compared to £259.9m for the previous year. The increase of £7.0m (2.7%) mainly arises due to the movement in the foreign exchange variance on US\$ denominated financial assets and liabilities of (£61.0m) offset by the movement in the transfers from the hedging reserve in relation to cash flow hedges of £63.9m.

Tax expense

Tax expense decreased by £96.8m (67.0%) from £144.4m in 2015 to £47.6m in 2016. This was mainly due to lower profit before tax and a reduction in the corporation tax rate in 2016 compared with 2015, a reduction in future corporation tax rates enacted in the Finance Act 2015 and an impairment loss in 2015 that is not deductible for tax.