Project Leap II

DRAFT
Phase 1: Cash Management

Reliance Restricted

21 February 2020 | Version 1.0 (Draft)

EY
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Project Leap II

21 February 2020

Dear Sirs

In accordance with our Framework Agreement dated 20 August 2019 and scoping letter dated 13 February 2020, we have undertaken a initial review of the affairs of Bristol Energy Limited ('the Company').

Purpose of our report and restrictions on its use

This draft report was prepared on your specific instructions solely to assist you in connection with assessing the financial position and future prospects of the Company and should not be relied upon for any other purpose. Because others may use it for different purposes, this draft report should not be quoted, referred to or shown to any other party (other than your professional advisers acting in that capacity in connection with assessing the financial position and future prospects of the Company provided that they accept that we assume no responsibility or liability whatsoever to them in respect of the contents) unless so required by court order or a regulatory authority, without our prior consent in writing. Ernst & Young LLP assumes no responsibility whatsoever in respect of or arising out of or in connection with the contents of this report to parties other than the Company and Bristol City Council. If other parties choose to rely in any other way on the contents of this report they do so entirely at their own risk.

Scope of our work

This review has encompassed the matters set out in Phase 1 of our scoping letter.

Limitation on the scope of our work

Our work in connection with this assignment is of a different nature to that of an audit. Our report to you is based on enquiries of and discussions with Management, a review of accounts and other documents made available to us and analytical procedures applied to data provided to us. We have not, except to such extent as you requested and we agreed to undertake, sought to verify independently the accuracy of the data or the information and explanations provided by Management. As highlighted in our engagement letter, we have commented on the underlying assumptions to the financial forecasts, however, the responsibility for these forecasts and the assumptions upon which they are based rests solely with the directors of the Company.

Prospective Financial Information (PFI)

We have made factual findings and recommendations about specific assumptions and components of the PFI herein, where we had sufficient evidence to provide a reasonable basis for them. Except as otherwise noted, we have not analysed or commented on macroeconomic or geopolitical conditions that could impact the PFI. We have not provided any opinion, conclusion or any type of assurance about specific assumptions or components of the PFI.

There will usually be differences between estimated and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We take no responsibility for the achievement of projected results.

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Basis of our work

The financial information contained in this report has been based on Management's 13 week cash flow forecast for the period ended 15 May 2020 and medium term forecast to week commencing 24 August 2020.

During the course of our work, we have also relied upon the following sources of information:

- Various supporting information and schedules provided by Management in response to EY requests for information; and
- Meetings and discussions with various of the Company's personnel.

Due to time constraints, the contents of the report and our key findings have not been reviewed with Management and therefore the factual accuracy of our report has not been confirmed at this time.

Structure of this report

The report is divided into two sections: our conclusions and commentary on the Company's short term cash flow forecast and then associated appendices. We stress that, whilst we have identified key issues in the body of the report based on your instructions, there may nevertheless be other issues raised in the appendices and therefore the entire report should be read for a full understanding of our findings and advice.

Each page is headed by a headline which is intended to be an introduction to the page and should be read in conjunction with the page as a whole. The headline should not be regarded as a conclusion, opinion or recommendation.

Yours sincerely

[redacted]

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STCFF Findings

1 STCFF Findings
Introduction

Phase 1 – Cash Management

As an extension to the work that EY colleagues are performing in respect to Project Leap, we have been asked to undertake a more detailed analysis of the Company's short-term cash flow forecast (‘STCFF’) for the period ending 15 May 2020 and medium-term cash flow forecast to August 2020. We were also requested to review the cash flow forecast to March 2021.

From the inception of our work, it was apparent that the cash position of the Company was critically stretched and therefore the initial focus of our work was on the STCFF, to identify any key risks and sensitivities whilst understanding the robustness of the STCFF itself.

Whilst we have been able to review at a high level the medium-term cash flow forecast to August 2020 and the implication of the ROC payment (due to be paid in August), we have given particular focus to the immediate concerns arising from the shortfall in cash that the Company will experience in March and April.

Therefore, this interim report highlights our key findings on the robustness of the Company’s STCFF and sets out potential options to mitigate the extent of any additional funding required in the forecast period.

Phase 2 – Strategic Options Review

In phase 2, we will gain a deeper understanding of the Company’s business and operations as well as the market environment in which the Company operates.

We will perform further work exploring the opportunities available to the Company in respect to the options detailed in this paper (at page 8).

We will seek to critically analyse and set out the comparative advantages and disadvantages of Managements options in resect to the Company as well as suggesting any interim measures that may help the Company more broadly which will focus on the possibility of an accelerated sale of all or part of the business and explore the possibility of “White Labelling”.

In addition to this we will also perform some high-level tax analysis on the forecast period.

Interim conclusions

- **The business is not sustainable in its current form without substantial immediate and indefinite ongoing investment.**
- **Even with that investment, the sustainability of all small retailers in the energy supply market is currently under considerable pressure.**
- **BE faces the additional challenge of a business infrastructure (in terms of IT systems, organisational design and potential for scaling) that lags behind its competitors.**

1 STCFF Findings
Overview

Short term cash flow forecast (STCFF)

Introduction to the STCFF

- The chart above illustrates Management's weekly STCFF through to mid May 2020 for the Original case, the Sensitised case and the cash position if no further funding contributions beyond those made to 20 February 2020 (totalling £34.9m). The medium term forecast to August 2020 is shown at Appendix B.
- The chart shows that without further funding from BCC, the Company will be unable to meet supplier commitments and pay staff wages in March 2020. **Technically, without confirmation of ongoing support, the Company is insolvent through an inability to pay its debt as they fall due.**

1 The troughs in cash position represent significant supplier payments that create timing issues from a cash management perspective.

2 The peaks in cash tend to fall early in the month when the bulk of direct debit payments from customers are received.

Funding position analysis	Core Funding	Innovation Funding	Cumulative Funding
	£m	*£m*	*£m*
Total amount of funding available	37.7	2.0	39.7
Drawdown of funds to 20 February 2020	(34.9)	(1.3)	(36.2)
Balance of funding remaining	**2.8**	**0.7**	**3.5**
Short term funding requirements			
Funding request in March 2020	(1.5)	-	(1.5)
Funding request in April 2020 (Original)	(2.0)	-	(2.0)
Total funding request in STCFF	**(3.5)**	**-**	**(3.5)**
Amount of agreed funding remaining	**(0.7)**	**0.7**	**-**

1 STCFF Findings

The Original STCFF requires funding in excess of the current funding cap of £37.7m

Original forecast - principal assumptions

- **Income projections** seem realistic with forecast reductions in customer numbers, but with an increase in ageing debt recovery through a debt adequacy programme.
- **Supplier payments** are significant and unpredictable, with aggressive payment terms. Failure to meet such terms would have immediate implications for the Company in terms of ongoing supply and may cause reputational damage.
  No provision has been made for ongoing rent payments to BCC.
- **Funding requests** – as shown in the table on the previous page, the forecast assumes further funding from BCC of £3.5m.
- Crucially, **this level of additional funding would breach the current cap of £37.7m by £700k** (if funds were taken solely from the core fund rather than the innovation fund).
- This results in a minimum cash position of £882k in w/c 11 May 2020, with the position fluctuating but generally rising until August 2020 when the ROC payment falls due.
- Management's medium term forecast to August 2020, included at Appendix B, includes funding from BCC of £4.5m primarily to meet the ROC payment (estimated to be c.£8.4m). This will take BCC funding well above the cap of £37.7m.
- A number of adjustments to the forecast were highlighted and discussed with Management, resulting in the Sensitised forecast, details of which are shown opposite.

Sensitised forecast - adjustments

- **Income projections** in the sensitised forecast apply a 50% reduction in assumed level of aged debt recovery.
- **Supplier payments** – given the nature of the sector, no sensitivity has been applied in respect of the energy providers.
  Due to the nature of the relationship between the Company and BCC, the sensitised forecast removes payment of rent arrears and interest due on the PCG (this approach would need to be agreed with BCC).
- **Funding requests** – Management's original request for £2m in April results in a more than adequate cash surplus, therefore the sensitised position has reduced this request to £1.2m.
- At this reduced level, the additional funding could be provided within the current core funding cap of £37.7m, leaving headroom for the future of £100k.
- As a consequence of the above sensitivities, the forecast cash requirement reaches a minimum position of £294k in w/c 20 April 2020 and then rises steadily until the ROC payment falls due in August 2020.
- At the lowest points in the forecast, the Company is left with a minimal cash cushion to protect against unforeseen costs and expenses – this needs to be closely monitored. This revised forecast also ignores BCC's requirement for the Company to maintain minimum cash levels of £1m.
- **No further material, short term mitigating actions have been identified that could improve the cash position of the Company and reduce the funding request.**
- Medium term options (with further details shown at Appendix C) could include,
  - arranging more favourable payment plans with suppliers (with BCC backed collateral) and HMRC
  - More rigorous debt collection arrangements
  - staff restructuring

1 STCFF Findings
Options

1 STCFF Findings
2 Appendices

	1. Do nothing – no further funding is provided to the Company	2. Short term funding – minimum of £2.7m of funding (£1.5m in March and £1.2m in April)	3. Longer term approach – unquantified funding requirement

Implication and observations	▸ Company has no viable future and an insolvency becomes inevitable
	▸ Ofgem is given notice, and a SOLR process is commenced, with result being that customers are transferred to an alternative supplier
	▸ The Company's energy license is revoked by Ofgem
	▸ Administrator appointed to the Company to commence a winding up of the business and assets
	▸ Risk of reputational issues and public scrutiny for BCC as a consequence of business failure and redundancies
	▸ The Company can no longer be part of the City Leap opportunity
	▸ Directors and shadow directors of the Company should be taking legal advice regarding the associated risks of continuing to trade a business in this position
		▸ This short term support allows for the exploration of two key options:
		  ▸ Accelerated sale of all or part of the Company's business and assets or a share sale
		  ▸ Agreement with alternative energy license holder to provide an agreed level of support and back-office function under the brand of "Bristol Energy", known as White Labelling
		▸ A significant number of other councils are providing energy supply businesses through White Labelling as it does not require a separate legal entity, and consequently the ongoing costs are not publicly known
		▸ Further high level exploration of these options will be provided in Phase 2 of our report.
		▸ This option would not negate the need to undertake any immediate restructuring opportunities to mitigate the short term funding requirement
		▸ This option would enable business continuity from a customer perspective
		▸ The impact of this option on the City Leap procurement process needs to be considered
			▸ The Company would require ongoing BCC support, including:
			  ▸ Unquantified cap on future funding requirements; and
			  ▸ Uncertainty on outcome and timeframe
			▸ Other similar businesses of this size and scale are either struggling or have ceased to trade
			▸ Management's current projections show a reduction in customer numbers of 42% between now and March 2021, illustrating the enormity of the challenge that would be required to make BE viable and future fit
			▸ Early indications are that the quality of management information is currently inadequate to support restructuring decisions of this nature
			▸ Furthermore, the senior management team do not appear to be accountable or measured against the performance of the business

Potential costs to BCC	▸ No immediate costs, but BCC debts unlikely to be recovered, including:
	  ▸ Investment costs (up to £36.2m)
	  ▸ Any intercompany balances, i.e. rent accrued, interest payable
	▸ Guarantees to suppliers from BCC called upon, a maximum current exposure c.£16m.
	▸ Contractual termination costs where BCC is contractor
		▸ Minimum £2.7m further funding to July 2020
		▸ Ongoing legal and professional fees to support the restructuring actions described above
		▸ Possible redundancy costs and possible breach of contract costs for certain suppliers
		▸ Risk of further calls for collateral and/or security from key suppliers
			▸ £2.7m upfront in March and April 2020
			▸ c.£4.5m funding in August 2020 to meet ROC payment obligations
			▸ Further funding in the future is inevitable and needs further investigation, however a very broad estimate based on current cost assumptions would suggest that a figure in excess of £10m per annum might be required

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Appendices

2 Appendices

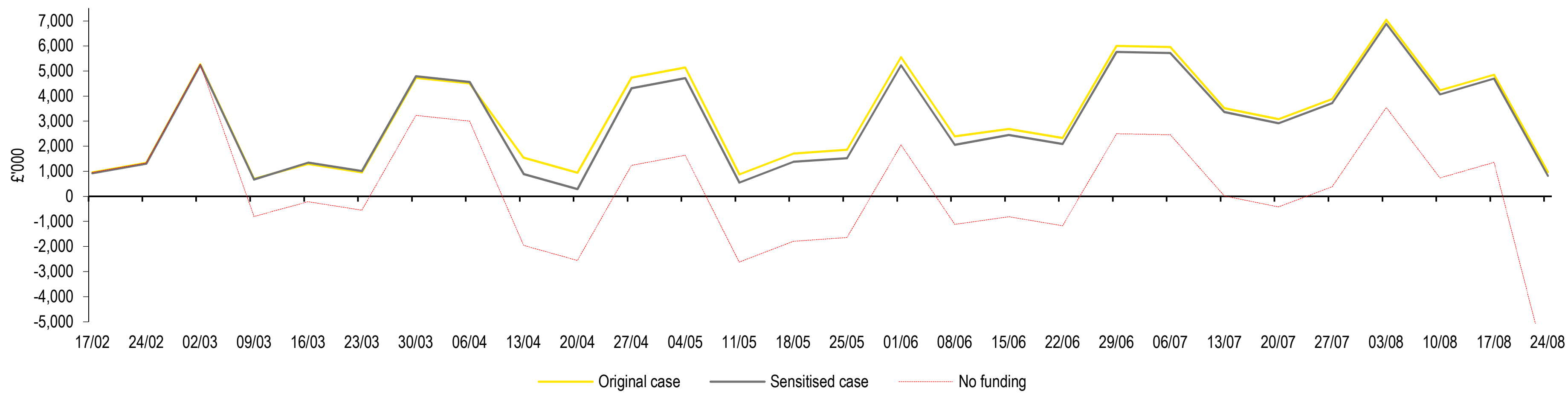
Appendix A: Definitions and abbreviations

£m	Millions
£000	Thousands
AMA	Accelerated merger and acquisition
BE	Bristol Energy Limited
BCC	Bristol County Council
b/f	Bought forward
c.	Circa
CFADS	Cash flow available for debt service
CfD	Contracts for Difference
EBITDA	Earnings before interest, depreciation and amortization
EY	Ernst & Young LLP
FiT	Feed in Tariff
FY20	Financial years ending 31 March 2020
FY21	Financial years ending 31 March 2021
£Xk	Thousands
Management	The Company Senior Management team
£Xm	Million
Ofgem	Office of Gas and Electricity Markets
PCG	Parent Company Guarantee
p/w	Per week
ROC	Renewables Obligation Certificate
SoLR	Supplier of last resort
STCFF	Short term cash flow forecast
the Company	Bristol Energy Limited
the Council	Bristol County Council
VAT	Value added tax

2 Appendices

Appendix B: Management STCFF to August 2020

Management STCFF to August 2020



Currency: £	17/2/20	24/2/20	2/3/20	9/3/20	16/3/20	23/3/20	30/3/20	6/4/20	13/4/20	20/4/20	27/4/20	4/5/20	11/5/20	18/5/20	25/5/20	1/6/20	8/6/20	15/6/20	22/6/20	29/6/20	6/7/20	13/7/20	20/7/20	27/7/20	3/8/20	10/8/20	17/8/20	24/8/20
Balance b/f	**5,361**	**952**	**1,335**	**5,266**	**702**	**1,290**	**956**	**4,729**	**4,508**	**1,547**	**949**	**4,737**	**5,140**	**882**	**1,710**	**1,857**	**5,559**	**2,390**	**2,692**	**2,331**	**6,004**	**5,960**	**3,520**	**3,081**	**3,888**	**7,048**	**4,236**	**4,861**
Income	1,937	2,754	4,417	1,564	1,605	1,815	3,947	889	2,142	1,193	4,480	1,035	1,406	1,503	1,797	4,077	1,320	1,462	1,617	3,846	918	1,850	1,168	1,129	3,814	1,253	1,375	1,648
Power	(606)	(606)	-	(1,658)	(61)	(75)	-	(567)	(1,152)	-	(65)	-	(1,292)	(36)	(65)	-	(1,304)	(39)	(57)	-	(424)	(837)	-	(62)	-	(1,276)	(42)	(60)
Gas	(4,342)	-	-	(4,578)	-	-	-	-	(4,151)	-	-	-	(3,148)	-	-	-	(2,345)	-	-	-	-	(1,871)	-	-	-	(1,740)	-	-
PPA	(673)	(307)	-	-	-	(851)	-	-	-	(246)	(599)	-	-	-	(663)	-	-	-	(659)	-	-	-	(184)	(443)	-	-	-	(662)
DUoS	(308)	(471)	(36)	(450)	(52)	(659)	-	(34)	(487)	(641)	-	(33)	(440)	-	(573)	(39)	-	(484)	(626)	-	(43)	(461)	(584)	-	(47)	(403)	(70)	(590)
TNUoS	-	-	-	(504)	-	-	-	-	(541)	-	-	-	(420)	-	-	-	(438)	-	-	-	-	(414)	-	-	-	(416)	-	-
BSUoS	(20)	(53)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)
DCC	-	-	-	(182)	-	-	-	(188)	-	-	-	(193)	-	-	-	-	(199)	-	-	-	(205)	-	-	-	(211)	-	-	-
CmD	(15)	-	(110)	-	-	-	(110)	-	-	-	-	(110)	-	-	-	(110)	-	-	-	(110)	-	-	-	-	(110)	-	-	-
FiT	-	(32)	(64)	-	-	-	-	(66)	-	-	-	(59)	-	-	-	(61)	-	-	-	-	(56)	-	-	-	(56)	-	-	-
ROCs	3	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(8,350)
Metering	(90)	(205)	(70)	(96)	(218)	-	-	(73)	(100)	(228)	-	(76)	(104)	(237)	-	-	(78)	(107)	(242)	-	(79)	(108)	(247)	-	(79)	(109)	(247)	-
CfD	(54)	(108)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)	(28)
Other COS	(150)	-	-	-	-	(5)	-	-	-	-	-	-	-	-	-	-	-	-	(5)	-	-	-	-	-	-	-	-	-
Overheads - salaries	(150)	(371)	-	-	(330)	(520)	(2)	-	(252)	(398)	(2)	-	-	(228)	(360)	(2)	-	(228)	(360)	(2)	-	(228)	(359)	(2)	-	-	(228)	(359)
Other overheads	(177)	(218)	(150)	(103)	(167)	(264)	(6)	(126)	(229)	(223)	(5)	(105)	(72)	(117)	(185)	(107)	(70)	(114)	(180)	(5)	(100)	(181)	(177)	(5)	(95)	(66)	(106)	(168)
VAT	238	-	-	-	-	280	-	-	-	-	270	-	-	-	252	-	-	-	205	-	-	-	-	247	-	-	-	218
Funding	-	-	-	1,500	-	-	-	-	2,000	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4,500
Rent	-	-	-	-	(87)	-	-	-	(87)	-	-	-	(87)	-	-	-	-	(87)	-	-	-	(87)	-	-	-	-	-	-
PCG interest	-	-	-	-	-	-	-	-	-	-	(235)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Courts	-	-	-	-	(46)	-	-	-	(46)	-	-	-	(46)	-	-	-	-	(46)	-	-	-	(46)	-	-	-	-	-	-
Balance c/f	**952**	**1,335**	**5,266**	**702**	**1,290**	**956**	**4,729**	**4,508**	**1,547**	**949**	**4,737**	**5,140**	**882**	**1,710**	**1,857**	**5,559**	**2,390**	**2,692**	**2,331**	**6,004**	**5,960**	**3,520**	**3,081**	**3,888**	**7,048**	**4,236**	**4,861**	**983**

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Appendix C: Summary of mitigation considerations

Mitigation	Rationale	Observations	RAG
Suppliers	▸ Exploring extended credit terms to provide some breathing space to the Company.	Unlikely to be possible due to sector mechanics and any enquiries in this regard could create nervousness resulting in increased demands for collateral.	
Customers	▸ Acceleration of debt adequacy programme to target aged debtor ledger of c.£3.8m. ▸ Steps to consolidate customer direct debit dates may assist cash flow throughout each month but would take time to implement.	Given time pressure on Company cash flow, unlikely to yield a quick recovery.	
HMRC TTP	▸ Agreement with HMRC to have longer term arrangements regarding settlement of tax liabilities (PAYE/NIC). ▸ It should be noted the Company receives a monthly VAT refund (c.£250k).	Not feasible due to there being no significant arrears and with a monthly run rate of c. £228k for PAYE & NIC the impact of any deferment would be insignificant and short term.	
Staff restructuring	▸ We understand there is a limited restructuring plan agreed, which involves the redundancy of certain senior personnel as well as a decision to not back fill any roles lost through future resignation.	We do not expect this to have any impact on the STCFF.	
Temporary funding	▸ Explore options for interim / temporary funding (i.e. bridging loan) to enable the Company to progress a major restructuring plan without the need for BCC to fund it.	We understand initial inquiries by management did not identified any immediate solutions. It's likely that any funder would require security from the Company (the extent of which is limited) and/or backing from BCC.	