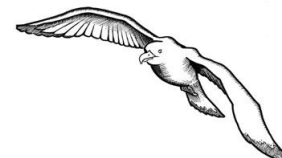


# EXAMPLE



## WestPier Consultants *Sponsor Covenant Measurement*

|         |  |
|---------|--|
| Sponsor | XYZ plc                                  |
| Scheme  | The XYZ Pension Scheme                   |
| Data    | 2006, 2005 and 2004 financial statements |
| Date    | 21 November 2007                         |

### Business description

XYZ plc has a stable asset base earning approximately 7.5% - 8% p.a. It is substantially leveraged with shareholders' funds representing 20% of liabilities. It has a constant 15% dividend policy. The company generates positive free cash flow and capital investment is continuous rather than sporadic.

The company is well established among the market leaders in its industry and there are no foreseeable challenges to the business model from technological innovation or competitive pressure.

### Financial ratio analysis

The last three years audited accounts are analysed in a manner similar to that used by the major credit rating agencies. Key to this assessment are the areas of activity of the corporate group, their long term prospects, the size and evolution of financial ratios appropriate to the group and the ability of the company to continue financing its operations on a continuing basis.

For XYZ plc typical three year average ratios are:

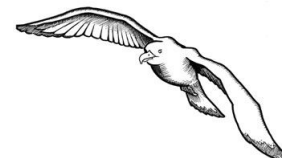
#### **XYZ plc = Industrial Company**

|                                       |        |
|---------------------------------------|--------|
| EBIT interest coverage                | 15 x   |
| EBITDA interest coverage              | 19 x   |
| Funds from operations / total debt    | 66%    |
| Free operating cash flow / total debt | 35%    |
| Total debt / EBITDA                   | 1.25 x |
| Return on capital (%)                 | 20%    |
| Total debt / (total debt + equity)    | 33%    |

*EBIT = Earnings before interest*

*EBITDA = Earnings before interest, depreciation & amortisation*

# EXAMPLE



## XYZ plc = Utility Company

|   |       |
|---|-------|
| EBIT interest coverage                  | 3.8 x |
| Funds from operations interest coverage | 4.8 x |
| Net cash flow / capital expenditure (%) | 85%   |
| Funds from operations / total debt (%)  | 25%   |
| Total debt / (total debt + equity)      | 50%   |
| Dividend payout ratio                   | 75%   |
| Return on equity                        | 11%   |

Results will be presented showing both the historic ratios as well as averages. Trends pertinent to possible changes in the strength of the scheme sponsor's covenant will be highlighted.

Financial services companies and groups can also be assessed. Such analysis is, however, highly dependent on the regulation, markets, mix and nature of the financial services offered.

## Default statistics

With continuation of the business model and dividend policy, the mean default likelihood of this entity at various horizons is tabulated below. Also tabulated is the standard deviation, minimum and maximum default likelihoods in each year from our analysis.

Across time we see general stability in the statistics for XYZ plc. The maximum default likelihood is 1% (year 2) with the average being between a 0.49% (year 2) and 0.23 (year 10).

|         | Annual Default (%) |         |      |                |
|---------|--------------------|---------|------|----------------|
|         | Minimum            | Maximum | Mean | Std. deviation |
| Year 1  | 0.00               | 0.70    | 0.35 | 0.18           |
| Year 2  | 0.20               | 1.00    | 0.49 | 0.19           |
| Year 3  | 0.00               | 0.70    | 0.36 | 0.18           |
| Year 4  | 0.10               | 0.60    | 0.34 | 0.14           |
| Year 5  | 0.00               | 0.50    | 0.29 | 0.12           |
| Year 6  | 0.10               | 0.50    | 0.25 | 0.09           |
| Year 7  | 0.10               | 0.50    | 0.26 | 0.10           |
| Year 8  | 0.20               | 0.50    | 0.36 | 0.09           |
| Year 9  | 0.10               | 0.50    | 0.29 | 0.09           |
| Year 10 | 0.00               | 0.50    | 0.23 | 0.12           |

# EXAMPLE

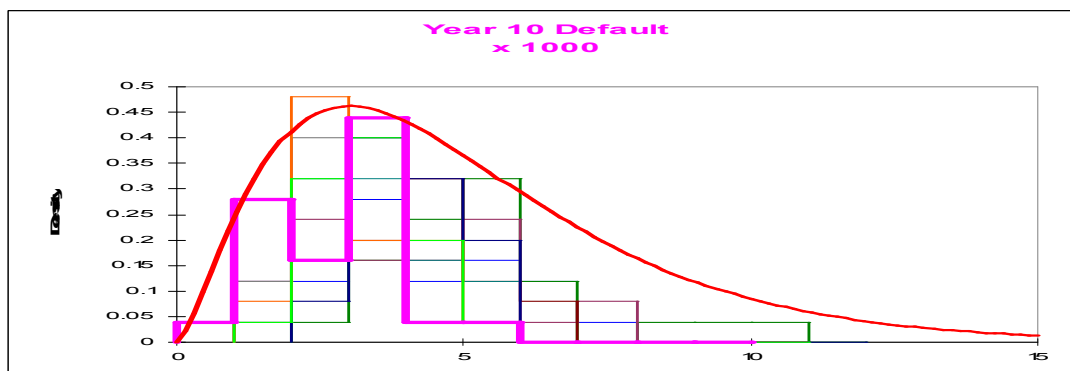
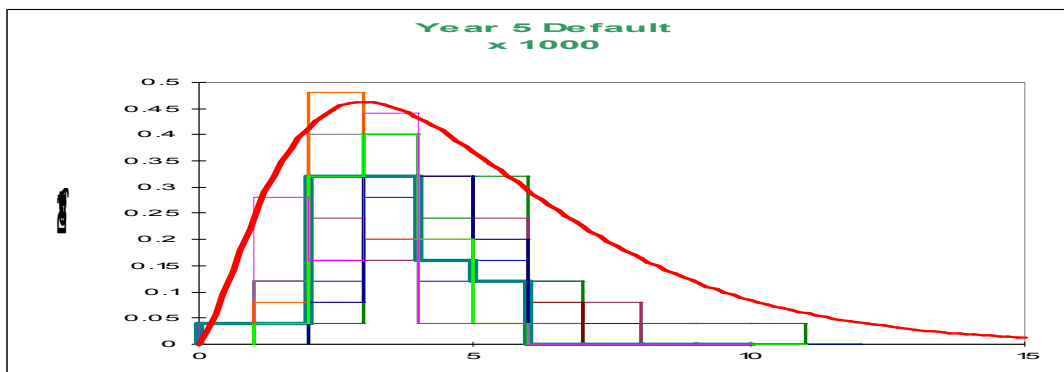
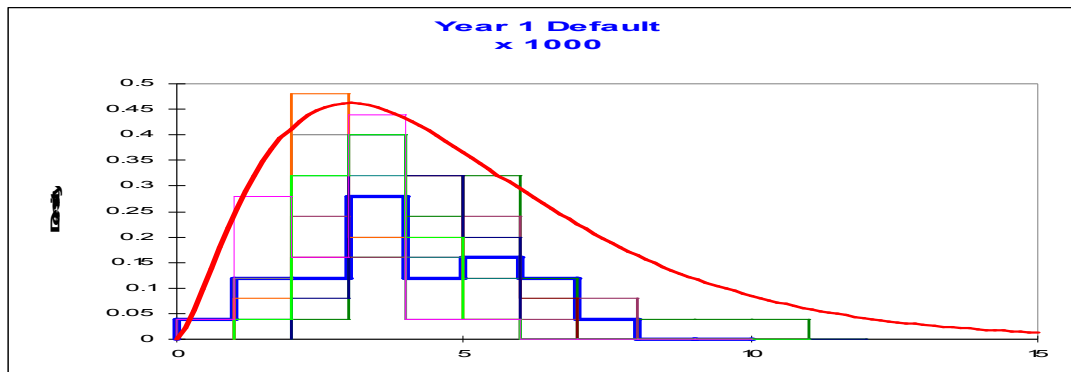


## Distribution of default

The three charts below show the expected default distribution of the entity at year 1, year 5 and year 10. For each chart the horizontal axis is the default probability expressed in units per 1,000, so 10 represents 1%. The vertical axis shows the density of the default probability which captures the full richness of the credit modelling. Default is not a single value but a distribution of values from which summary statistics, such as mean probability, can be derived.

Each chart shows 11 lines. There are 10 “square” lines which show the default density in year 1 through to year 10. Year 1 is highlighted in the top chart in blue, year 5 is highlighted in the middle chart in green and year 10 in the bottom chart in red. For example, the middle chart shows the probability that the entity will become insolvent during year 5.

The red line is the default distribution across all time, the probability of insolvency, on average, at any point in time in the future.



# EXAMPLE



## Survival probabilities

The default statistics from our analysis can be expressed as survival probabilities of the entity. The expected probability of XYZ plc surviving to each year in the next ten years is given below. For example, there is an expected 91% probability that XYZ will be in existence in 5 years time.

| Year            | 1    | 2    | 3    | 4    | 5    | 6    | 7    | 8    | 9    | 10   |
|-----------------|------|------|------|------|------|------|------|------|------|------|
| Probability (%) | 99.0 | 97.4 | 95.7 | 92.8 | 91.0 | 89.4 | 88.2 | 86.5 | 84.9 | 83.7 |

## Deficit repair uplift factors

This is the adjustment required to deficit repair contributions to reflect the fact that sponsor survival is not certain. It is calculated as the Scheme Specific Funding discount rate. Select the uplift factor for the term of deficit repair used in Scheme Specific Funding and apply to each year's deficit repair contribution.

| Year       | 1     | 2     | 3     | 4     | 5     | 6     | 7     | 8     | 9     | 10    |
|------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Uplift (%) | 101.0 | 101.8 | 102.7 | 103.8 | 104.8 | 105.8 | 106.7 | 107.6 | 108.4 | 109.2 |