ENERGY REGULATORY OFFICE
OF THE CZECH REPUBLIC

Estimating fair rate of return in times of high inflation

Roundtable input by Czechia

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WACC calculation model

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- Capital Asset Pricing Model (CAPM) - reflects the cost of equity and the cost of debt adjusted for the tax burden

$$WACC = \left(c_e \times \frac{E}{D+E}\right) + \left[\left(c_d \times \frac{D}{D+E}\right) \times (1-T)\right],$$

where

$\mathbf{c_e}$ is the cost of equity,

$\frac{\mathbf{E}}{\mathbf{D+E}}$ is the equity to total capital ratio,

$\mathbf{c_d}$ is the cost of debt,

$\frac{\mathbf{D}}{\mathbf{D+E}}$ is the debt to total capital ratio,

$\mathbf{T}$ is the corporate income tax rate (19%).

- Further details accessible in chapter 16.1.2. of Price control principles, available online

WACC specification

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- Constant value for the whole regulatory period
- 6.43 %, nominal, pre-tax
- Value established to incentivize further development of distribution systems

WACC adjustments

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- Same value for both distribution and transmission
- 2020 → WACC 7.94 %
- 2021-2025 → WACC 6.43 %
- Both nominal, pre-tax
- Drop in the market parameters entering the calculation of the regulated rate of return using CAPM
- Saving 6.8 billion CZK *ceteris paribus*
- Storage not regulated

Inflation effect on WACC and/or tariffs

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- WACC remains unchanged for entire regulatory period; adjustments possible only in response to changes in corporate income tax rate
- Inflation rate impacts both CAPEX and OPEX
- Increase/decrease of CAPEX and OPEX reflected in allowed revenues (tariffs) with a time delay

Methodology adjustments

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- WACC review every five years (2021-2025) → next revision 2026
- No special adjustments considered during the V. regulatory period
- Considerations for revising WACC determination methodology, reflecting trends from the past two years for VI. regulatory period

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FOR YOUR ATTENTION!

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