

Funding the Future

The failure of Bulb was predictable given the state of ...

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Bulb Energy failed yesterday, [and reports suggest](#) that to keep its 1.7 million supplied with power will require significant state financial support. I thought it appropriate to have a look at the accounts of the company to see if this could have been predicted. The short answer is that it was predictable.

In this post I will be referring to the accounts of two companies. They are [Bulb Energy Ltd \(Bulb\)](#) and its parent company [Simple Energy Ltd \(Simple\)](#). The links are to the files of both companies at Companies House, from where I obtained all the information that I will use.

Bulb was a loss-making company in 2019 and 2020, as its income statement shows:

Bulb Energy Limited			
Statement of Comprehensive Income for the year ended 31 March 2020			
	Note	2020 £m	2019 £m
Turnover	4	1,521	823
Cost of sales		(1,344)	(815)
Gross profit		177	8
Administrative expenses		(236)	(136)
Operating loss	5	(59)	(128)
Interest payable and similar charges	8	(4)	(1)
Loss before taxation		(63)	(129)
Taxation	9	-	-
Loss for the financial year		(63)	(129)

All amounts relate to continuing operations.

There was no other comprehensive income for 2020 (2019 - £Nil).

The notes on pages 16 to 28 form part of these financial statements.

More worryingly, the balance sheet showed the company to have many more liabilities than assets, which is a fairly clear indicator of insolvency:

Bulb Energy Limited			
Registered number: 08469555			
Statement of Financial Position As at 31 March 2020			
	Note	2020 £m	2019 £m
Fixed assets			
Intangible assets		10	1

The company owed £223 million more than it had in assets. £173 million of the liabilities fell due in less than a year without assets to cover them.

The directors were not worried though. They said in the directors' strategic report:

Bulb Energy Limited

Strategic Report
for the year ended 31 March 2020

Principal activity

Bulb Energy Limited (the "Company" or "Bulb") is operating as a subsidiary Company for Simple Energy Limited (together with Simple Energy Limited's international subsidiaries in France, Spain and the United States, the "Group").

The principal activity of Bulb is that of supplying renewable electricity and gas to its members. The Company's mission is to help as many people as possible to lower their bills and carbon emissions. The Company has therefore prioritised investing in growth.

Bulb had another very successful year, during which it achieved 46% growth in its UK customer base to approximately 1.7 million properties (2019 - 1.1 million properties).

In order to continue offering high quality customer service, Bulb made significant investment in all areas of the business, increasing headcount in customer service and operations. Sustainable low costs, great service and a simple, single tariff model has meant Bulb has been able to achieve a 4.7 out of 5 rating with over 60,000 reviews on Trustpilot and been awarded the 'Best Value for Money Winner 2020' by Uswitch.

During the period, as Bulb's customer base grew, Company turnover increased by 85% to £1,521 million (2019 - £823 million) and with further operational efficiencies, saw gross margin increase to £177 million (2019 - £8 million).

Operating losses improved to £59 million (2019 - £128 million). The current year losses are as a result of the Bulb's continued and significant investment in customer growth. These losses were expected and part of the directors' long term strategy.

It is an interesting idea that a company might have a strategic goal of making a loss. I am also curious as to the claim that investment was made in all parts of the business when, as is apparent from the balance sheet, just £1 million of fixed assets were owned. This was a company that added no value by itself: everything it did was about trading at a profit margin. The only difficulty was, that margin was absent at the level required.

Having made such bullish claims, the directors had necessarily to consider whether the apparent insolvency shown by the balance sheet suggested that the company was not a going concern meaning it did not have the resources to continue to trade and settle its liabilities as they fell due. It had this to say on that issue in the directors' report:

Bulb Energy Limited

Directors' Report
for the year ended 31 March 2020

The Directors present their report and the audited financial statements for the year ended 31 March 2020.

Directors

The Directors who served during the year were:

H Wood
A Gudka

Going concern

Notwithstanding current year losses of £63 million (2019 - £129 million), and net liabilities of £223 million (2019 - £160 million) which were expected and part of the Company's growth strategy, the Company's financial statements have been prepared on a going concern basis. This is on the grounds that current sources of funding at the date of signing of the 31 March 2020 financial statements are adequate to meet the Company's needs for a period of at least 12 months from the date of approval of these financial statements, together with the fact that the parent Company, Simple Energy Limited have provided a letter confirming they will provide support as required for a period of at least 12 months from the signing of these financial statements.

The Company's sources of external financing are its £55 million loan facility, where an additional £20 million was drawn down during the financial year. These facilities fall due for repayment on 31 December 2021 and the Company intends to review options to refinance its borrowings in the next twelve months and have commenced discussions with the Company's current lenders. The Company made a payment of £140 million in August 2020 in relation to its Renewable Obligations (RO) for FY20.

Similar to other energy suppliers, the key risk to the going concern basis of preparation is a lack of working capital to manage the seasonality of the business' cash flows. Management addresses this through the use of the facilities outlined above.

The Directors considered it appropriate to assess the future cash flows in two circumstances: a base case prepared in current conditions adjusted for different scenarios and a second known as a 'reverse stress test' a scenario where the Company would run out of cash.

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The different scenarios focused on changes to customer payment rates and available cost savings. The key assumptions in the company's cash flow forecasts are management's ability to meet target gross profit margins, maintaining these despite wholesale price movements, and the growth of the Company's member base and the associated acquisition and marketing costs. Management reached the going concern conclusion after modelling

For reasons that are not explained a loan facility of £55 million was deemed sufficient to cover the deficit of almost four times that sum.

It was not as if the directors were unaware of the risk that they were taking. When discussing those risks they said:

Bulb Energy Limited

Strategic Report (continued)
for the year ended 31 March 2020

Principal risks and uncertainties (continued)

Wholesale market prices
To mitigate the risk of wholesale price movements, the Company operates a variable tariff model and, unlike most other energy suppliers, does not offer multiple different tariffs including fixed price tariffs or tariffs that default to higher payments over time, or rely on penalty fees or charges. This also means the Company is able to more accurately forecast its margins and cash flow in advance.

I am not suggesting that anyone should have foreseen the increase in wholesale fuel prices that have taken place since March 2020. I would, however, suggest that if the directors were aware of the significant risk to the company then they had a very obvious duty to model the possible consequences of substantial change in that price to determine whether this would have put the company at risk. What now appears certain is that their belief that the use of a variable price tariff would cover any risk without the apparent use of hedging appears to have been misplaced. It did, however, appear to keep the auditors satisfied. BDO LLP said in their audit report:

Bulb Energy Limited

Independent Auditor's Report to the Members of Bulb Energy Limited

Opinion

We have audited the financial statements of Bulb Energy Limited ("the Company") for the year ended 31 March 2020 which comprise the statement of comprehensive income, the statement of financial position, the statement of changes in equity and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2020 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

It is very apparent that BBO satisfied themselves that the company was a going

concern. Despite that fact it has not lasted long enough to file its next due financial statements.

It is only fair to note that Bulb did, when making a statement that it was a going concern, suggest that it was also relying upon support from its parent company, Simple. For the record, this is Simple's income statement for the same period, followed by its balance sheet at the same date:

Simple Energy Limited

Consolidated statement of comprehensive income
for the Year Ended 31 March 2020

	Note	2020 £M	2019 £M
Turnover	4	1,521	823
Cost of sales		(1,344)	(815)
Gross profit		177	8
Administrative expenses		(236)	(136)
Operating loss	5	(59)	(128)
Interest payable and expenses	9	(4)	(1)
Loss before taxation		(63)	(129)
Tax on loss	10	-	-
Loss for the financial year		(63)	(129)

All amounts relate to continuing operations.

There was no other comprehensive income for FY19 and FY20.

The notes on pages 18 to 33 form part of these financial statements.

Simple Energy Limited

Registered number: 09249540

Consolidated statement of financial position
As at 31 March 2020

	Note	2020 £M	2019 £M
Fixed assets			
Intangible assets	11	1	-
Tangible assets	12	3	1
		4	1
Current assets			
Debtors	13	191	123
Cash at bank and in hand		105	21
		296	144
Creditors: amounts falling due within one year	14	(398)	(203)
Net current liabilities		(102)	(59)
Total assets less current liabilities		(98)	(58)
Creditors: amounts falling due after more than one year	15	(54)	(35)
Net liabilities		(152)	(93)
Capital and reserves			
Share capital	18	-	-
Share premium account	19	67	67
Accumulated losses	19	(219)	(160)
Shareholders' deficit		(152)	(93)

The financial statements were approved and authorised for issue by the board and were signed on its behalf by:


H. Wood

Director

Date: 21/12/20

The notes on pages 18 to 33 form part of these financial statements.

As is apparent the financial performance of the two companies are virtually identical: Simple is simply consolidating the results of Bulb. None of its other subsidiaries make any significant contribution to the financial results.

That said, the balance sheets are different. Simple has significantly more share capital than Bulb and for that reason appears to be running a lower overall deficit of assets than Bulb. Bulb suggest that this let Simple provide it with a financial guarantee. I admit to some doubt as to the basis on which that guarantee had value.

Simple says of its accounts being prepared on a going concern basis that:

Simple Energy Limited

Directors' report
for the Year Ended 31 March 2020

The directors present their annual report and audited consolidated financial statements for the year ended 31 March 2020.

Directors

The directors who held office during the year and after the year end were as follows:

H Wood
J Wells
D Scott
A Gudka

Going concern

Not withstanding current year losses of £63 million (2019 - £129 million) and net liabilities of £152 million (31 March 2019 - net liability position of £93 million), which were expected and part of the Group's growth strategy, the Group's financial statements have been prepared on a going concern basis. This is on the grounds that current sources of funding at the date of signing of the 31 March 2020 financial statements are adequate to meet the Company's needs for a period of at least 12 months from the date of approval of these financial statements.

The Group's sources of external financing are its £55 million loan facility, where an additional £20 million was drawn down during the financial year. These facilities fall due for repayment on 31 December 2021 and the Group intends to review options to refinance its borrowings in the next twelve months and have commenced discussions with the Group's current lenders. The Group made a payment of £140 million in August 2020 in relation to its Renewable Obligations (RO) for FY20.

Similar to other energy suppliers, the key risk to the going concern basis of preparation is a lack of working capital to manage the seasonality of the business' cash flows. Management addresses this through the use of the facilities outlined above.

The Directors considered it appropriate to assess the future cash flows in two circumstances; a base case prepared in current conditions adjusted for different scenarios and a second known as a 'reverse stress test' a scenario where the Company would run out of cash.

The different scenarios focused on changes to customer payment rates and available cost savings. The key assumptions in the Group's cash flow forecasts are management's ability to meet target gross profit margins, maintaining these despite wholesale price movements, and the growth of the Group's member base and the associated acquisition and marketing costs. Management reached the going concern conclusion after modeling the Group's forecast cash flow, income statement and balance sheet under the different scenarios noted, and the 'reverse stress test', which is not considered likely.

The impacts of COVID-19 are continuously monitored and evaluated by the Company's senior leadership team and the Company's board. A number of measures are currently in place to ensure the Group's going concern status, these include a series of cost saving and cost deferral measures. Please refer to the Strategic Report for further details on the impact of COVID-19 on the Group.

In effect, the directors are saying three things. The first is that they could adjust prices quickly enough to cover any change in wholesale prices for energy. Second, they claim that their ability to meet gross profit margin goals apparently provided them with the ability to maintain themselves as a going concern even though that gross profit margin was insufficient to cover their ongoing costs. Third, they imply that continuing growth would address this last risk, meaning they dismiss the likelihood that they could run out of cash.

The auditors (BDO LLP, again) offered a similar comment on this issue in this company to that which they supplied for Bulb. They were as a consequence satisfied that the company was a going concern.

The reality is that the model used for these purposes was obviously wrong. It has transpired that the company could run out of cash, presumably implying that there was insufficient durability within the pricing model of the company to cover the volatility in energy markets and so provide continuing gross margins, irrespective of the ability to control costs. The company has failed as a result.

What is to be concluded from this? I suggest the following.

First, it has to be said that this company simply did not add value. It wheeled and sealed in the energy market, seeking an ever larger market share in what did already by March 2020 look to be a vain attempt to earn sufficient gross profit to cover costs that were disproportionate to the scale of activity, almost certainly because (as the directors imply in their reports) marketing was the focus of their attention, and any amount of money can be sunk into that activity.

Second, whatever risk appraisal was undertaken with regard to future cash flows of this company it now looks unlikely that they were sufficient. The assumption implicit in the directors' comments that there would always be an adequate time lag between moves in wholesale price and the ability to increase tariffs was clearly not true.

Third, the apparent indifference of the auditors to the going concern risk, given the fact that wholesale price changes were identified as a material cause of concern, will, I very strongly suspect, give rise to a referral in due course of BDO LLP for a thorough review of the adequacy of the audit that they undertook.

Fourth, as is so commonly the case, the narrow focus of this audit fail to take into consideration the interests of so many of the stakeholders of this company. The conventional focus was on a report to the shareholders as to whether the company in which they own shares could survive, or not, with the conclusion being drawn that this was possible. The risks to other stakeholders, including wholesale energy suppliers, employees, customers, regulators and the government, as well as society at large, do not appear to feature in the consideration given as to the consequences of the company being a going concern, or not. This only reveals the inadequacy of the U.K.'s financial reporting standards, which were used for the preparation of this report.

Fifth, this company does, then, appear to be added to the catalogue of audit failure which is now becoming so commonplace. I suspect that BDO will offer two defences. The first is that the regulator must have known of some of these issues. I also suspect that the regulator would deny this. The second is that last year's accounts were signed on the 21 December 2020, and maybe given that BDO must have had their audit well in progress by now it was their refusal to sign another audit report on a going concern basis that might have caused the current insolvency, but I am entirely speculating when saying that.

Some final comments are appropriate. First, [as I have already suggested today](#), the

reliance of so many UK households on such a peripheral company within the UK energy market, which had by itself literally no investment in energy production, is profoundly worrying and a systemic risk that surely should not have been permitted.

Nor, surely, should it have been allowed that a company with such a weak balance sheet, even before wholesale energy price volatility was apparent, should have been allowed to grow to have the number of account holders that this one did. In itself this appeared to be a crisis that was always in the making.

And, yet again, it has to be said that accounting, accounting standards, accounting regulators, auditors and audit regulation have failed with the tab being picked up by society at large.

There is a persistent thread that runs through these failures. That recurrent theme is a belief that markets can deliver better outcomes than any other supply mechanism. It is abundantly clear that this assumption is wrong, and not just with regard to energy, where Bulb is just the latest of many companies to fail, albeit that it is by some way the largest. That assumption also applies to the supplier of audit services. Whether the market can now be relied upon to really deliver audit services of the quality that society needs is a question that has to be asked however uncomfortable that might make my own profession and this government feel. It would appear that the time for radical reform has arrived.