Dŵr Cymru
Welsh Water

Annual Performance Report 2019-20

Part 1 – Regulatory financial reporting

dwrcymru.com

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Foreword

References to "the Company", "Dŵr Cymru" and "Welsh Water" in the Annual Performance Report Parts 1, 2 3 and 4 relate to Dŵr Cymru Cyfyngedig, the sole operating company in the whole business securitisation formed by the Glas Cymru Anghyfyngedig group. References to "Glas Cymru" and "the Group" refer, respectively, to Glas Cymru Holdings Limited and the group of which it is the parent.

Statement of Directors' responsibilities for regulatory information

The following confirmations from our Directors are provided to comply with the requirements of Condition F of our Licence, which requires that accounting statements are prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat. In particular, Regulatory Accounting Guideline 3.11 issued in March 2019 requires the following statements to be made by our Directors:

- statement of Directors' pay and standards of performance;
- statement on disclosure of information to auditors;
- statement on dividend policy;
- accounting policy note for price control units;
- a note on revenue recognition;
- a note on capitalisation policy;
- a note on bad debt policy;
- statement on sufficiency of non-financial resources;
- statement on sufficiency of financial resources and facilities;
- tax strategy note;
- statement on differences between statutory and RAG definitions;
- statement on long term viability; and
- statement explaining out/under performance of the return on regulatory equity (RORE).

Statement of Directors' responsibilities for regulatory information (continued)

Statement on Directors' pay and standards of performance

The Company is required under s35A of the Water Industry Act 1991 to provide a statement that the remuneration paid to Executive Directors is linked to standards of performance. This Statement is provided within the Directors' Remuneration Report which can be found within Part 4 of this Annual Performance Report (page 128) and also in the Group's 2020 Annual Report and Accounts which are available at www.dwrcymru.com.

Statement on disclosure of information to auditors

In the case of each of the persons who are Directors at the time when the Annual Performance Report is approved under Section 418 of the Companies Act 2006 the following applies:

a) so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and

b) he/she has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of the information.

Statement on dividend policy

Paragraph 6 and line 1A of the Appendix to Licence Condition F requires companies to report on the value of any dividend paid and provide a comprehensive explanation of the basis of the dividend.

Dŵr Cymru's ultimate parent undertaking is Glas Cymru Holdings Cyfyngedig. As a Company limited by guarantee, and having no shareholders, all financial surpluses are reinvested for the benefit of customers. The reserves built up from retained profits help to insulate Dŵr Cymru and its customers from any unexpected costs and also to improve credit quality to keep the cost of finance as low as possible.

A new dividend policy was approved by Ofwat in December 2015 and formally adopted by the Board in the June 2016 Board meeting. No monies are transferred out of the Glas Cymru group of companies under this policy and all financial surpluses are retained for the benefit of customers. Our dividend policy expressly provides that dividends will not be paid unless the Directors are satisfied that this would not impair Dŵr Cymru's ability to finance its regulated activities.

During the year to 31 March 2020 no dividends were paid or received by the Company (2019: none).

Statement of Directors' responsibilities for regulatory information (continued)

Accounting policy note for price control units

The financial statements have been drawn up in accordance with RAG2 – Guidance for classification of costs across the price control units. An accounting policy note for price control units is disclosed in Part 2 of this Annual Performance Report. The tables presented in Parts 2 and 4 have been prepared in accordance with our Accounting Methodology Statement which can be found at www.dwrcymru.com.

Revenue recognition note

The revenue recognition note is included in the accounting policies note in Part 4.

Capitalisation policy note

The capitalisation policy note is included in the accounting policies note in Part 4.

Bad debt policy note

The bad debt policy note is included in the accounting policies note in Part 4.

Statement on sufficiency of non-financial resources

Under paragraph 3.1 of Condition K of the Licence, the Company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the Company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the Company.

Going concern

The financial statements have been prepared on the going concern basis as the Directors have a reasonable expectation that the Company has adequate resources for a period of at least 12 months from the date of their approval and that there are no material uncertainties to disclose.

In assessing the appropriateness of the going concern basis of accounting the Directors have reviewed the resources available to the Company in the form of cash and committed bank facilities as well as consideration of the Company's capital adequacy, along with a baseline plan which reflects a view of the estimated impact of the COVID-19 pandemic on the Company.

This baseline plan assumes that lockdown is lifted in early June and social distancing continues into the autumn, with gradual lifting of restrictions. Unemployment is assumed to be around 10%, recovering to pre-pandemic levels by 2023; CPIH falls to an average of 1.5% during 2020 and recovers to the

Statement of Directors' responsibilities for regulatory information (continued)

Going concern (continued)

government's long-term target of 2% by December 2021. The estimated impacts on turnover in 2020/21 are an £11m reduction in non-household revenues (6%, demand-driven), offset by an increase in household revenues of circa £8m – a net reduction of £3m (however under regulatory mechanisms lost revenues are recoverable in future years).

This baseline plan has then been subject to a further more extreme downside stress scenario, which assumes an additional drop in CPIH below 1%, recovering to 2% by March 2023 and unemployment at around 12%. Consequential impacts on the Company's cost base are greater pressure on bad debts (circa £9m per annum through to 2022/23) and delays in the delivery of cost efficiencies in 2020/21 (£9 million), as well as further reductions in revenues.

Reduced cash flows would impact on key financial metrics, in particular interest cover ratios. In the extreme downside scenario, gearing and interest covers retain significant headroom within the trigger levels specified in borrowing covenants; and whilst the reduced cash flows weaken financial metrics, they remain within rating agencies' guidance for current ratings.

Having considered these matters, the Directors do not believe there are any material uncertainties to disclose in relation to the Company's ability to continue as a going concern.

Further details are provided in the long-term viability statement in Part 4 of this Annual Performance Report.

Statement on sufficiency of financial resources and facilities

The Directors have resolved that a Certificate required under Condition F6A.2A be issued to the Water Services Regulation Authority confirming that in the opinion of the Directors:

a) the Company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the regulated activities (including the investment programme necessary to fulfil the Company's obligations under the Instrument of Appointment); and

b) the Company will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions.

In providing this Certificate, the Directors have taken into account:

a) the Company's Licence, which is in place on a rolling 25-year basis;

b) the certainty on customer tariffs to March 2021 provided by the 2019 Final Determination of prices by Ofwat, following its acceptance by the Board;

Statement of Directors' responsibilities for regulatory information (continued)

Statement on sufficiency of financial resources and facilities (continued)

c) the financial strength of the Company and the management and other resources available to the Company as recorded in the financial statements for the year ended 31 March 2020;

d) the bond programme of financing implemented by Dŵr Cymru (Financing) UK Plc, an associate Company, inter alia, to provide future financing for the Company (including the investment programme necessary to fulfil the Company's obligations under the Instrument of Appointment);

e) the strong credit rating of the Company's bonds;

f) the results from the ongoing monitoring of financial, operational and compliance controls and the risk management process reported to the Board via four formal committees: the Audit Committee; the Remuneration Committee; the Nominations Committee; and the Quality and Environment Committee. The Group's internal audit function has carried out a programme of work, which incorporates a review of the control environment;

g) the annual review of the effectiveness of internal controls in compliance with the requirements of the UK Corporate Governance Code;

h) the Company's formal risk and governance arrangements which are monitored by the Audit Committee and Board;

i) the Company's employment policies and strategy;

j) the Company's plans for the AMP7 regulatory period; and

k) the undertaking that Glas Cymru Cyfyngedig ("Glas Cymru") has given following the acquisition of the Company, in which Glas Cymru confirms that it (and each of its subsidiaries other than the Company) will:

- provide the Company with all such information as may be necessary to enable the Company to comply with the requirements of the conditions of Appointments, or such additional information as the Director may reasonably require about their activities and the financing of them;
- refrain from any action which would or may cause the Company to breach any of its obligations under the Act or conditions of Appointments;
- ensure that at all times the Board of the Company contains a majority of Non-Executive Directors;
- comply with the Principles of Good Governance outlined in the current UK Corporate Governance Code published by the Financial Reporting Council (or any successor document having a similar purpose or intent) as may from time to time be appended to or approved for the purposes of the Listing Rules of the UK Listing Authority; and
- not make any changes to their respective Memorandum and Articles of Association without the consent of Ofwat.

Statement of Directors' responsibilities for regulatory information (continued)

Statement on sufficiency of financial resources and facilities (continued)

This Directors' Certificate also confirms that in the opinion of the Directors all contracts entered into with any associated Company include all necessary provisions and requirements concerning the standard of service to the Company, to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

Section 6A.4 (2) (a) of Licence Condition F requires our independent auditors to produce a report that sets out:

- whether they are aware of any inconsistencies between the Director's Certificate and any of the accounting records; and
- the extent to which the Company has complied with its obligations under Licence Condition F6A.2A.

The independent auditors' report can be found on page 9.

Licence Condition F6A.6 – maintaining an investment grade rating

The Directors confirm that throughout 2019/20 the Company, or an associated Company as issuer of debt on its behalf, has ensured that it has maintained at all times an issuer credit rating which is an investment grade rating. Dŵr Cymru has the strongest credit ratings in the water sector, reflecting the Company's high level of creditworthiness. The ratings of the Company's Class A and B debt at 31 March 2020 were A-, A3 and A (all with stable outlook) from Standard and Poor, Moody's and Fitch Ratings.

Tax strategy note

As required by RAG 3.11 the tax strategy note is included within this Annual Performance Report, in Note 7 of Part 4, and covers the following key areas:

- the Company's approach to risk management and governance arrangements;
- the Company's attitude towards tax planning;
- the level of risk that the Group is prepared to accept; and
- the Company's approach towards its dealings with HMRC.

Statement on differences between statutory and RAG definitions

Tables 1A, 1B, 1C and 1D all have a column to report any resulting differences between statutory and regulatory definitions on a line by line basis. A table summarising the differences is shown at the end of each table as well as a narrative explanation of any material movements in Note 1 of Part 4. A reconciliation between total borrowings included in the statutory financial statements and borrowings in the regulatory accounts is provided alongside Table 1C.

Statement of Directors' responsibilities for regulatory information (continued)

Long term viability statement

Our customers need to know they can rely on the services we provide over the long term. Ensuring the long-term resilience of our business, including financial resilience, is therefore a key area of focus for us. Ofwat expects companies to confirm that they are financially viable over the longer term. Our approach to doing this complies with Provision 31 of the UK Corporate Governance Code.

As a result of our assessment, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to March 2030. The Long Term Viability Statement is provided in Note 8 of Part 4 of this Annual Performance Report and also in the 2020 Glas Cymru Annual Report and Accounts which are available at www.dwrcymru.com.

Statement explaining out/under performance of the return on regulated equity (RORE)

The movement in RORE compared to the base RORE set at the last price review is reported in Note 6 of Part 4 .This identifies and quantifies the key components of the out/under performance as required by RAG 3.11.

Licence Condition F6.1 – trading with associate companies at arm's length

We have an obligation to ensure that every transaction between the appointed business and any associated company is at arm's length so neither gives to nor receives from the other any cross-subsidy. There were no material transactions with associated companies except for:

- the Directors of Dŵr Cymru Cyfyngedig (DCC) are also directors of other companies within the Glas Cymru Group. However, the emoluments of the Directors are paid in full by DCC as their activities are predominantly related to the regulated water and sewerage business. During the year the Directors' emoluments amounted to £2,320,031 (2019: £2,511,211);
- no dividends were paid or received by the Company during the year;
- during the year £2,400 (2019: £312,542) of Welsh Water Infrastructure Limited (WWIL) costs were paid by the Company on behalf of WWIL. This value has been included in the Company's balance sheet as an intercompany balance;
- during the year £149,259 (2019: £4,874) of Welsh Water Organic Energy (Cardiff) Limited (WOEC) costs were paid by the Company on behalf of WOEC. This value has been included in the Company's balance sheet as an intercompany balance;
- during the year £9,675 (2019: £7,509) of Welsh Water Organic Energy Limited (WWOE) costs were paid by the Company on behalf of WWOE. This value has been included in the Company's balance sheet as an intercompany balance;
- during the year £277,127 (2019: £nil) of Welsh Water Organic Waste Limited (WWOW) costs were paid by the Company on behalf of WWOW. This value has been included in the Company's balance sheet as an intercompany balance;

Statement of Directors' responsibilities for regulatory information (continued)

Licence Condition F6.1 – trading with associate companies at arm's length (continued)

- during the year £18,901 (2019: £3,759) of Glas Cymru Holdings Cyfyngedig (CGHC) costs were paid by the Company on behalf of GCHC. This value has been included in the Company's balance sheet as an intercompany balance;
- £8,481 (2019: 8,481) of Glas Cymru Anghyfyngedig costs remain outstanding. This value has been included in the Company's balance sheet as an intercompany balance;
- during the year £4,265 (2019: £nil) of Cambrian Utilities Limited costs were paid by the Company on its behalf. This value has been included in the Company's balance sheet as an intercompany balance;
- during the year an intercompany loan of £2,812,458 was received from Dŵr Cymru Holdings Limited and is included in the Company's balance sheet as an intercompany balance; and
- intercompany interest payable to the Group's financing company Dŵr Cymru (Financing) Limited and, from 1 August 2019, Dwr Cymru (Financing) UK Plc (DCF), totalled £141,866,998 (2019: £144,819,501). As at 31 March 2020 the balance outstanding on the intercompany loan from DCF stood at £3,075,771,969 (2019: £2,577,311,471). All borrowings raised by DCF are immediately on-lent to DCC on an arm's length basis. The intercompany loan agreement is subject to the terms and conditions of the whole business securitisation structure of Glas Cymru Anghyfyngedig and its subsidiaries. DCC, in its capacity as debtor, repays such principal and interest as is due on each borrowing on the due date plus a margin of 0.01%.

For a complete list please see Note 3 of Part 4.

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig

Opinion

We have audited the sections of Dŵr Cymru Cyfyngedig's Annual Performance Report for the year ended 31 March 2020 ("the Regulatory Accounting Statements") which comprise:

- the regulatory financial reporting tables comprising the income statement (Table 1A), the statement of comprehensive income (Table 1B), the statement of financial position (Table 1C), the statement of cash flows (Table 1D), the net debt analysis (Table 1E), the financial flows (Table 1F) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of grants and contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), the non-household wastewater revenues by customer type (table 2H), the revenue analysis & wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2J), the infrastructure charges reconciliation (table 2K) and the related notes.

We have not audited the outcome performance tables (Tables 3A to 3S) or the additional regulatory information in Tables 4A to 4W.

In our opinion, Dŵr Cymru Cyfyngedig's Regulatory Accounting Statements have been prepared, in all material aspects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.08, RAG 2.07, RAG 3.11, RAG 4.08 and RAG 5.07) and the accounting policies (including the Company's published Accounting Methodology Statement, as defined in RAG 3.11, Appendix 2), set out in Part 4 on page 69.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law, except as stated in the section on Auditors' responsibilities for the audit of the Regulatory Accounts below, and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England and Wales.

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory Accounting Statements within the Annual Performance Report section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit, including the Financial Reporting Council's (FRC's) Ethical Standards as applied to public interest entities, and we have fulfilled our 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.

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with a special purpose framework, Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the Company's published Accounting Methodology Statement(s), as defined in RAG 3.11, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment. In addition, we are not required to assess whether the methods of cost allocation set out in the Accounting Methodology Statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA.

The Regulatory Accounting Statements are separate from the statutory financial statements of the Company and has not been prepared under the basis of International Financial Reporting Standards as adopted by the European Union ("IFRSs"). Financial information other than that prepared on the basis of IFRSs does not necessarily represent a true and fair view of the financial performance or financial position of a Company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements in Parts 1 and 2 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IFRSs. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within Part 1.

The Regulatory Accounting Statements are prepared in accordance with a special purpose framework for the specific purpose as described in the Responsibilities for the audit of the Regulatory Accounting Statements section below. As a result, the Regulatory Accounting Statements may not be suitable for another purpose.

Our opinion is not modified in respect of this matte

Conclusions relating to going concern

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

- the Directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounting Statements is not appropriate; or

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

- the Directors have not disclosed in the Regulatory Accounting 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 Regulatory Accounting Statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Performance Report other than the Regulatory Accounting Statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the Regulatory Accounting Statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the Regulatory Accounting Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounting Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounting Statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement or inconsistency of this other information, we are required to report that fact.

We have nothing to report based on these responsibilities.

Responsibilities of the Directors for the Annual Performance Report

As explained more fully in the Statement of Directors' Responsibilities set out above, the Directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published Accounting Methodology Statement, as defined in RAG 3.11, Appendix 2).

The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Annual Performance Report that is free from material misstatement, whether due to fraud or error.

In preparing the Annual Performance Report, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

Auditors' responsibilities for the Audit of the Regulatory Accounting Statements within the Annual Performance Report

Our objectives are to obtain reasonable assurance about whether the Regulatory Accounting Statements are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Regulatory Accounting Statements.

A further description of our responsibilities for the audit of the Regulatory Accounting Statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditors/audit-assurance/auditor-s-responsibilities-for-the-audit-of-the-fi/description-of-the-auditor%E2%80%99s-responsibilities-for.

This description forms part of our auditor's report, except for the following:

The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment. In addition, the Company has presented the allocation of operating costs and assets in accordance with the accounting policy for price control segments set out in the accounting policies note 4 and in its Accounting Methodology Statement.

We are not required to assess whether the methods of cost allocation set out in the accounting methodology statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK).

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Annual Performance Report are consistent with those used in the preparation of the statutory financial statements of the company.

Opinion on other matters prescribed by Condition F

Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

Independent auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of Dŵr Cymru Cyfyngedig (continued)

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Annual Performance Report.

Use of this report

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have

agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the WSRA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2020 on which we reported on 05 June 2020, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

James Ledward
For and on behalf of KPMG LLP
Chartered Accountants
3 Assembly Square
Britannia Quay
Cardiff CF10 4AX
8 July 2020

1A – Income statement for the year ended 31 March 2020

	Ref	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed[2] £m	Adjustments: Total adjustment £m	Total appointed £m
Revenue	2A	**777.255**	(3.879)	5.135	(9.014)	**768.241**
Operating costs	2A	**(746.126)**	(11.403)	(6.409)	(4.994)	**(751.120)**
Other operating income	2A	**0.351**	-	-	-	**0.351**
Operating profit	1D, 2A	**31.480**	(15.282)	(1.274)	(14.008)	**17.472**
Other income		**-**	19.506	-	19.506	**19.506**
Interest income		**6.075**	-	0.366	(0.366)	**5.709**
Interest expense		**(171.260)**	(12.176)	-	(12.176)	**(183.436)**
Other interest expense		**-**	(2.224)	-	(2.224)	**(2.224)**
Loss before tax and fair value movements		**(133.705)**	**(10.176)**	(0.908)	(9.268)	(142.973)
Fair value losses on financial instruments		**(18.075)**	-	-	-	**(18.075)**
Loss before tax		**(151.780)**	(10.176)	(0.908)	(9.268)	**(161.048)**
UK corporation tax		**1.890**	-	-	-	**1.890**
Deferred tax		**0.166**	3.409	0.225	3.184	**3.350**
Loss for the year	1B	**(149.724)**	(6.767)	(0.683)	(6.084)	**(155.808)**
Dividends		**-**	-	-	**-**	**-**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 16.

[2] See accounting policies note in Part 4 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

1A – Income statement for the year ended 31 March 2020 (continued)

Tax analysis

		Adjustments			
	Statutory £m	RAG differences[1] £m	Non-appointed[2] £m	**Total adjustments £m**	**Total appointed £m**
Current year	**(0.600)**	-	-	**-**	**(0.600)**
Adjustments in respect of prior years	**(1.290)**	-	-	**-**	**(1.290)**
UK Corporation tax	**(1.890)**	-	-	-	**(1.890)**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 16.

[2] See accounting policies note in Part 4 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

Analysis of non-appointed revenue

	Non-appointed[2] £m
Imported sludge	-
Tankered waste	**1.524**
Other non-appointed revenue	**3.611**
Revenue	**5.135**

1A – Income statement for the year ended 31 March 2020 (continued)

The differences arising from statutory IFRS and RAG definitions are summarised below:

	Revenue recognition-measured income accrual adjustment £m	Removal of interest capitalisation and related depreciation £m	Deferred income release moved from depreciation to other income £m	Infrastructure renewal income moved from operating costs to other income £m	New connection income moved from revenue to other income £m	Searches income moved from revenue to other income £m	Pension interest moved from interest expense to other interest £m	Tax charge relating to measured income accrual and capitalisation of interest £m	Total £m
Revenue	1.5	-	-	-	(4.8)	(0.6)	-	-	(3.9)
Operating costs	-	2.7	(7.2)	(6.9)	-	-	-	-	(11.4)
Other income	-	-	7.2	6.9	4.8	0.6	-	-	19.5
Interest expense	-	(14.4)	-	-	-	-	2.2	-	(12.2)
Other interest expense	-	-	-	-	-	-	(2.2)	-	(2.2)
Deferred tax	-	-	-	-	-	-	-	3.4	3.4
Loss for the year	1.5	(11.7)	-	-	-	-	-	3.4	(6.8)

1B – Statement of comprehensive income for the year ended 31 March 2020

	Ref	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed[2] £m	Adjustments: Total adjustments £m	Total appointed £m
Loss for the year	1A	**(149.724)**	(6.767)	(0.683)	**(6.084)**	**(155.808)**
Actuarial losses on post-employment plans		**(0.687)**	**-**	-	**-**	**(0.687)**
Other comprehensive income[3]		**79.872**	-	-	**-**	**79.872**
Total comprehensive income for the year		**(70.539)**	(6.767)	(0.683)	**(6.084)**	**(76.623)**

[1] Differences in the loss for the year arising from statutory IFRS and RAG definitions are shown in the table on page 16.

[2] See accounting policies note in Part 4 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] Further details are provided in the statement of changes in equity; Note 4 in Part 4.

1C – Statement of financial position as at 31 March 2020

	Ref	Statutory £m	Adjustments: RAG differences[1] £m	Adjustments: Non-appointed[2] £m	Adjustments: Total adjustments £m	Total appointed activities £m
Non-current assets						
Fixed assets	2D	**5,748.648**	(77.891)	-	**(77.891)**	**5,670.757**
Intangible assets		**191.800**	(8.246)	-	**(8.246)**	**183.554**
Financial instruments		**0.200**	-	-	**-**	**0.200**
Total non-current assets		**5,940.648**	(86.137)	-	**(86.137)**	**5,854.511**
Current assets						
Inventories		**3.964**	-	-	**-**	**3.964**
Trade and other receivables		**574.565**	5.368	-	**5.368**	**579.933**
Financial instruments		**0.100**	-	-	**-**	**0.100**
Cash and cash equivalents	1E	**658.662**	-	45.480	**(45.480)**	**613.182**
Total current assets		**1,237.291**	5.368	45.480	**(40.112)**	**1,197.179**
Current liabilities						
Trade and other payables		**(517.793)**	(6.665)	-	**(6.665)**	**(524.458)**
Capex creditor		**(46.299)**	-	-	**-**	**(46.299)**
Borrowings[3]		**(415.263)**	13.849	-	**13.849**	**(401.414)**
Financial instruments		**(23.448)**	-	-	**-**	**(23.448)**
Provisions		**(6.400)**	(7.184)	-	**(7.184)**	**(13.584)**
Total		**(1,009.203)**	-	-	**-**	**(1,009.203)**
Net current assets		**228.088**	5.368	45.480	**(40.112)**	**187.976**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 20.

[2] See accounting policies note in Part 4 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] A reconciliation between borrowings in statutory accounts and regulatory accounts is shown on page 20.

1C – Statement of financial position as at 31 March 2020 (continued)

		Adjustments			
	Statutory	RAG differences[1]	Non-appointed[2]	**Total adjustments**	**Total appointed activities**
	£m	£m	£m	**£m**	**£m**
Non-current liabilities					
Trade and other payables	**(314.390)**	277.089	-	**277.089**	**(37.301)**
Borrowings[3]	**(3,760.037)**	37.324	-	**37.324**	**(3,722.713)**
Financial instruments	**(278.690)**	-	-	**-**	**(278.690)**
Retirement benefit obligations	**(87.414)**	-	-	**-**	**(87.414)**
Provisions	**(8.667)**	-	-	**-**	**(8.667)**
Deferred income – grants and contributions	**-**	**-**	-	-	-
Deferred income – adopted assets	-	(314.413)	-	**(314.413)**	**(314.413)**
Deferred tax	**(481.402)**	15.989	0.225	**15.764**	**(465.638)**
Total non-current liabilities	**(4,930.600)**	15.989	0.225	**15.764**	**(4,914.836)**
Net assets	**1,238.136**	(64.780)	45.705	**(110.485)**	**1127.651**
Equity					
Called-up share capital	**309.900**	-	-	**-**	**309.900**
Retained earnings and other reserves	**928.236**	(64.780)	45.705	**(110.485)**	**817.751**
Total equity[3]	**1,238.136**	**(64.780)**	**45.705**	**(110.485)**	**1,127.651**

[1] Differences arising from statutory IFRS and RAG definitions are shown in the table on page 20.

[2] See accounting policies note in Part 4 (appointed and non-appointed business) for a description of the Company's non-appointed activities.

[3] A reconciliation between borrowings in statutory accounts and regulatory accounts is shown on page 20.

[4] A statement of changes in equity has been provided in Note 4 in Part 4 to enable reconciliation between tables 1B and 1C.

1C – Statement of financial position as at 31 March 2020 (continued)

The differences arising from statutory IFRS and RAG definitions are summarised below:

	Revenue recognition - measured income accrual adjustment £m	Accrued interest moved from borrowings to trade payables £m	Deferred income £m	Capitalisation of interest removed £m	Tax charge relating to changes £m	Overdraft moved from borrowings to trade payables £m	Total £m
Fixed assets	-	-	-	(77.9)	-	-	**(77.9)**
Intangible assets	-	-	-	(8.3)	-	-	**(8.3)**
Current assets							
Trade and other receivables	5.4	-	-	-	-	-	**5.4**
Current liabilities							
Trade & other payables	-	(11.4)	7.2	-	-	(2.4)	**(6.6)**
Borrowings	-	11.4	-	-	-	2.4	**13.8**
Provisions	-	-	(7.2)	-	-	-	**(7.2)**
Non-current liabilities							
Trade and other payables	-	(37.3)	314.4	-	-	-	**277.1**
Borrowings	-	37.3	-	-	-	-	**37.3**
Deferred income - adopted assets	-	-	(314.4)	-	-	-	**(314.4)**
Deferred tax	-	-	-	-	16.0	-	**16.0**
Net assets	**5.4**	**-**	**-**	**(86.2)**	**16.0**	**-**	**(64.8)**
Equity							
Called up share capital	5.4	-	-	(86.2)	16.0	-	**(64.8)**
Total equity	**5.4**	**-**	**-**	**(86.2)**	**16.0**	**-**	**(64.8)**

Reconciliation between total borrowings in statutory accounts and Regulatory Accounting Statements

	£m
Borrowings per statutory financial statements	**4,175.3**
Accrued interest reclassified as trade and other payables	(48.8)
Bank overdraft reclassified as trade and other payables	(2.4)
Borrowings per Regulatory Accounting Statements	**4,124.1**

1D – Statement of cash flows for the year ended 31 March 2020

			Adjustments			
Statement of cash flows	**Ref**	**Statutory £m**	RAG differences[1] £m	Non-appointed £m	**Total adjustments £m**	**Total appointed £m**
Operating profit	**1A**	**31.480**	(15.282)	(1.274)	**(14.008)**	**17.472**
Other income		-	12.289	-	**12.289**	**12.289**
Depreciation[2]	**2D**	**322.277**	(2.700)	-	**(2.700)**	**319.577**
Amortisation – grants and contributions		**(7.217)**	7.217	-	**7.217**	-
Changes in working capital		**(0.871)**	(1.524)	-	**(1.524)**	**(2.395)**
Pension contributions		**(11.900)**	-	-	-	**(11.900)**
Movement in provisions		**7.600**	-	-	-	**7.600**
Profit on sale of fixed assets		**(0.351)**	-	-	-	**(0.351)**
Cash generated from operations		**341.018**	-	(1.274)	**1.274**	**342.292**
Net interest paid		**(130.875)**	-	0.366	**(0.366)**	**(131.241)**
Tax paid		**2.094**	-	-	-	**2.094**
Net cash generated from operating activities		**212.237**	-	(0.908)	**0.908**	**213.145**
Investing activities						
Capital expenditure		**(383.135)**	-	-	-	**(383.135)**
Grants and contributions		**24.629**	-	-	-	**24.629**
Disposal of fixed assets		**0.600**	-	-	-	**0.600**
Net cash used in investing activities		**(357.906)**	-	-	-	**(357.906)**
Net cash flow before financing activities		**(145.669)**	-	(0.908)	**0.908**	**(144.761)**
Cash flows from financing activities						
Net loans received		**314.021**	-	-	-	**314.021**
Net cash flow from financing activities		**314.021**	-	-	-	**314.021**
Increase in net cash		**168.352**	-	(0.908)	**0.908**	**169.260**

[1] Differences arising from statutory IFRS and RAG definitions; for further details see table on page 22.

[2] **Reconciliation to Table 2A:**

Depreciation of:	**£m**
Tangible fixed assets (2D)	291.064
Intangible fixed assets	28.513
	319.577

1D – Statement of cash flows for the year ended 31 March 2020 (continued)

The differences arising from statutory IFRS and RAG definitions are summarised below:

	Revenue recognition: measured income accrual adjustment	Reversal of interest capitalisation	Deferred income	IRE income moved from operating costs to other income	New connections income moved from revenue to other income	Searches income moved from revenue to other income	Total
	£m	£m	£m	£m	£m	£m	£m
Operating profit	1.5	2.7	(7.2)	(6.9)	(4.8)	(0.6)	(15.3)
Other income	-	-	-	6.9	4.8	0.6	12.3
Depreciation	-	(2.7)	-	-	-	-	(2.7)
Amortisation – grants and contributions	-	-	7.2	-	-	-	7.2
Changes in working capital	(1.5)	-	-	-	-	-	(1.5)
Increase/(decrease) in net cash	-	-	-	-	-	-	-

1E – Net debt analysis (appointed activities) as at 31 March 2020

	Interest rate risk profile			
	Fixed rate £m	Floating rate[1] £m	Index-linked £m	Total appointed £m
Borrowings (excluding preference shares)	817.868	225.031	3,081.230	4,124.129
Preference share capital				-
Total borrowings				**4,124.129**
Cash				(0.066)
Short term deposits				(613.116)
Cash and cash equivalents[2]				**(613.182)**
Net debt				**3,510.947**
Gearing				59.64%
Adjusted gearing[3]				59.74%
Full year equivalent nominal interest cost	42.281	4.996	125.495	172.772
Full year equivalent cash interest payment	42.281	4.996	85.067	132.344
Indicative interest rates				
Indicative weighted average nominal interest rate	5.17%	2.22%	4.07%	4.18%
Indicative weighted average cash interest rate	5.17%	2.22%	2.76%	3.21%
Weighted average years to maturity	7.42	2.04	12.25	11.19

[1] February 2020 bond issues totalled £500m: £300m 1.375% 2033 senior bonds and £200m 1.625% 2026 junior bonds.

[2] Cash and cash equivalents does not include overdrawn funds of £2.4m which have been reported within trade and other payables in accordance with the RAGs.

[3] The gearing ratio used by the Company includes accrued interest as well as all cash held within the whole business securitisation structure.

The Ofwat measure of gearing excludes accrued interest and uses cash allocated to the appointed business only:

	Net debt £m	RCV £m	Gearing %
Gearing	3,511	5,887	59.64%
Accrued interest	63		
Overdrawn funds	2		
Loan from parent	(3)		
Non-appointed cash	(45)		
	17		
Adjusted gearing	3,528	5,906	59.74%

1F – Financial flows for the year ended 31 March 2020 and for the price review to date (2012-13 financial year average RPI)

	Year ended 31 March 2020					
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
	%	%	%	£m	£m	£m
Return on regulatory equity	5.62%	6.32%	5.62%	103.163	116.038	116.038
Actual performance adjustment 2010-15	(0.51%)	(0.57%)	(0.51%)	(9.362)	(10.530)	(10.530)
Adjusted return on regulatory equity	5.11%	5.75%	5.11%	93.801	105.508	105.508
Regulatory equity	**1,835.639**	**1,835.639**	**2,064.739**			
Financing						
Gearing	-	(0.34%)	(0.34%)	-	(6.952)	(6.952)
Variance in corporation tax	-	0.04%	0.04%	-	0.749	0.749
Group relief	-	-	-	-	-	-
Cost of debt	-	0.69%	0.63%	-	12.735	13.090
Hedging instruments	-	(0.88%)	(0.78%)	-	(16.147)	(16.147)
Financing total	**5.11%**	**5.27%**	**4.66%**	**93.801**	**95.893**	**96.248**
Operational Performance						
Totex underperformance	-	(0.46%)	(0.41%)	-	(8.406)	(8.406)
ODI underperformance	-	(0.17%)	(0.15%)	-	(3.192)	(3.192)
Retail underperformance	-	(0.29%)	(0.26%)	-	(5.283)	(5.283)
Operational performance total	**-**	**(0.92%)**	**(0.82%)**	**-**	**(16.881)**	**(16.881)**
Total earnings	**5.11%**	**4.35%**	**3.84%**	**93.801**	**79.012**	**79.367**
RCV growth from RPI inflation	**2.63%**	**2.63%**	**2.63%**	**48.277**	**48.277**	**54.303**
Total shareholder return	**7.74%**	**6.98%**	**6.47%**	**142.078**	**127.289**	**133.670**
Net dividend	**4.00%**	**-**	**-**	**73.426**	**-**	**-**
Retained value	**3.74%**	**6.98%**	**6.47%**	**68.653**	**127.289**	**133.670**
Gross dividend	4.00%	-	-	73.426	-	-
Interest received on intercompany loans	-	-	-	-	-	-
Net dividend	4.00%	-	-	73.426	-	-

1F – Financial flows for the year ended 31 March 2020 and for the price review to date (2012-13 financial year average RPI) (continued)

	Average 2015-20					
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
	%	%	%	£m	£m	£m
Return on regulatory equity	5.63%	6.42%	5.63%	100.702	114.873	114.873
Actual performance adjustment 2010-15	(0.52%)	(0.59%)	(0.52%)	(9.301)	(10.610)	(10.610)
Adjusted return on regulatory equity	5.11%	5.83%	5.11%	91.401	104.263	104.263
Regulatory equity	**1,788.661**	**1,788.661**	**2,040.373**			
Financing						
Gearing	-	(0.38%)	(0.38%)	-	(7.668)	(7.668)
Variance in corporation tax	-	0.01%	0.01%	-	0.182	0.182
Group relief	-	-	-	-	-	-
Cost of debt	-	0.66%	0.60%	-	11.768	12.265
Hedging instruments	-	(1.07%)	(0.94%)	-	(19.121)	(19.121)
Financing total	**5.11%**	**5.05%**	**4.41%**	**91.401**	**89.424**	**89.921**
Operational Performance						
Totex underperformance	-	(0.56%)	(0.49%)	-	(9.935)	(9.935)
ODI underperformance	-	(0.04%)	(0.03%)	-	(0.628)	(0.628)
Retail underperformance	-	(0.13%)	(0.11%)	-	(2.297)	(2.297)
Operational performance total	**-**	**(0.72%)**	**(0.63%)**	**-**	**(12.860)**	**(12.860)**
Total earnings	**5.11%**	**4.33%**	**3.78%**	**91.401**	**76.564**	**77.061**
RCV growth from RPI inflation	**2.62%**	**2.62%**	**2.62%**	**46.863**	**46.863**	**53.458**
Total shareholder return	**7.73%**	**6.95%**	**6.40%**	**138.263**	**123.427**	**130.519**
Net dividend	**4.00%**	**3.69%**	**3.24%**	**71.546**	**66.039**	**66.039**
Retained value	**3.73%**	**3.26%**	**3.16%**	**66.717**	**57.388**	**64.480**
Gross dividend	4.00%	3.69%	3.24%	71.546	66.039	66.039
Interest received on intercompany loans	-	-	-	-	-	-
Net dividend	4.00%	3.69%	3.24%	71.546	66.039	66.039

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary

EXECUTIVE SUMMARY: WHAT DOES THE TABLE TELL US?

Over the past four years the returns to equity for Welsh Water have averaged 6.40%, after inflation; lower than the 7.72% assumed by Ofwat. Our cautious financing structure and higher capital expenditure, funded by surpluses which would have gone to shareholders (if we had any) have contributed to this, along with slight underperformance against a challenging Retail PR14 Final Determination (FD14).

Gearing and cost of debt

Our gearing is lower in all of the years reported. This reduces our return on regulatory equity as there is therefore more equity in the business than assumed in FD14 for a notional Company. In practice, of course, the Glas group does not have shareholders and all returns are reinvested into the business or returned to customers. We had no allowance for corporation tax in FD14, and so the tables report variances in individual years as a consequence of non-cash tax accounting charges; the average is broadly neutral although there is a very small beneficial impact on returns to equity. Our cost of debt, excluding the impact of hedging instruments, slightly outperforms the FD14 assumptions. However, while our hedging instruments provide cost certainty and stability, they have increased our average cost of debt over the past four years. Overall therefore our cost of debt has been higher than the FD14 assumptions, giving a reduction to the returns to equity.

Cost and operational performance

We had a generally slow start to our investment programme at the beginning of AMP6, but we have caught up with our regulated programme and our overall increase in spending includes “Customer Distributions” expenditure, being additional investment for the benefit of customers funded from surpluses which would otherwise, in shareholder-owned companies, go to shareholders. Our ODI profile reflects initial and sustained outperformance on pollution prevention and property flooding, however we expect to suffer penalties as a result of our performance in 2017/18, 2018/19 and 2019/20 on customer acceptability and reliability of supply (and, in 2019/20 only, safety of drinking water), mainly from the impact adverse weather events. These broadly net to zero over the reporting period. We have invested more than our FD14 Retail cost allowances, with additional expenditure to improve service and achieve future cost reductions (focusing on debt management and customer contact activity, as well as enhanced Web services).

Dividends

The reported dividend values do not represent payments to shareholders in the traditional sense. Our group structure is based on a not-for-shareholder business model and Glas Cymru Holdings Cyfyngedig, the ultimate parent Company, has no shareholders. All retained earnings are used for the benefit of customers; in recent years we have used these to reduce the bills of vulnerable customers, to improve service to customers and to bring down the level of gearing to reduce the cost of new debt.

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

DETAILED TABLE PREPARATION COMMENTARY

Introduction

Welsh Water shares Ofwat's vision for the water sector in England and Wales: one where customers, the environment and wider society have trust and confidence in vital public water and waste water services. Ofwat intends Table 1F to improve the transparency concerning financial flows to investors, providing a comparison in the annual performance reports (APR) between the financial flows to investors on the basis of the actual capital structures of water companies and what they would have been under a notional structure.

In order to support the goal of providing clarity and comparability, we have set out below our detailed calculations underpinning each input as well as narrative to explain variances against the PR14 Final Determination.

Line 1 – Return on regulatory equity

Guidance
Notional returns and notional regulatory equity
The allowed equity return as set in the published Final Determination (contained in the 'Companies populated risk assessment tools' files, 'RORE Tables' tab). Companies should enter the value associated with the relevant reporting period.

	2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Allowed equity return	5.65%	5.64%	5.63%	5.63%	**5.62%**	**5.63%**

The % equity return allowed in the PR14 Final Determination is used, in conjunction with the notional and actual regulatory equity inputs to Line 4, to create monetary values of the allowed returns at notional and actual levels of gearing. The actual allowed return is a higher value as it reflects our lower gearing and higher regulatory equity.

Our lower gearing (%) and higher regulatory equity (£m) mean that we might expect to generate a higher £ return, however this does not necessarily reflect our actual return which is impacted by a number of other factors reported in sections B and C of the table.

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 2 – Actual performance adjustment 2010-2015

<u>*Guidance*</u>
This relates to the PR09 out/(under)performance adjustments, contained in the 'companies populated PR14 financial models file' ('Input Real' tab – 'Post financeability adjustments'). The value for the reporting period should be divided by regulated equity (Line 4), for the same period, and entered as a percentage.

		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Post financeability adjustments:							
- Water	£m	(6.6)	(6.6)	(6.6)	(6.6)	**(6.6)**	
- Wastewater	£m	(2.7)	(2.8)	(2.8)	(2.8)	**(2.8)**	
		(9.3)	(9.4)	(9.4)	(9.4)	**(9.4)**	
Notional regulatory equity (Line 4)	£m	1,738	1,765	1,790	1,814	**1,836**	
Actual performance adjustment		(0.54%)	(0.53%)	(0.52%)	(0.52%)	**(0.51%)**	**(0.52%)**

The "actual performance adjustment" adjusts the allowed equity return for our Water and Wastewater post financeability adjustments, set out in Ofwat's PR14 Final Determination. These reflect performance in AMP5 against the PR09 Determination and reduce the overall allowed return slightly (Line 3).

This line demonstrates that the £ impact allowed on our actual regulatory equity is higher than on notional equity as we have more equity (lower actual gearing) than Ofwat assumed for a notional Company.

Line 4 – Regulatory equity

<u>*Guidance*</u>
Notional returns and notional regulatory equity
The values to be used for notional regulatory equity for the reporting period are those included in Ofwat's publication 'Regulatory capital values' from the 2019 update onwards.
Actual returns and actual regulatory equity
Calculated as the average of the opening and closing values (NB: do not use the 'average' value stated in the report) for regulatory capital value (RCV) for the period, (included in Ofwat's publication 'Regulatory capital values' from the 2019 update onwards) less average gearing (using the opening and closing balances, for the reporting period, as reported in Table 1E).

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 4 – Regulated equity (continued)

		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Calculated as:							
Opening RCV (March 2020 prices)	£m	5,499	5,585	5,669	5,750	**5,821**	
Closing RCV (March 2020 prices)	£m	5,585	5,669	5,750	5,821	**5,887**	
Indexation							
12/13 year average RPI		244.7	244.7	244.7	244.7	**244.7**	
March 2020 RPI		292.6	292.6	292.6	292.6	**292.6**	
Opening RCV (12/13 year average prices)	£m	4,598	4,670	4,741	4,808	**4,867**	
Closing RCV (12/13 year average prices)	£m	4,670	4,741	4,808	4,867	**4,923**	
Average RCV (12/13 year average prices)	£m	4,634	4,705	4,774	4,838	**4,895**	
Notional gearing		62.50%	62.50%	62.50%	62.50%	**62.50%**	
Regulatory equity: notional	**£m**	1,738	1,765	1,790	1,814	**1,836**	**1,789**
Average RCV (12/13 year average prices)	£m	4,634	4,705	4,774	4,838	**4,895**	
Opening gearing (Table 1E)		59.70%[2]	57.01%	56.38%	57.05%	**56.00%**	
Closing gearing (Table 1E)		57.01%	56.38%	57.05%	56.00%	**59.64%**	
Average actual gearing		58.36%	56.70%	56.72%	56.53%	**57.82%**	
Regulatory equity: actual	**£m**	1,930[1]	2,038	2,067	2,103	**2,065**	**2,040**

The actual regulatory equity base input is used to report the £ value of regulatory equity for Welsh Water at both a notional and actual level of gearing. It drives the calculation of allowed returns in Lines 1 to 3.

Regulatory equity is calculated as the RCV value published in Ofwat's PR09 Final Determination multiplied by either the notional or actual gearing level. We have shown the calculations for completeness, however where available the values are as published by Ofwat (with the exception of 2015/16 actual equity; [1] here we have used our calculation of £1,930m as we believe Ofwat's value of £1,827m to be incorrect). [2] Opening gearing as at 1 April 2015 predates the APR and has therefore been taken from Note 5 to the regulatory accounts for the year ended 31 March 2015.

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 5 – Gearing

Guidance
The impact of having a different gearing structure to that assumed in the notional Company structure. Calculated by:

a) the difference in the notional gearing ratio (62.5%) and actual average gearing (using the opening and closing balances, for the reporting period, unless the Company considers that a weighted average is more accurate, in which case a narrative explanation must be provided) as reported in Table 1E (Net Debt)
b) the difference between the adjusted allowed return on regulatory equity - base and the allowed cost of debt as set in the Final Determination
c) multiplying a) x b) AND d) multiplying c) by the average RCV

Note: the adjustment only applies to the actual return and actual regulatory equity column, and no adjustment should be made for corporation tax.

The allowed cost of debt is stated in the Ofwat publication: Setting price controls for 2015-20, Final price control determination notice: policy chapter A7 - risk and reward [December 2014]; page 42.

		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
a)							
Notional gearing		62.50%	62.50%	62.50%	62.50%	**62.50%**	
Average actual gearing (Line 4 calc)		58.36%	56.70%	56.72%	56.53%	**57.82%**	
Difference		(4.15%)	(5.80%)	(5.79%)	(5.98%)	**(4.68%)**	
b)							
Allowed equity return (Line 1)		5.65%	5.64%	5.63%	5.63%	**5.62%**	
Allowed cost of debt		2.59%	2.59%	2.59%	2.59%	**2.59%**	
Difference		3.06%	3.05%	3.04%	3.04%	**3.03%**	
c)							
a) multiplied by b)		(0.13%)	(0.18%)	(0.18%)	(0.18%)	**(0.14%)**	
d)							
Average RCV (12/13 year average prices; Line 4 calc)	£m	4,634	4,705	4,774	4,838	**4,895**	
c)		(0.13%)	(0.18%)	(0.18%)	(0.18%)	**(0.14%)**	
Impact of gearing difference	**£m**	(5.9)	(8.3)	(8.4)	(8.8)	**(7.0)**	**(7.7)**

The impact of gearing difference is the impact on our actual equity return of having a different level of gearing than Ofwat’s assumption for a notional Company.

Our gearing is lower in all of the years reported hence, as we would expect, “shareholder returns” are also lower than allowed in the PR14 Final Determination, although in practice, of course, the Glas group does not have shareholders and all returns are invested back into the business or returned to customers.

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 6 – Variance in corporation tax

Guidance

The difference between the amount allowed for corporation tax as published in the Final Determination less:

- *tax payable at the standard rate of corporation tax on the profit/(loss) on appointed activities only, before any fair value adjustments.*
- *plus or minus any adjustment for accelerated or deferred capital allowances*
- *plus or minus any amounts for prior year adjustments*
- *plus or minus other Final Determination adjustments to accounting profit*

The corporation tax allowance is stated in the Ofwat publication: Setting price controls for 2015-20, Final price control determination notice: Company-specific appendix - Dŵr Cymru [December 2014]; page 28.

		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Corporation tax FD allowance (12/13 year average prices)	£m	0.0	0.0	0.0	0.0	**0.0**	**0.0**

		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Profit/(loss) before tax and fair value movements (Table 1A)	£m	32.3	(47.5)	(113.3)	(107.2)	(143.0)	
Standard rate of corporation tax		20.00%	20.00%	19.00%	19.00%	19.00%	
Profit/(loss) X standard rate	£m	(6.5)	9.5	21.5	20.4	27.2	
Adjustment for capital allowances	£m	0.0	(2.1)	(22.7)	(21.0)	(27.6)	
Prior year adjustments	£m	0.5	0.2	0.9	(0.5)	1.3	
(Charge)/rebate (outturn prices)	£m	(6.0)	7.6	(0.3)	(1.1)	0.9	
12/13 year average RPI	Index	244.7	244.7	244.7	244.7	244.7	
Report year average RPI	Index	259.4	265.0	274.9	283.3	290.6	
(Charge)/rebate (12/13 year average prices)	£m	(5.6)	7.0	(0.2)	(1.0)	**0.7**	**0.2**
FD allowance less actual tax (12/13 year average prices)	£m	(5.6)	7.0	(0.2)	(1.0)	**0.7**	**0.2**

The adjustments shown above have been taken from Note 7 of Part 4 of the APR for the reporting years 2016/17 to 2019/20 inclusive. We did not include a tax reconciliation in the APR for 2015/16; in this case the adjustments have been taken from Dŵr Cymru Cyfyngedig's statutory accounts.

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 6 – Variance in corporation tax (continued)

The variance in corporation tax is the difference between the level of corporation tax allowed in the Final Determination and actual corporation tax. The guidance states that we should deduct from the Determination allowance *"the tax payable at the standard rate of corporation tax of the profit/(loss) on appointed activities before fair value adjustments, plus or minus any adjustment for accelerated or deferred capital allowances, plus or minus any amounts for prior year adjustments plus or minus other Final Determination adjustments to accounting profit"*. We have reflected this guidance in the table above.

Compared to a corporation tax allowance of £nil in the PR14 Final Determination, the table reports an adverse variance in 2015/16 (our tax charge was higher than the allowance), a positive variance in 2016/17 (the calculation generates a tax credit on actual results) and a broadly neutral result in 2017/18 (and, indeed, on average for the five years) with a small variances in both 2018/19 and 2019/20.

Note that we have not reflected certain items below which were excluded from the guidance. While the overall impact of these is relatively small, we have included them in our commentary for completeness and transparency.

The adjusted values above do not equal the tax credit or charge for the report year in the APR; these reconcile as follows (sources as noted above):

		2015/16	2016/17	2017/18	2018/19	**2019/20**
Reconciliation to actual charge per APR						
Difference per above	£m	6.0	(7.6)	0.3	1.1	(0.9)
Expenses not deductible for tax	£m	0.0	0.1	0.1	0.4	0.1
Tax on R&D credit	£m	0.2	0.0	0.0	0.0	0.0
Non-taxable dividend income	£m	0.0	(0.6)	0.0	0.0	0.0
Non-taxable adopted asset income	£m	0.0	(0.9)	(1.0)	(1.1)	(1.4)
Other timing differences	£m	0.0	(1.1)	(0.4)	(0.5)	(0.2)
Other permanent differences	£m	(6.3)	0.0	0.0	0.0	0.0
Tax losses created	£m	0.0	8.8	0.0	0.0	0.0
Surrender of losses re energy efficient capex	£m	0.0	0.1	0.0	0.2	0.0
Rate differences re ECA surrender and 19%	£m	0.0	0.0	0.0	0.0	0.4
Total current tax charge/(credit) (Table 1A)	**£m**	(0.1)	(1.2)	(1.0)	0.1	**(1.9)**

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 7 – Group relief

<u>Guidance</u>
The amount of group relief utilised in assessing the amount of corporation tax payable minus any amounts paid by way of compensation for the transfer from the parent or affiliated undertaking.

No group relief has been utilised during the reporting period.

		2015/16	2016/17	2017/18	2018/19	2019/20	Average
Group relief	**£m**	0.0	0.0	0.0	0.0	**0.0**	**0.0**

Line 8 – Cost of debt (excluding the impact of hedging instruments)

<u>Guidance</u>
Calculated as:
The cost of debt (unadjusted for hedging instruments) less Line 9.

Comparison of actual cost of debt to allowance on basis of notional regulatory equity:

		2015/16	2016/17	2017/18	2018/19	2019/20	Average
Notional							
Cost of debt (under)/outperformance	£m	(18.4)	(11.6)	0.5	(3.8)	(3.4)	
Remove hedging impact (Line 9)	£m	14.6	18.8	25.6	20.4	16.1	
Cost of debt outperformance (adjusted for hedging instruments)	**£m**	(3.8)	7.3	26.1	16.6	**12.7**	**11.8**

Comparison of actual cost of debt to allowance on basis of actual regulatory equity:

		2015/16	2016/17	2017/18	2018/19	2019/20	Average
Actual							
Cost of debt (under)/outperformance	£m	(17.6)	(10.6)	0.4	(3.5)	(3.1)	
Remove hedging impact (Line 9)	£m	14.6	18.8	25.6	20.4	16.1	
Cost of debt outperformance (adjusted for hedging instruments)	**£m**	(3.0)	8.3	26.0	16.9	**13.1**	**12.3**

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 8 – Cost of debt (excluding the impact of hedging instruments) (continued)

Our cost of debt, excluding the impact of hedging instruments, is slightly lower than the allowance in Ofwat's PR14 Final Determination. While our hedges provide stability within the regulatory framework, our overall cost of debt including these is higher than allowed at PR14.

As can be seen from the summaries above, our performance on an actual basis is slightly worse than compared to the notional Company as a result of our lower level of gearing.

We outperform the allowance in 2016/17 as a result of timing differences between actual average RPI inflation and the indices used to calculate indexation on our index-linked debt (a lag of three to nine months, depending on the instrument).
Detailed guidance and calculations to support these values is shown below.

<u>*Guidance*</u>
Actual returns and notional regulatory equity
Impact of the actual cost of debt compared to the allowed cost of debt in the published Final Determination. Calculated by:

- *a) taking net actual interest paid (interest paid on loans, borrowings, finance leases and adjustments associated with indexation for inflation), less any interest received on cash and short term deposits as reported in the income statement*
- *b) divided by the average net debt (calculated using the opening and closing balances, for the reporting period)*
- *c) Less; movement in RPI for the reporting period, and allowed cost of debt in the published Final Determination*
- *d) multiplying c) by the average RCV (as defined in Line 4 guidance) for the period*
- *e) multiplying d) by the notional gearing ratio (62.5%)*
- *f) adjusted for Corporation Tax (at the standard rate)*

Note that we have not included "other interest income/(expense)" from Table 1A in the net actual interest paid total, as this is a non-cash item relating to the defined benefit pension scheme service charge under IAS 19. Opening net debt for 2015/16 has been taken from Note 5 to the current cost financial statements in the 2014/15 regulatory accounts.

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 8 – Cost of debt (excluding the impact of hedging instruments) (continued)

		2015/16	2016/17	2017/18	**2018/19**	**2019/20**	**Average**
Interest expense (Table 1A)	£m	133.2	154.5	195.0	187.2	183.4	
Interest income (Table 1A)	£m	(5.4)	(3.4)	(3.7)	(4.6)	(5.7)	
a) Net interest paid		127.8	151.1	191.3	182.6	177.7	
Opening net debt (Table 1E)	£m	2,884	2,841	2,942	3,120	3,176	
Closing net debt (Table 1E)	£m	2,841	2,942	3,120	3,176	3,511	
b) Average net debt	£m	2,863	2,892	3,031	3,148	3,343	
Interest paid divided by average net debt		4.46%	5.22%	6.31%	5.80%	5.32%	
Average RPI for prior report year (2015/16/17/18/19)		256.7	259.4	265.0	274.9	283.3	
Average RPI for report year (2016/17/18/19/20)		259.4	265.0	274.9	283.3	290.6	
c) Movement in RPI		1.08%	2.14%	3.74%	3.06%	2.59%	
Allowed cost of debt (Line 5 calc)		2.59%	2.59%	2.59%	2.59%	2.59%	
Interest paid/net debt, less RPI movement and cost of debt		(0.80%)	(0.49%)	0.02%	(0.16%)	(0.14%)	
Average RCV for the period (12/13 prices, see F2 commentary)	£m	4,634	4,705	4,774	4,838	4,895	
d) c) multiplied by average RCV	£m	(36.9)	(23.2)	1.0	(7.6)	(6.7)	
Notional gearing ratio		62.50%	62.50%	62.50%	62.50%	62.50%	
e) d) multiplied by notional gearing	£m	(23.1)	(14.5)	0.6	(4.7)	(4.2)	
f) Standard rate of corporation tax		20.00%	20.00%	19.00%	19.00%	19.00%	
Notional cost of debt (under)/outperformance	£m	(18.4)	(11.6)	0.5	**(3.8)**	**(3.4)**	**(7.4)**

Guidance

Actual returns and actual regulatory equity

Impact of the actual cost of debt compared to the allowed cost of debt in the published Final Determination. Calculated by:

a) taking net actual interest paid (interest paid on loans, borrowings, finance leases and adjustments associated with indexation for inflation), less any interest received on cash and short term deposits as reported in the income statement. All other items should be excluded.

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

b) divided by the average net debt (using the opening and closing balances for the reporting period)
c) Less; movement in RPI for the reporting period, and allowed cost of debt in the published Final Determination
d) multiplying c) by the average RCV (as defined in Line 4 guidance) for the period
e) multiplying d) by the actual average gearing ratio (using the opening and closing balance for the reporting period, unless the Company considers that a weighted average is more accurate in which case a narrative explanation must be provided)
f) Adjusted for Corporation Tax (at the standard rate)

		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Interest expense (Table 1A)	£m	133.2	154.5	195.0	187.2	183.4	
Interest income (Table 1A)	£m	(5.4)	(3.4)	(3.7)	(4.6)	(5.7)	
a) Net interest paid		127.8	151.1	191.3	182.6	177.7	
Opening net debt (Table 1E)	£m	2,884	2,841	2,942	3,120	3,176	
Closing net debt (Table 1E)	£m	2,841	2,942	3,120	3,176	3,511	
b) Average net debt	£m	2,863	2,892	3,031	3,148	3,343	
Interest paid divided by average net debt		4.46%	5.22%	6.31%	5.80%	5.32%	
Average RPI for prior report year (2015/16/17/18/19)		256.7	259.4	265.0	274.9	283.3	
Average RPI for report year (2016/17/18/19/20)		259.4	265.0	274.9	283.3	290.6	
c) Movement in RPI		1.08%	2.14%	3.74%	3.06%	2.59%	
Allowed cost of debt (Line 5 calc)		2.59%	2.59%	2.59%	2.59%	2.59%	
Interest paid/net debt, less RPI movement and cost of debt		(0.80%)	(0.49%)	0.02%	(0.16%)	(0.14%)	
Average RCV for the period (12/13 prices, see F2 commentary)	£m	4,634	4,705	4,774	4,838	4,895	
d) c) multiplied by average RCV	£m	(36.9)	(23.2)	1.0	(7.6)	(6.7)	
Opening gearing (Table 1E)		59.70%	57.01%	56.38%	57.05%	56.00%	
Closing gearing (Table 1E)		57.01%	56.38%	57.05%	56.00%	59.64%	
Actual average gearing		58.36%	56.70%	56.72%	56.53%	57.82%	
e) multiplied by actual average gearing	£m	(22.0)	(13.2)	0.6	(4.3)	(3.8)	
f) Standard rate of corporation tax		20.00%	20.00%	19.00%	19.00%	19.00%	
Actual cost of debt (under)/outperformance	£m	(17.6)	(10.6)	0.4	(3.5)	**(3.1)**	**(6.9)**

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 9 – Hedging instruments

Guidance
The income statement impact of hedging instruments on the actual cost of debt. This figure is calculated by the Company.

We have determined the £ impact of the hedging instruments as the report year cash cost (within income statement interest) of those instruments.

Note that, as in prior years, we have excluded from this table the effect of instruments held in our financing Company, Dŵr Cymru (Financing) UK Plc, which swap floating rate bond liabilities to an RPI indexed rate. The reason for their exclusion is that the bonds and related swaps are on-lent to the appointee as a single instrument.

The swap payment data has been taken from our internal management accounts, adjusted for the standard rate of corporation tax for consistency with Line 8.

		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Floating to RPI swaps	£m	(9.6)	(15.5)	(25.4)	(19.8)	(14.2)	
Floating to fixed swap	£m	(9.8)	(10.0)	(10.1)	(9.4)	(9.4)	
Total (outturn prices)	£m	(19.4)	(25.5)	(35.5)	(29.2)	(23.7)	
12/13 year average RPI		244.7	244.7	244.7	244.7	244.7	
Report year average RPI		259.4	265.0	274.9	283.3	290.6	
Total (12/13 year average prices)	£m	(18.3)	(23.5)	(31.6)	(25.2)	(19.9)	
Standard rate of corporation tax		20.00%	20.00%	19.00%	19.00%	19.00%	
Total adjusted for corporation tax	**£m**	**(14.6)**	**(18.8)**	**(25.6)**	(20.4)	**(16.1)**	**(19.1)**

While providing effective economic hedges, our swap arrangements result in additional costs over the reporting period and drive a higher cost of debt; these have therefore been entered in Line 9 as a negative value.

Line 11 – Totex out/(under) performance

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Guidance

The difference between the actual totex performance versus the amount allowed in the published Final Determination, for the reporting period, adjusted for timing differences and Company sharing ratio with customers. No adjustment should be made for corporation tax.

We have taken this data from the reconciliations underpinning Part 4 of the APR, Table 4B which are also used in the calculation of the RORE ratio in Table 4H (line 5).

The company sharing ratio with customers element of the calculation is derived by applying the water and wastewater pay as you go ratios to the totex over-or-underspend for the respective price controls as adjusted for timing differences (source: pages 22 and 39 of Final price control determination notice: company-specific appendix).

		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Actual totex – Table 4B (12/13 prices)							
Water	£m	219.3	274.7	296.4	298.7	280.6	
Wastewater	£m	222.9	264.9	278.7	304.1	285.5	
Total	£m	442.2	539.6	575.1	602.8	566.2	
Final determination totex – Table 4B (12/13 prices)							
Water	£m	255.5	243.2	239.5	234.1	230.0	
Wastewater	£m	280.8	277.6	272.8	265.9	261.4	
Total	£m	536.3	520.8	512.3	500.0	491.4	
Difference	£m	94.1	(18.8)	(62.8)	(102.8)	(74.7)	
Adjustments for:							
Timing differences (see commentary to Table 4B)							
Water	£m	(22.6)	12.7	0.7	6.4	2.8	
Wastewater	£m	(29.9)	(5.4)	(7.5)	6.5	36.3	
Company sharing ratio	£m	(25.9)	8.7	46.6	58.8	27.2	
Adjusted difference	**£m**	15.7	(2.8)	(23.1)	(31.1)	**(8.4)**	**(9.9)**

This line shows the extent of our out/(under)performance against the PR14 FD allowance, excluding the impact of separately identifiable timing differences in delivery of the capital programme.

Line 11 – Totex out/(under) performance

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

While we had a generally slow start to our investment programme at the beginning of AMP6, we have caught up with our regulated programme and our apparent overall underperformance includes "Customer Distributions" expenditure, being additional investment for the benefit of customers (explained more fully in the commentary to Table 4B).

Line 12 – ODI out/(under) performance

Guidance
The ODI out/(under) performance as reported in Table 3A, for the in-period and notional outperformance payments and underperformance payments relating to the reporting period only.

(Note the value is already reported in 12/13 prices so no further conversion is required.)

No adjustment should be made for corporation tax

We have taken this data from Table 3A of the APR, wherein a full commentary can be found.

ODI in-period rewards/(penalties)		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Table 3A							
A1 safety of drinking water	£m	0.0	0.0	0.0	0.0	(2.5)	
A2 customer acceptability	£m	0.0	0.0	(1.9)	(1.9)	(1.9)	
A3 reliability of supply	£m	0.0	0.0	(3.9)	(0.8)	(0.5)	
B3 preventing pollution	£m	1.0	0.9	0.9	0.6	0.5	
D3 properties flooded within the year	£m	0.0	1.9	1.5	1.7	1.2	
Total out/(under) performance		1.0	2.8	(3.4)	(0.4)	**(3.2)**	**(0.6)**

Our ODI profile reflects initial and sustained outperformance on pollution prevention and property flooding, however we expect to suffer penalties as a result of our performance in 2017/18, 2018/19 and 2019/20 on customer acceptability and reliability of supply (and, in 2019/20 only, safety of drinking water), mainly from the impact of adverse weather. These average a small annual underperformance penalty over the five year reporting period.

Line 13 – Retail out/(underperformance)

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

<u>*Guidance*</u>

The difference between the allowance for retail operating costs, excluding margin, for Household and Non-Household in the Final Determination compared to the actual costs as reported in Table 2C - Operating cost analysis - retail. The allowance for Household retail costs is as per the published Final Determination. The allowance for Non-Household retail costs is as set out in the 'Non-Household populated retail model'.
Note: no adjustment should be made for corporation tax

We have not deflated actual costs to 12/13 prices as no inflation allowance was given for retail costs at FD14.

		2015/16	2016/17	2017/18	2018/19	**2019/20**
Allowed retail revenues (12/13 prices)						
Household retail (including margin)	£m	57.0	55.6	54.3	52.8	52.8
Non-household retail (including margin)	£m	9.6	9.1	8.7	8.3	8.3
Total allowed retail revenues	£m	66.6	64.7	63.0	61.1	61.1

		2015/16	2016/17	2017/18	**2018/19**	**2019/20**
Allowed retail margins						
Household retail		1%	1%	1%	1%	1%
Non-household retail		1%	1%	1%	1%	1%

		2015/16	2016/17	2017/18	**2018/19**	**2019/20**	**Average**
Allowed retail operating costs							
Household retail	£m	56.4	55.0	53.8	52.3	52.3	
Non-household retail	£m	9.5	9.0	8.6	8.2	8.2	
Total allowed retail operating costs	£m	65.9	64.1	62.4	60.5	60.5	
Actual reported costs							
Household retail	£m	62.1	57.4	58.0	56.3	60.1	
Non-household retail	£m	6.7	5.8	6.9	5.9	5.6	
Actual reported retail costs	£m	68.8	63.2	64.9	62.1	65.8	
Retail out/(under) performance	**£m**	(2.9)	0.9	(2.5)	**(1.7)**	**(5.3)**	**(2.3)**

Line 13 – Retail out/(underperformance) (continued)

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

We have struggled to meet a challenging PR14 Final Determination target, with ongoing expenditure required to ensure that we are able to achieve future cost reductions. From 2016/17 we have secured an increasing value of charging orders against customer debt which has helped to reduce our bad debt charge. Commentary on factors affecting Retail performance is provided alongside Table 2C in our published APRs (extracts from prior years are summarised below).

2015/16

- Increased debt management activity, in particular reviewing old accounts and improving in-house litigation activities.

2016/17

- Further focus on recovery and debt management activity.
- The volume of cases pursued and enforced through the legal process grew by more than 50% - bringing additional cost, but more than offset by bad debt charge reductions.
- More than 17,000 visits to customers who we believe to require financial assistance to pay their bill.

2017/18

- Investment in improved web and email services.
- Support to more than 100,000 customers with help in paying their bill, including £0.9m of discretionary expenditure to engage with these customers.
- Initiatives established in prior years generated improved collections and a 5% reduction in doubtful debt year-on-year.

2018/19

- Further investment in improved web and email services.
- Support to more than 110,000 customers with help in paying their bills.
- A further 5% reduction in doubtful debts year-on-year.
- Retail costs include depreciation totalling £3m on assets acquired before 1 April 2015 (included in the wholesale RCV and not part of the PR14 cost base).

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 14 – Other exceptional items

We have reported a £nil value in the table for exceptional items as all expenditure has been incurred in the ordinary operation of the Company's business. However, note our inclusion of atypical costs in tables 4J and 4K relating to costs associated with adverse weather events and the focused restructuring of parts of the business in order to help meet our AMP7 cost efficiency target.

Line 16 – Total earnings

This line compares total allowed (shareholder) earnings in Ofwat's PR14 Final Determination with actual earnings calculated per the table guidance.

"Actual total earnings" are, on average over AMP6 to date, slightly lower than Ofwat's allowances. This is predominantly the impact of our discretionary "Customer Distributions" policy via which we return value to customers under our not-for-shareholder ownership model. However, it is also impacted by our lower gearing than Ofwat's notional Company and our higher, overall, embedded cost of debt.

Line 21 – Gross dividend

Guidance
The total amount of dividends paid during the period for the appointee business only.

While we have completed this line in accordance with the guidance, these values do not represent payments to shareholders in the traditional sense. Our group structure is based on a not-for-shareholder business model and Glas Cymru Holdings Cyfyndgedig, the ultimate parent Company, has no shareholders – rather, it has members who do not have a financial interest in the group and who are selected based on their ability to represent our customer base.

All retained earnings are used for the benefit of customers. In recent years we have used our retained earnings to being down the level of gearing to strengthen our credit ratings and reduce the cost of new debt. We believe that a gearing level of around 60% is optimal for our purposes and as such will return additional value to customers via appropriate mechanisms e.g. direct investment for the benefit of customers, or customer rebates (a method we used in AMP4).

In 2015/16, dividends totalling £320.5m were paid to the parent Company, Dŵr Cymru (Holdings) Limited, and were used to repay an intercompany loan within the not-for-profit group and are not dividends to the owners of equity in a traditional sense.

1F – Financial flows for the year ended 31 March 2020 and for the price review to date: commentary (continued)

Line 21 – Gross dividend (continued)

In 2016/17; dividends totalling £30.2m were paid to the parent Company, Dŵr Cymru (Holdings) Limited, to provide funding for commercial activities within the wider group, for which the profits will accrue to the group and therefore its customers.

No dividends were paid during 2017/18, 2018/19 or 2019/20.

		2015/16	2016/17	2017/18	2018/19	**2019/20**	**Average**
Gross dividend (outturn prices)	£m	320.5	30.2	0.0	0.0	0.0	
12/13 year average RPI		244.7	244.7	244.7	244.7	244.7	
Report year average RPI		259.4	265.0	274.9	283.3	290.6	
Gross dividend (12/13 year average prices)	**£m**	302.3	27.9	0.0	0.0	**0.0**	**66.0**

Line 22 – Interest received on intercompany loans

<u>Guidance</u>
The total amount of interest income received on intercompany loans (as included in the P&L Account).

No interest was received on intercompany loans during the reporting period (agreed to Note 3 in Part 4 of the APR for each reporting year).