Dŵr Cymru
Welsh Water

Annual Performance Report 2020/21

Addendum to Part 1 – Regulatory financial reporting

September 2021

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Following the publication of our 2020/21 Regulatory Annual Performance Report in July 2021 and the subsequent review period by Ofwat, the below restatements have been made to Part 1 Regulatory Financial Reporting.

Table 1F

Date	Version	Change	Reason for change
September 2021	v2	page 3	Gearing : revision of formula Totex performance : revision of formula in table 4C Voluntary sharing agreement: change in polarity
		page 4	Gearing : revision of formula Totex performance : revision of formula in table 4C Voluntary sharing agreement: change in polarity
		page 11	Totex performance : revision of formula in table 4C
		page 15	Voluntary sharing agreement: change in polarity

1F – Financial Flows

	Year ended 31 March 2021[1]					
	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						
Return on regulatory equity	3.78%	3.80%	3.78%	86.020	86.427	86.427
Regulatory equity	2,275.659	2,275.659	2,286.435			
Financing						
Gearing		(0.02%)	0.00%		[2] (0.407)	(0.068)
Gearing benefits sharing		0.00%	0.00%		0.000	0.000
Variance in corporation tax		0.04%	0.04%		0.890	0.890
Group relief		0.00%	0.00%		0.000	0.000
Cost of debt		(0.07%)	(0.07%)		(1.561)	(1.532)
Hedging instruments		(0.79%)	(0.78%)		(17.896)	(17.896)
Return on regulatory equity including financing adjustments	3.78%	2.96%	2.97%	86.020	[2]67.453	67.821
Operational performance						
Totex underperformance		[2] (0.18%)	[2] (0.17%)		[2] (3.984)	[2] (3.984)
ODI underperformance		(0.32%)	(0.32%)		(7.285)	(7.285)
C-Mex out/(under)performance		0.00%	0.00%		0.000	0.000
D-Mex out/(under)performance		0.00%	0.00%		0.000	0.000
Retail underperformance		(1.30%)	(1.30%)		(29.640)	(29.640)
Other exceptional items		0.00%	0.00%		0.000	0.000
Operational performance total		[2] (1.80%)	[2] (1.79%)		[2] (40.909)	[2] (40.909)
RoRE	**3.78%**	[2]**1.17%**	[2]**1.18%**	**86.020**	[2]**26.544**	[2]**26.912**
Actual performance adjustment 2015-20	(0.11%)	(0.11%)	(0.11%)	(2.609)	(2.609)	(2.609)
Total earnings	3.67%	[2]1.06%	[2]1.07%	83.411	[2]23.935	[2]24.303
RCV growth from RPI inflation	1.01%	1.01%	1.01%	22.984	22.984	23.093
Voluntary sharing arrangements		(0.49%)	(0.49%)		[2] (11.198)	[2] (11.198)
Total shareholder return	4.68%	[2]1.57%	[2]1.59%	106.395	[2]35.721	[2]36.198
Gross dividend	4.00%	0.00%	0.00%	91.026	0.000	0.000
Interest received on intercompany loans	0.00%	0.00%	0.00%	0.000	0.000	0.000
Retained value	0.68%	[2]1.57%	[2]1.59%	15.369	[2]35.721	[2]36.198

[1]Actual for 12 months ended 31 March 2021 and average 2020-25 are the same values in this report year.

[2] Version 2 updated due to revision of formula for gearing and totex performance together with change in polarity for voluntary sharing agreement. V2 September 21

1F – Financial flows for the year ended 31 March 2021: commentary

EXECUTIVE SUMMARY: WHAT DOES THE TABLE TELL US?

During the year to 31 March 2021 the returns to equity for Welsh Water totalled [1]1.59%, after inflation; lower than the 4.68% assumed by Ofwat. The principal factors contributing to this lower return are the financial impact of our response to the Covid-19 pandemic (which has impacted on our totex and retail performance), our cautious financing structure and slight overall ODI underperformance against our PR19 Final Determination (FD19) targets.

Gearing and cost of debt

Our gearing is marginally lower than Ofwat's assumed 60% for a notional company. 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. Our cost of debt, excluding the impact of hedging instruments, slightly underperforms the FD19 assumptions. The impact of our hedging instruments, while providing cost certainty and stability, has further increased our cost of debt. Overall our cost of debt has been higher than the FD19 assumptions, reducing the returns to equity.

Cost and operational performance

Our AMP7 investment programme has been delivered broadly in line with plan during 2020-21 despite the pandemic, however the costs associated with ensuring that we were able to continue to safely deliver our capital schemes and provide our operational services have resulted in totex underperformance. In addition and against as a consequence of the pandemic, we have reported a significantly higher bad debt charge within retail costs than was allowed in FD19, hence retail has also underperformed. Our ODI profile reflects slight underperformance during the year.

Dividends

No dividends were declared or paid during the year. Dividends paid by Welsh Water 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.

[1] Version 2 updated due to revision of formula for gearing and totex performance together with change in polarity for voluntary sharing agreement. V2 September 21

1F – Financial flows for the year ended 31 March: 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 wastewater 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 details of the calculations underpinning each input as well as narrative to explain variances against the PR19 Final Determination.

Line 1 – Return on regulatory equity

This line reports the allowed equity return per Ofwat's Financial Flows Data Source model.

Line 2 – Regulatory equity

This line reports notional regulatory equity per Ofwat's Regulatory Capital Values publication.

Actual regulatory equity is calculated as the average of the opening and closing RCV, less average net debt (using the opening and closing balance for the reporting period as reported in table 1E).

1F – Financial flows for the year ended 31 March: commentary (continued)

Actual regulatory equity			**2020/21**
Average of the opening and closing RCV (in 2017/18 year average CPIH prices)			
Opening RCV			
Opening RCV per Ofwat's Regulatory Capital Values (2020/21 year-end prices)			5,967.031
2020/21 year-end CPIH			109.700
2017/18 year-average CPIH			104.217
Opening RCV deflated			5,668.770
Closing RCV			
Closing RCV per Ofwat's Regulatory Capital Values (2020/21 year-end prices)			6,009.929
2020/21 year-end CPIH			109.700
2017/18 year-average CPIH			104.217
Closing RCV deflated			5,709.524
Average RCV			**5,689.147**
Less: average net debt (using opening and closing values in table 1E, in 2017/18 year average CPIH prices)			
Opening net debt			
Table 1E 2019/20 outturn			3,510.947
Outturn CPIH			108.600
2017/18 year-average CPIH			104.217
Table 1E 2019/20 deflated			3,369.238
Closing net debt			
Table 1E 2020/21 outturn			3,616.980
Outturn CPIH			109.700
2017/18 year-average CPIH			104.217
Table 1E 2020/21 deflated			3,436.186
Average net debt			**3,402.712**
Actual regulatory equity	**£m**	**3DP**	**2,286.435**

Line 3 – Gearing

1F – Financial flows for the year ended 31 March: commentary (continued)

This line reports the impact of having a different level of gearing from that assumed in Ofwat's notional company structure. Our gearing is marginally lower than Ofwat's notional company level of 60% hence, as we would expect, "shareholder returns" are also marginally lower than allowed in the PR19 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.

Gearing			**2020/21**
a)			
Notional gearing			60.00%
Actual average gearing			
Table 1E 2019/20 (opening)			59.64%
Table 1E 2020/21 (closing)			60.18%
Actual average gearing			59.91%
Difference			(0.09%)
b)			
Allowed return on regulatory equity - base (Line 1 calculation)			3.78%
Allowed cost of debt per Ofwat's Financial Flows Data Source model			2.42%
			1.36%
c)			
a) multiplied by b)			(0.00%)
d)			
Average RCV (Line 2 calculation)			5,689.147
Gearing	**£m**	**3DP**	**(0.068)**

Line 4 – Gearing benefits sharing

The value reported on this line is zero as actual gearing is lower than that for the notional company (see Line 3 calculation, above) and therefore there is no outperformance to share.

1F – Financial flows for the year ended 31 March: commentary (continued)

Line 5 – Variance in corporation tax

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 only and 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 below, the data having been drawn from the tax calculations underpinning the corporation tax value reported in table 1A.

Compared to the PR19 corporation tax allowance, the table reports a positive variance in 2020/21 (i.e. our tax charge was lower than the allowance).

Variance in corporation tax			**2020/21**
Corporation tax allowance per Ofwat's Financial Flows Data Source model			1.384
Less: tax payable at the standard rate of corporation tax on the profit/(loss) on appointed activities only, before any fair value adjustments:			
Loss on appointed activities before tax and fair value movements (table 1A)			(130.012)
Standard rate of corporation tax			19.00%
Corporation tax credit			(24.702)
Plus or minus: any adjustment for accelerated or deferred capital allowances			25.672
Plus or minus any amounts for prior year adjustments			(0.453)
Plus or minus other final determination adjustments to accounting profit			-
Total corporation tax - outturn prices			0.517
2020/21 year-average CPIH			109.108
2017/18 year-average CPIH			104.217
Total corporation tax - 2017/18 prices			0.494
Variance in corporation tax	**£m**	**3DP**	**0.890**

Line 6 – Group relief

The value reported on this line is zero as no group relief has been utilised during the reporting period.

Line 7 – Cost of debt

1F – Financial flows for the year ended 31 March: commentary (continued)

Our cost of debt, excluding the impact of hedging instruments, is higher than the allowance in Ofwat's PR19 Final Determination. We still hold a significant proportion of debt which was raised in 2001 (on Welsh Water's acquisition by Glas Cymru) when rates were higher than their equivalents today. If interest rates remain low, our cost of debt will fall as the older debt matures and we are able to secure refinancing at a lower cost.

Cost of debt	**2020/21**
a) Net actual interest paid per income statement (table 1A)	
Interest income	(4.650)
Interest expense	148.267
Net interest	143.617
b) Divided by average net debt	
Opening net debt	
Table 1E 2019/20 outturn	3,510.947
Closing net debt	
Table 1E 2020/21 outturn	3,616.980
Average net debt	3,563.964
Divided by b)	4.03%
c) Less:	
Movement in CPIH for the reporting period	
CPIH at 2020/21 year-end	109.700
CPIH at 2019/20 year-end	108.600
Movement in CPIH for the reporting period	1.01%
Use Fisher equation to remove CPIH movement	2.99%
Less: allowed cost of debt per Ofwat's Financial Flows Source Data model	2.42%
Cost of debt underperformance	(0.57%)

Line 7 – Cost of debt (continued)

	Actual/ notional	**Actual/ actual**
d) Multiplying c) by the average RCV for the period		
Average RCV (Line 2 calculation)	5,689.147	5,689.147
c) multiplied by average RCV	(32.428)	(32.428)
e) Multiplying d) by the notional gearing ratio		

1F – Financial flows for the year ended 31 March: commentary (continued)

Notional/actual gearing ratio			60.00%	59.91%
Cost of debt including impact of hedging instruments			(19.457)	(19.428)
Exclude hedging instruments (Line 8 calculation)			17.896	17.896
Cost of debt - unadjusted for hedging instruments			(1.561)	(1.532)
Cost of debt	**£m**	**3DP**	**(1.561)**	**(1.532)**

Line 8 – Hedging instruments

We have determined the £ impact of the hedging instruments as the report year cash cost (within income statement interest) of those instruments. As in prior years, we have excluded from this line 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; their impact is therefore taken into account in Line 7, Cost of debt. The swap payment data has been taken from our internal management accounts.

Hedging instruments			**2020/21**
Floating to RPI swaps			(8.245)
Floating to fixed swap			(10.492)
Total - outturn prices			(18.736)
2020/21 year-average CPIH			109.108
2017/18 year-average CPIH			104.217
Total - 2017/18 prices	**£m**	**3DP**	**(17.896)**

Line 10 – Totex out/(under)performance

This line reports the difference between actual totex performance and the amount allowed in the published Final Determination for the reporting period, adjusted for timing differences and the company sharing ratio with customers.

The values reported on this line are taken from table 4C, Line 21 and converted from outturn prices into 2017/18 CPIH prices. During the year to 31 March 2021 we incurred significant additional expenditure as a result of the Covid-19 pandemic in order to maintain our operational services and investment programme. Please refer to that table for a full breakdown of the elements of the overall totex overspend.

1F – Financial flows for the year ended 31 March: commentary (continued)

[1]Totex out/(under)performance			2020/21
Company share of totex out/(under)performance (table 4c Line 21)			
Water resources			(6.560)
Water network plus			(2.986)
Wastewater network plus			(0.685)
Bioresources			0.089
Additional Control			-
Total - outturn prices			(4.171)
2020/21 year-average CPIH			109.108
2017/18 year-average CPIH			104.217
Total - 2017/18 prices	**£m**	**3DP**	**(3.984)**

Line 11 – ODI out/(under) performance

This line reports the overall financial value of the ODI out/(under)performance in respect of the reporting period.

The data feeding into this line have been taken from table 3A, wherein a full commentary can be found.

ODI out/(under)performance	**2020/21**
Table 3A	
Water quality compliance (CRI)	**(1.059)**
Water supply interruptions	**(2.796)**

[1] Version 2 changes relate to correction of formula in table 4C

1F – Financial flows for the year ended 31 March: commentary (continued)

Leakage			0.114
Per capita consumption			(1.310)
Mains repairs			(0.133)
Unplanned outage			-
Acceptability of drinking water			(1.107)
Lead pipes replaced			-
Business customer satisfaction			(0.125)
Unbilled properties			(0.340)
Visitors to recreational facilities			(0.530)
Delivery of our reservoirs enhancement programme			-
Delivery of our water network improvement programme			-
Delivery of our South Wales Grid water supply resilience scheme			-
Delivery of our new visitor centre			-
Cwm Taf Water Supply Strategy Scheme (Underperformance)			-
Cwm Taf Water Supply Strategy Scheme (Outperformance)			-
Total - 2017/18 prices			(7.285)
Total - 2017/18 prices	£m	3DP	(7.285)

Line 14 – Retail out/(underperformance)

This line reports the difference between the FD19 allowed retail operating costs (excluding margin) compared to the actual costs reported in table 2C.

During 2020/21 we incurred additional expenditure as a consequence of the Covid-19 pandemic in order to maintain our services, as well as a significantly higher bad debt charge than had been allowed at FD19. Further details are provided in the commentary to table 2C.

Retail out/(under)performance	2020/21
Allowed retail operating costs per Ofwat's Financial Flows Data Source model	38.218

1F – Financial flows for the year ended 31 March: commentary (continued)

Actual retail operating costs (table 2C, line 21) - outturn prices			71.043
2020/21 year-average CPIH			109.108
2017/18 year-average CPIH			104.217
Actual retail operating costs - 2017/18 prices			67.858
Retail out/(under)performance	**£m**	**3DP**	**(29.640)**

Line 15 – Other exceptional items

A zero value has been reported on this line as all exceptional (Covid-related) and atypical (weather-related) expenditure has been included within totex and to report on this line would be duplication. There have been no proceeds from land sales during the reporting year.

Line 18 – Actual performance adjustment 2015-20

The values on this line relate to the total PR14 out/(under)performance adjustments which are published in Ofwat's Financial Flows Data Source model. Our adjustment reflects a small level of underperformance for the period.

			Notional/ notional	**Actual/ notional**	**Actual/ actual**
PR14 underperformance adjustment (Ofwat's Financial Flows Data Source model)			(2.609)	(2.609)	(2.609)
Notional returns and notional regulatory equity					
Notional regulatory equity (line 2 calculation)			2,275.659	2,275.659	2,286.435
Actual performance adjustment 2015-20	**%**	**2DP**	**(0.11%)**	**(0.11%)**	**(0.11%)**
Actual performance adjustment 2015-20	**£m**	**3DP**	**(2.609)**	**(2.609)**	**(2.609)**

1F – Financial flows for the year ended 31 March: commentary (continued)

Line 20 – RCV growth from inflation

The values used in this calculation are included in Ofwat’s published Regulatory Capital Values.

RCV growth from inflation			2020/21
Data from Ofwat's Regulatory Capital Values			
Total: RCV at 31 March 2020 expressed in March 2020 prices			5,905.241
Total: Indexation roll forward in 2021 update			59.814
Actual performance adjustment 2015-20	**%**	**2DP**	**1.01%**

Line 21 – Voluntary sharing arrangements

This line reports the value of any payment associated with voluntary sharing arrangements or similar schemes as set out in Ofwat’s published document, PR19 final determination: aligning risk and return technical appendix. In the case of Welsh Water, our voluntary sharing relates to the company’s contribution to the cost of providing more affordable social tariffs during 2020/21 (we incur this ‘cost’ by billing less than Ofwat allows us to and so our total revenues are lower).

Voluntary sharing arrangements	2020/21
Company contribution to social tariffs	[1](11.724)
2020/21 year-average CPIH	109.108

[1] Version 2 changed polarity

1F – Financial flows for the year ended 31 March: commentary (continued)

2017/18 year-average CPIH			104.217
Voluntary sharing arrangements	**£m**	**3DP**	**(11.198)**

Line 23 – Gross dividend

This line reports the total amount of dividends paid during the period for the appointee business only

			2020/21
Notional			
We have used 4% as the notional gross dividend as confirmed by Ofwat in their query log			
Gross dividend	**%**	**2DP**	**4.00%**
Actual			
Gross dividend	**%**	**2DP**	**-%**