GLAS CYMRU

PRELIMINARY RESULTS

2017

Dŵr Cymru
Welsh Water

COMANY NUMBER: 09917809

FOREWORD TO THE PRELIMINARY RESULT ANNOUNCEMENT

BASIS OF PREPARATION

The following announcement of preliminary results includes information which has been extracted directly from the Glas Cymru Holdings Cyfyngedig Annual Report and Accounts for the year ended 31 March 2017.

The audited Annual Report and Account will be put to Members for approval at the Glas Cymru Holdings Cyfyngedig Annual General Meeting on 7 July 2017. The Annual Report and Accounts will be made available online at dwrcymru.com shortly afterwards.

The financial information does not constitute statutory accounts within the meaning of sections 434(3) and 435(3) of the Companies Act 2006 or contain sufficient information to comply with the disclosure requirements of International Financial Reporting Standards (IFRS). The Company's auditors, PricewaterhouseCoopers LLP, have given an unqualified report on the consolidated financial statements for the year ended 31 March 2017. The auditors' report did not include reference to any matters to which the auditors drew attention without qualifying their report and did not contain any statement under section 498 of the Companies Act 2006. The consolidated financial statements will be filed with the Registrar of Companies, subject to their approval by the Company's Members on 7 July 2017 at the Company's Annual General Meeting.

This report contains certain forward-looking statements with respect to the future business prospects and strategies of the Glas Cymru Group. These statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. A number of factors exist which could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements. Past performance is no guide to future performance and persons needing advice should consult an independent financial adviser.

CHAIRMAN'S STATEMENT

This is my first statement having been appointed Chairman at the beginning of last July following my joining the Board in May. As such I thought I might share some initial observations based on my exposure so far to our business and people.

Many businesses talk about being different, but Welsh Water strikes me as truly different. Much of that difference stems from its constitution as a not-for-shareholder business with all its profits available to be ploughed back into the business for the benefit of customers — this year we announced an additional £32m of funds generated to be applied to finance investments and activities that our customers have told us they support. We are different in basing everything we decide and do on seeking to understand our customers, their circumstances, priorities, and needs: different in our absolute commitment to delivering the highest possible standards at an affordable cost: different in being able to set our planning in the truly long-term context of a vision of Welsh Water 2050 that itself is informed by ongoing engagement with our customers.

From those colleagues whom I have met during the visits I have made to our treatment works for both clean and waste water, our retail customer contact centres, our offices and our recreational visitors centres, I take away a great pride, and a considerable depth of knowledge and experience, in what they do, alongside an openness to find ways to deliver an even better service to our customers. Whilst many have very long service records, we are also attracting significant numbers of new recruits to the sector, in particular through our apprenticeship and graduate schemes, and our average age is falling while diversity more generally is increasing.

When there is a need to react urgently to events I find a business that gives its all. With a substantial legacy infrastructure, particularly of pipework, and the climatic changes that create more volatile weather which in turn alters ground conditions, it is inevitable that mains will burst from time to time and sewers will be inundated with rain water. When this happens the teams at Welsh Water work tirelessly to maintain supply, remediate flooding, and restore normal service, all to the most demanding standards of personal safety. There can be periods where event follows event and there is little respite, particularly for those responsible for making the difficult decisions on how best to respond. On behalf of the Board, I would like to thank our colleagues for the commitment they show to our customers and the communities we serve.

The discussions I have had with our Executive team and that we have subsequently had at our Board meetings reveal a business that is deeply conscious of its environmental responsibility and of the contribution it can make to the well-being of future generations. First, what is happening in the environment has a huge impact on what we do, from the levels of rainfall in our catchment areas to the propensity for warmer conditions to create algal growth in the water we treat. Secondly, the business itself has a great impact on the environment, from the quality of water we discharge into watercourses to our ability to generate the energy we need to power our pumps and treatment works. We also recognise our role in society as the provider of fundamental necessities of day-to-day living and the consequent responsibility to be a catalyst in the development of thinking to improve the lives of our customers. Accordingly, we have been playing our part in putting this thinking into effect in such areas as removing lead from the water system in Wales and improving urban drainage. We are listening every day to the concerns of our customers and seek to make what contribution we can to address them.

As a large landowner in some of the most beautiful natural environments, Welsh Water has an unrivalled opportunity to enrich the communities we serve by making the land and reservoirs we own available to the wider public, investing in facilities that allow them to be used to the full. We are delighted to have begun work on the Llanishen and Lisvane reservoirs in Cardiff and are working to restore that facility to its former glory as a natural haven in the middle of a capital city. Walking this February around our Brenig reservoir in Denbighshire and meeting the team that manages our visitor centre and fishery, I couldn't but think how lucky I am to have a job that allows me to spend working time in such fantastic settings!

The business recognises clearly that as necessities of life, water and sewerage services need to be affordable. It has, therefore, the responsibility of developing the most efficient ways of delivering these services, combining re-engineered operating practices with investment in modern, lower cost assets. In this regard it is constructive that our economic regulator (Ofwat) has moved to assess business performance on the basis of total expenditure, leaving the company to determine whether the best outcome is derived from operational expenditure or by investing capital to reduce operating costs in the future. Affordability is also an issue of key importance to the business, and I am pleased to report that in 2016-17 for the eighth year in a row, the increase in the average household bill is again below the rate of (RPI) inflation. Notwithstanding this, we recognise that there are segments within our customer base that struggle to afford to pay their utility bills and we continue to promote subsidised tariffs that these customers also can afford. Our wider customer consultation tells us that the broad base of our customers expect us to support those who need help and are content that we should apply a part of the surplus we generate to support such social tariffs.

Then there is the scale and complexity of what we do — 27,500 kms of water mains, 63 treatment works and 91 reservoirs, £350m invested in the last year in maintaining and enhancing our assets spread across 6,260 distinct projects. And all this is delivered to stringent quality standards, this year achieving our best ever performance against the six DWI water quality measures.

That strong performance does not cloud the team's awareness of where we need to do better, and these areas, particularly the reduction of occasional discolouration issues with tap water and of periods without supply, determine where we prioritise our longer-term investment plans.

There is a huge amount currently going on in the business as we engage with our customers and the Customer Challenge Group over the submission of the next five year business plan, which has to be with Ofwat in September 2018. We believe we can only take a view of what the business wants to achieve over the five years from 2020 to 2025, if we take a longer-term context. Whereas other water companies may sometimes have to focus on the short-term priorities dictated by their shareholders, our constitution allows us to develop plans that will meet the needs of our customers today, tomorrow, and in the future. Our business is subject to long-term trends — environmental, climatic, social, technological. Much of what we design and build to support our delivery takes a long time to think through and then implement and, by virtue of the substantial investment required, has a long asset life. It was this that determined the need to articulate a vision of what we might achieve between now and 2050 and we are currently consulting with our customers and other stakeholders on how we should prioritise our ambitions within the context of what we can afford to do.

Our industry is also undergoing material change with the introduction of retail competition for business customers of English water companies and preparations for the economic separation in 2020 of water resources and bioresources alongside the existing clean and waste water price controls. Our driving force at Welsh Water will continue to be the needs of our customers, whether household or business, and we will seek to develop for them the services they need, taking our lead from the best in the market alongside our own capacity to come up with innovative solutions to customers' requirements. Our aim is for all customers to receive a highly competitive service regardless of whether or not they are within the defined competitive market. We will continue to approach all of our customers with a coherent strategy harnessing Welsh Water's operational delivery alongside our customer service capabilities to deliver what our customers tell us they want.

The corporate restructure of our business that took place last year gives us the capability to develop commercial enterprise alongside our regulated business. We will explore such opportunities where the enterprise in question is a logical profitable extension of our existing activities, particularly where it applies shared capabilities, benefits existing customers, or can give rise to either revenue or cost synergies. We are, however, very aware of the potential pitfalls of diversification away from core competence.

Since becoming Chairman I have not only had the opportunity to meet a lot of colleagues, but also many of our Glas Members, another point of difference for Welsh Water. Having been used to public company AGMs, where one is lucky to get a few private shareholders and one never sees the institutions that hold the voting power, the Welsh Water AGM, attended by some two-thirds of our Members and lasting for four hours, was a very different and energising experience. We are very lucky to have a membership that is as engaged and interested in our business, and willing to give selflessly of their time to provide independent critique of our Board's stewardship and to offer their advice and encouragement. My thanks, on behalf of the Board, to the significant number of Members who will this year be coming to the end of their appointed term, and also to the independent Member Selection Panel for the work they are doing to select new Members.

In closing may I say how much I have appreciated being made so welcome by my colleagues on the Board and by all with whom I have had the opportunity to spend time. May I also express my appreciation of the way in which Bob Ayling, my predecessor as Chairman, introduced me to the Board and the business, achieving a seamless and highly constructive transition: I know Welsh Water owes him a deep debt of gratitude.

I am conscious that I come to the water industry as a complete novice and am very grateful for the patience and forbearance of those who are teaching me so much about the sector and the company and have corrected my misunderstandings. I look forward to continuing my learning in the coming year!

Alastair Lyons
Chairman

8 June 2017

CHIEF EXECUTIVE'S REVIEW

Last year we celebrated the 15th anniversary of Glas Cymru's unique corporate structure and achieved the best year's overall operational performance for Welsh Water since 2001. We are focused on looking forward, understanding our customers' priorities in formulating our long-term plans for the essential public service that we provide. Our objective is to deliver further improved and sustainable performance across some of our key reporting measures – drinking water quality, environmental protection, developer services, customer satisfaction, cost reduction, and above all, improving customer service. Whilst we have made good progress on all these fronts in the last year, we are ambitious to do even better in the coming years, so that we can continue to earn the trust of our customers every day.

CUSTOMER SERVICE

Over the past 12 months, we have developed our Customer-led Success approach, seeking to place customers at the centre of everything we do across the company. Customer-led Success has been developed from an ongoing analysis of our customers' wants and needs. Teams across the business have created Team Charters to help them better identify what their customers value and what we can do differently to deliver the best possible customer service. This is making a real difference – as evidenced by the most recent independent research from CCWater which shows we are leading the water industry across Wales and England in terms of customer satisfaction and value for money for our services – both for our household and business customers.

The launch of our first television advertising campaign in 2016, featuring colleagues from around the business, helped to raise awareness and inform customers about our unique corporate structure. Our customer research indicates that this campaign played a key part in helping improve awareness of our not-for-shareholder model from 31% (June 2016) to 52% (January 2017). Awareness of our unique structure in turn helps us to earn the trust of more of our customers, and building trust in this way helps us encourage our customers to work with us to improve customer service, for example through our "Stop the Block" campaign which has been successful in reducing the number of avoidable sewer blockages.

After several consecutive years of reducing numbers of written complaints, we experienced a temporary but significant rise in written complaints early in 2016. Our review of the reasons for this shows it was attributable to changes in systems and processes – primarily, issues arising from the implementation of a new billing system and the introduction of more robust processes for chasing customer debt from those customers who are able to pay, as well as changes we made to our website which made it easier for customers to email us with issues, rather than to telephone. We have since made very positive progress in improving customer service in 2016-17, with the total number of complaints, whether made in writing or by telephone, now down to the lowest levels we have seen for many years. We know that delivering great customer service is imperative if we are to earn the trust of customers, and we are aiming to achieve the UK's Institute of Customer Service (UK ICS) 'Service Mark – Distinction' accreditation by 2020.

BUSINESS CUSTOMERS

During the year, we also prepared for the opening of the competitive market for business retail services in April 2017. The competitive market has not expanded to the same extent as in England for our customers. As a company based mainly in Wales, our largest non-household customers (those taking more than 50ML of water per annum) are now able to switch water retailer more easily should they choose to do so. Our fundamental focus is to continue to deliver the best possible service and value for money to all our business customers, as well as providing a range of additional services.

DEVELOPERS

We have continued to improve our service to developers, with our standards of service judged to be among the highest in the industry according to industry monthly benchmarking of levels of service indicators. We have also streamlined our processes for concluding Build over Sewer agreements for standard sized sewers, in direct response to feedback from our customers, and have continued to hold regular, successful workshops across our region with house-builders and other developers.

PUBLIC WATER SUPPLY

Our performance for safe and reliable drinking water remained strong during 2016-17. We delivered our best ever performance on some measures such as reducing the total number of water quality and iron compliance failures, while we matched our best ever performance for quality at customers' taps and supply points, or Mean Zonal Compliance, at 99.97% and Service Reservoir Bacteriological performance at 99.97%. With only one bacteriological failure at our water treatment works and also a strong performance against the Drinking Water Inspectorate's indices for disinfection and process control, our annual performance was amongst the very best in the sector.

Our one area of water service performance where we still have considerable issues to address involves intermittent problems with the taste, odour or discolouration of water for some customers. Last year, we had 2.9 contacts per 1,000 customers on such issues, the same as the year before (against a target of 2.7 per 1,000). We are determined to improve on this performance. Our £130 million Zonal Studies investment programme is targeted to help address this and transform customer service in a dozen specific geographic areas, which together account for the majority of our customer contacts and complaints about the quality of drinking water supply. We intend to add considerable extra investment over coming years to this programme, which is driven by detailed analysis of customer and operational data and which uses a range of innovative techniques to address asset deficiencies which have arisen over many decades.

ENVIRONMENTAL PERFORMANCE

Wastewater Services also delivered its best ever performance over a wide range of areas. The number of pollution incidents remained stable in 2016-17 with 114 incidents (2015-16: 112 – our best ever performance on this measure) but we also had the lowest ever number of sites considered to be 'at risk' of failure – 14 compared to 21 in 2015. The number of treatment works failing to comply with environmental discharge permits has more than halved (3) compared to last year (8) and overall consent compliance at 99.47% is also better than last year and equals our previous best ever performance.

The number of properties flooded internally with wastewater from our sewers during 2016-17 was 242 (2015: 223). We will continue to invest to try to bring down this figure. Many flooding incidents are caused by blocked sewers from misuse, for example when fats, oils, greases and wet wipes enter the sewer. We intend to continue our drive to work with local communities to remove these from our network.

WORKING WITH OUR CUSTOMERS

Customers are now more directly involved in how we should develop and deliver customer service. This was a fundamental part of the way we engaged with our customers last summer as part of our award-winning, 'Have Your Say' consultation. We invited all Welsh Water customers to express their views on how the value generated by our not-for-shareholder model should be used in the future – money that would in other companies have gone to shareholders in dividends. We received more than 12,000 responses which provide a solid platform on which to build as we continue our customer engagement activity to help shape our Business Plan for 2020-2025.

Over 2000 of those who responded to the survey said that they would welcome us staying in touch with them and we are in the process of developing a customer forum which will involve those customers in our decision-making processes on a much more regular basis. This group will sit alongside our customer focus groups, the Customer Challenge Group and our wider engagement programme for customers.

We are pleased that for the eighth year in a row, we were able to keep the annual price increase below RPI inflation for the majority of our customers, while also committing to an additional £5 million investment in our flagship social tariff scheme, HelpU. We are now providing assistance through a range of schemes to more than 70,000 of our customers who genuinely struggle to pay their bills.

Because of our unique not-for-shareholder model, we were able to announce in June 2016 an additional £32 million of investment – or around £25 per customer – on projects including: improving the acceptability of drinking water to over 30,000 customers in the Rhondda Valleys and Pembrokeshire; extending our renewable energy portfolio; and extra support for vulnerable customers.

COLLEAGUES

We remain focused on maintaining high levels of employee engagement, so we are pleased this increased in our annual Employee Engagement Survey to 77% in 2016 (2015: 71%) with a record response rate of 81% (2015: 77%). Our network of Employee Engagement Champions across the business continues to work with teams to address issues identified through the survey. We have also continued to work well with our Trade Unions under our long-standing Working Together Agreement – for example, in jointly promoting our award winning Essential Skills Programme, under which colleagues have achieved over 1,100 external qualifications in areas such as literacy, numeracy and IT skills.

We have also been successful in attracting and retaining talented people — and have continued to expand our apprenticeship and graduate programmes. Given this investment, we were pleased to have received external recognition for our apprentice and graduate schemes. We continue to champion diversity across our organisation and were pleased to feature in the International Women's Day event at the Senedd organised by Women in Science and Engineering (WISE). We have also become a member of Chwarae Teg, an organisation which promotes gender equality across Wales, in 2016, and welcomed Joy Kent, their Chief Executive, to speak to an enthusiastic group drawn from across the company.

Health and Safety remains a key priority in all our undertakings — and we welcome the continued improvement in 2016-17, with fewer, less serious injuries and increased levels of positive intervention and reporting. However, we remain committed to further improving our focus on health, safety and wellbeing in years to come. We are working with the HSE to promote their "Help GB Work Well" initiative.

We would not have been able to deliver the significant improvements for customers over the last 12 months without the enthusiasm and commitment of our colleagues. We are proud of their unrelenting dedication which is matched by that of our contracting partners, who have worked very hard all year round to support customers and protect the environment around us — and I would also like to thank them for their significant contribution.

INNOVATION

We welcomed over 300 delegates to our Innovation Conference held at Swansea University in January 2017 as we seek new ways to deliver better and more efficient services to the communities we serve. One example is our RainScape programme, which continues to deliver innovative sustainable drainage solutions across our supply area to reduce the number of flooding incidents and the numbers of discharges from overflows. We are also keen to adopt best practice ideas from leading international water and sewerage companies, and in 2016-17 we worked with Oasen Drinkwater in the Netherlands and Danva in Denmark, welcoming colleagues from these partner organisations and exchanging ideas.

We are including innovation in diverse ways across our business — we continue to engage with the farming community to help manage catchments through our "Weed Wiper" initiative to avoid widespread use of weedkillers in sensitive catchments; we have launched our "Pestsmart" campaign to work together with all user groups, including farmers, to encourage "smarter" techniques to reduce the impact of pesticides; and we are beginning to focus on developing a "Mega Catchments" approach in co-operation with other land owners, so that we can together manage our water catchments more holistically.

OUR VISION FOR THE FUTURE

One of the advantages of our ownership model is that it allows us to focus on our single, clear vision to earn our customers' trust every day. We take a longer-term perspective in investing to deliver that vision for the benefit of future, as well as current, customers. The communities we serve face a number of future challenges, including climate change, population growth, wider environmental change and challenges to the nature of technology and the economy. These challenges will impact how we work at a time when we also need to manage a changing regulatory environment, especially as we monitor the possible implications of Brexit and prepare for further devolution of powers to the National Assembly for Wales through the provisions of the Wales Act 2017.

The Welsh Government's Well-being of Future Generations (Wales) Act 2015 is aimed at improving the social, economic, environmental, and cultural well-being of the people of Wales. We want to play a leading role in helping to deliver these well-being goals. We have worked with a range of leading independent experts to develop a consultation — Welsh Water 2050, the blueprint for our long-term strategy. We are confident that this long term plan will help us become a truly world-class, resilient and sustainable water service. We will continue to engage with our customers over summer 2017 so that we can further reflect their priorities in finalising this strategy, and to inform our business plan for 2020-25. Our unique ownership model places our customers at the centre of our business structure, and by working together we can find the best balance between meeting the high standards expected by today's customers, whilst preparing for the challenges and opportunities that will be faced by future generations and ensuring that we always keep bills affordable for our customers.

Chris Jones
Chief Executive
8 June 2017

FINANCE DIRECTORS' REPORT

FINANCIAL PERFORMANCE

The Group has delivered a strong financial performance during the year to 31 March 2017: it has continued to deleverage, with gearing falling from 57% to 56%, and has retained and improved its sector-leading credit ratings.

OPERATIONAL ITEMS

Glas Cymru incurred total operational costs (excluding infrastructure renewals expenditure on maintaining our underground pipe network, depreciation and exceptional items) of £313 million (2016: £297 million). A number of specific cost increases (higher maintenance contract rates, energy prices and ICT contract transition costs) have been partially offset by efficiency savings, increased income from hydro assets and debt collection improvements.

All water and sewerage companies use a lot of power, particularly for water treatment and pumping processes. The undulating topography across Wales makes this a particular challenge for us. Power costs during 2016-17 were £41 million (2016: £43 million). There remains significant uncertainty over future energy costs, and we have forward purchased a proportion of the estimated power requirements of the business for the three years to March 2020.

Water and sewerage companies are not permitted to disconnect supplies to non-paying domestic customers and cash collection has continued to be challenging. The high priority and increased focus on debt recovery in the Retail business has resulted in further collections improvements during the year, and as a consequence the bad debt charge for the year has fallen to £23 million (2016: £27 million). We are targeting customers who won't pay their bills, as opposed to those who can't pay, and the reduction comes principally from securing charging orders over property owned by customers, with some 2,500 orders secured over nearly £6 million of our customers' debt.

REVENUE

Glas Cymru's turnover in the year to 31 March 2017 remained stable at £744 million (2016: £743 million); a modest increase of 1.4% reflecting Ofwat's PR14 Final Determination pricing adjustment was offset by reduced revenues due to customers opting to move to a metered supply and a higher number of customers benefiting from affordability tariffs.

EXCEPTIONAL ITEMS

During the prior year a business rates refund of £20 million was received following a longstanding challenge of the 2005 water network assessment. This was treated as exceptional due to its size.

FINANCING COSTS

Net interest payable of £141 million (excluding accounting losses on derivatives noted below) was £17 million higher than the previous year. Glas Cymru has a number of derivative swap contracts which fix or inflation-link the cost of debt which were entered into when the company was highly geared. While these are effective commercial hedges, they do not qualify for hedge accounting under IAS 39. Changes in market values create volatility in the income statement and fair value losses in 2016-17 amounted to £63 million (2016: gains of £39 million). There is, however, no impact on cash flows: the company intends to hold its remaining swaps to the maturity of the underlying debt and, over the life of the swaps, such losses will revert to zero.

LOSS BEFORE TAX

The consolidated income statement shows a loss before taxation of £99 million (2016: profit of £77 million) which takes into account the fair value movements and prior year exceptional item as discussed above. Operational and financing costs have risen by some £32 million, as explained above, and infrastructure renewals expenditure has increased by £12 million in line with our higher level of capital investment in year two of the five year investment programme. In addition, depreciation is £10 million higher than the prior year principally due to the revaluation of fixed assets.

The underlying loss before taxation (excluding fair value movements and exceptional items) was £36 million (2016: profit of £18 million).

TAXATION

The group continues to invest heavily in capital expenditure for the benefit of our customers. The tax relief for this capital expenditure and the interest we pay to fund it have the effect of delaying corporation tax payments to future periods. A tax credit of £1m has been generated from the surrender of tax losses relating to our investment in energy efficient capital expenditure under a government-approved scheme.

The total tax credit in the income statement was £28.9m (2016: £8.9m). This includes a deferred tax credit of £12.4m (2016: £24.1m credit) as a result of the corporation tax rate falling from 17% to 18% from 1 April 2020. If this credit is excluded from the total tax credit, the effective tax rate for the period would be 16.7% (2016: 19.7%) which is slightly lower than the standard rate of corporation tax for the period (20%). The Government has not announced any further reductions to corporation tax rates and therefore no further credits arising from rate changes are expected in future periods.

OUR GROUP TAX STRATEGY

OUR APPROACH TO RISK MANAGEMENT AND GOVERNANCE ARRANGEMENTS

Our Finance and Commercial Director has overall responsibility for tax governance and strategy with oversight from the Board and the Audit Committee.

Our tax strategy is supported by a detailed internal Group Tax Policy, together with a framework of internal systems and controls which govern the commercial operations of Glas Cymru Holdings and its subsidiaries (the Group). Our Head of Tax is responsible for the day-to-day application of the tax strategy and the management of the Group's tax affairs. Our Head of Tax works closely with the Finance and Commercial Director. All material tax issues, risks and developments are regularly communicated to the Audit Committee.

Our tax team comprises a small group of professionals with extensive experience of tax in the water sector. This expertise is supplemented by the use of reputable external advisers where required.

OUR APPROACH TO TAX PLANNING AND TAX RISK

All of our group companies are UK tax resident and subject to UK corporation tax on their profits.

Our focus is on compliance; ensuring that all taxes are correctly calculated, accurately reported and paid when due.

We do not engage in artificial arrangements with no commercial purpose, or transactions which are directed at exploiting tax legislation in order to reduce the tax we pay. We comply with the spirit of the law as well as the letter of the law.

Tax risks are held within the Group's risk register and are updated regularly.

Our key tax risks principally arise from business developments and changes to tax legislation which may result in unforeseen tax implications. Where possible we seek to mitigate tax risk so that residual risk is minimal.

Our tax team is involved in all significant business developments enabling a full assessment of the tax implications to be made. We seek input from reputable external advisers where the tax implications are still unclear. In cases where residual uncertainty remains we liaise with HMRC to gain clarity.

Our tax team participates in a number of water industry tax forums. The team receives regular technical updates from our professional advisers and from our periodic meetings with HMRC. This ensures that the team is kept informed of all relevant developments in tax law, enabling them to develop appropriate systems and controls to address legislative changes.

We actively contribute to the UK tax policy making process by participating in Government consultations.

OUR RELATIONSHIP WITH HMRC

We are committed to an open, transparent relationship with HMRC. Our policy is to fully disclose any issues or errors as they arise, and seek to resolve them as soon as practicable.

We meet HMRC biannually to formally discuss our business plans and developments, together with relevant changes to tax legislation.

The Group has been classified as low risk by HMRC from the inception of the Business Risk Review process in 2009. This is due for review in March 2019.

TAX RELIEFS AND INCENTIVES

Our Group has no shareholders and is run solely for the benefit of our customers. We therefore seek to utilise available tax reliefs and incentives put in place by the Government in order to maximise funds available to benefit our customers.

The Group invests heavily in capital expenditure, for example treatment works and our network of pipes and pumping stations, to continually improve the service we provide to our customers. We are therefore able to take advantage of tax reliefs which aim to stimulate this type of investment. A significant proportion of this capital expenditure can be deducted in calculating the Group's taxable profit. We are also able to deduct interest costs incurred to fund this capital investment. This effectively delays corporation tax payments to future periods. Our customers therefore also benefit from cheaper bills.

The Government's Research & Development (R&D) Expenditure Credit regime incentivises companies to increase their investment in R&D. The Group invests heavily in R&D and claims tax credits under this regime.

TRANSPARENCY

We understand the value of insightful financial reporting to our customers, investors and other stakeholders. Taxation is an area which can be difficult to understand. We therefore seek to give a clear and balanced view of our tax affairs.

CONTRIBUTION

The Group is subject to a range of taxes and duties, including corporation tax, business rates, environmental taxes, employment taxes, National Insurance, VAT, fuel duty and licences. The Group thus makes a significant contribution to public finances, as well as employing over 3,000 people and playing an important role in the regional economy.

PENSION FUNDING

The statement of comprehensive income reports defined benefit pension scheme actuarial losses of £43 million (2016: £25 million) and the balance sheet liability as at 31 March 2017 was £95 million (2016: £57 million). This valuation is on an IAS 19 basis for accounting purposes and is not consistent with the actuarial valuation of the scheme for funding purposes. The latest such valuation of the scheme, as at 31 March 2016, projected a deficit, recoverable by payments of £7 million per annum until 2019 and then £3 million per annum until 2030. Exposure to any significant additional future liabilities is mitigated by the closure of most sections of the scheme with effect from 1 April 2017.

FINANCIAL PERFORMANCE

The consolidated balance sheet shows net assets of £1,116 million at 31 March 2017 (2016: £1,082 million). Excluding non-cash fair value adjustments for derivative financial instruments, referred to above, the Group has net assets of £1,593 million (2016: assets of £1,417 million).

GOING CONCERN

The Directors are satisfied that the business has adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements for the year ended 31 March 2017 have been prepared on the going concern basis.

CAPITAL INVESTMENT

Glas Cymru's strong financial position has been built up over the last 16 years, and provides a stable base from which it can respond positively to the challenges of economic uncertainty and drive forward its continuing large capital programme. Glas Cymru works with an alliance of partners to deliver the capital investment programme at the best value for money for customers. Total net capital expenditure during the year (including infrastructure renewals expenditure) was £350 million (2016: £262 million). The increase is mainly due to a temporary slowdown in our capital construction programme during 2015-16 at the start of the current five year regulatory period (AMP6). We invested around £1.5 billion over the five year period from 2010 to 2015 in our AMP5 investment programme which brought sustained improvements in customer service, drinking water quality and the environment. The Group plans to invest at least a further £1.7 billion over the course of the current five year regulatory period (2015-2020), our largest ever investment programme.

CREDIT RATING AND INTEREST RATE MANAGEMENT

Glas Cymru has the strongest credit ratings in the water sector, reflecting the Group's high level of creditworthiness. The ratings of the Group's Class A and B debt at 31 March 2017 were A/A2/A from Standard & Poor's (S&P), Moody's and Fitch Ratings respectively.

As at 31 March 2017, approximately 65% of gross debt was index-linked via bonds and derivatives (2016: 65%), with the remainder at fixed interest rates. The expected maturity of the outstanding fixed-rate and index linked bonds ranges from 2021 to 2057, with not more than 20% falling due in any two-year period, in accordance with our refinancing policy.

GEARING POLICY

Glas Cymru's gearing to RCV policy is to target gearing at or around 60% and interest cover ratios commensurate with maintaining our sector leading 'A' grade credit ratings. This should help us to maintain our low risk profile giving the Group access to low cost financing throughout AMP6 and beyond.

LIQUIDITY AND FINANCIAL RESERVES

Glas Cymru aims to offer a secure, low risk investment to investors. By building and maintaining a strong financial position, we intend to keep our borrowing costs low, enabling us to finance future investment efficiently. On Glas Cymru's acquisition of Welsh Water in May 2001, gearing (net debt/Regulatory Capital Value) stood at 93%. Since then, the financial position has improved steadily. Gearing to RCV has fallen to 56% by 31 March 2017 (2016: 57%) and 'customer reserves' (RCV less net debt) were £2.3 billion. As at 31 March 2017, the Group had available total liquidity of £555 million, including cash balances of £95 million.
We are substantially pre-funded through to 2019-20 and have a further £150 million of undrawn revolving credit facilities.

EVENTS AFTER THE FINANCIAL YEAR END

There have been no post balance sheet events.

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH 2017

Continuing activities	Note	2017 £m	2016 £m
Revenue		**743.6**	743.2
Operating costs:			
Operational expenditure	3	**(312.6)**	(297.3)
Exceptional items	4	**-**	20.0
Infrastructure renewals expenditure		**(69.7)**	(58.0)
Depreciation and amortisation	3	**(256.6)**	(247.1)
		(638.9)	(582.4)
Operating profit		**104.7**	160.8
Financing costs:			
Finance costs payable and similar charges	5a	**(144.2)**	(128.7)
Finance income receivable		**3.6**	5.6
Fair value (losses)/gains on derivative financial instruments	5b	**(63.0)**	39.3
		(203.6)	(83.8)
(Loss)/profit before taxation		**(98.9)**	77.0
Taxation	6	**28.9**	8.9
(Loss)/profit for the year		**(70.0)**	85.9

Underlying (loss)/profit for the year	2017 £m	2016 £m
(Loss)/profit before taxation per Income Statement	**(98.9)**	77.0
Adjustment for:		
Fair value losses/(gains) on derivative financial statements (see note 5b)	**63.0**	(39.3)
Exceptional items (see note 4)	**-**	(20.0)
Underlying (loss)/profit for the year	**(35.9)**	17.7

The company has elected to take the exemption under section 408 of the Companies Act 2006 not to present the parent company's income statement. The profit of the parent company for the 15 month period to 31 March 2017 was £30.2m.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2017

	Note	2017 £m	2016 £m
(Loss)/profit for the year		**(70.0)**	85.9
Items that will not be reclassified to profit or loss			
Actuarial loss recognised in the pension scheme	22	**(43.3)**	(24.6)
Related deferred tax	7	**5.9**	3.7
Revaluation of property, plant and equipment	8	**156.8**	1,247.8
Related deferred tax	7	**(15.3)**	(224.6)
Total items that will not be reclassified to profit or loss		**104.1**	1,002.3
Total comprehensive income for the year		**34.1**	1,088.2

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2017

	Revaluation reserve £m	Retained earnings £m	Total £m
At 1 April 2015	-	(6.4)	**(6.4)**
Profit for the year	-	85.9	**85.9**
Actuarial loss net of tax	-	(20.9)	**(20.9)**
Revaluation net of tax	1,023.2	-	**1,023.2**
Transfer to retained earnings	(45.3)	45.3	**-**
At 31 March 2016	977.9	103.9	**1,081.8**
(Loss)/profit for the year	-	(70.0)	**(70.0)**
Actuarial loss net of tax	-	(37.4)	**(37.4)**
Revaluation net of tax	141.5	-	**141.5**
Transfer to retained earnings	(50.3)	50.3	**-**
At 31 March 2017	1,069.1	46.8	**1,115.9**

The parent company had £30.2m reserves as at 31 March 2017 which related to dividends received from its wholly-owned subsidiary.

CONSOLIDATED BALANCE SHEET AS AT 31 MARCH 2017

	Note	2017 £m	2016 £m
Assets			
Non-current assets			
Property, plant and equipment	9	**5,065.2**	4,841.3
Intangible assets	10	**119.5**	105.7
Financial assets:			
- derivative financial instruments	16	**2.2**	0.2
		5,186.9	4,947.2
Current assets			
Trade and other receivables	12	**563.2**	544.2
Inventories		**2.8**	2.1
Financial assets:			
- derivative financial instruments	16	**4.0**	3.6
Cash and cash equivalents	13	**100.6**	135.1
		670.6	685.0
Total assets		**5,857.5**	5,632.2
Liabilities			
Current liabilities			
Trade and other payables	14	**(556.5)**	(527.4)
Financial liabilities:			
- borrowings	15	**(39.3)**	(73.5)
- derivative financial instruments	16	**(35.2)**	(24.0)
Provisions for other liabilities and charges	18	**(1.2)**	(3.2)
		(632.2)	(628.1)
Net current assets		**38.4**	56.9
Non-current liabilities			
Trade and other payables	14	**(204.6)**	(159.2)
Financial liabilities:			
- borrowings	15	**(2,938.8)**	(2,869.7)
- derivative financial instruments	16	**(448.0)**	(393.8)
Post employment benefits	22	**(95.2)**	(56.5)
Provisions for other liabilities and charges	18	**(9.6)**	(11.3)
		(3,696.2)	(3,490.5)
Net assets before deferred tax		**1,529.1**	1,513.6
Deferred tax - net	7	**(413.2)**	(431.8)
Net assets		**1,115.9**	1,081.8
Equity			
Revaluation reserve		**1,069.1**	977.9
Retained earnings		**46.8**	103.9
		1,115.9	1,081.8

C A Jones
Chief Executive

P J Bridgewater
Finance and Commercial Director

PARENT COMPANY BALANCE SHEET AS AT 31 MARCH 2017

	Note	2017 £m
Assets		
Non-current assets		
Investment in subsidiaries	11	**3,228.6**
		3,228.6
Current assets		
Cash and cash equivalents	13	**30.1**
		30.1
Net assets		**3,258.7**
Reserves		
Retained earnings		**30.2**
Revalution reserve		**3,228.5**
Total reserves		**3,258.7**

STATEMENT OF CHANGES IN RESERVES FOR THE PERIOD ENDED 31 MARCH 2017

	Revaluation reserve £m	Retained earnings £m	Total £m
Balance at incorporation	-	-	-
Profit for the period	**3,228.5**	**30.2**	**3,258.7**
Balance at 31 March	**3,228.5**	**30.2**	**3,258.7**

The parent company was incorporated on 15 December 2015. It acts as a holding company and does not trade.

C A Jones
Chief Executive

P J Bridgewater
Finance and Commercial Director

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2017

	Note	2017 £m	2016 £m
Cash flows from operating activities			
Cash generated from operations	19a	**336.9**	368.9
Interest paid	19b	**(124.6)**	(128.9)
Income tax received		**1.1**	0.2
Net cash generated from operating activities		**213.4**	240.2
Cash flows from investing activities			
Interest received		**3.8**	5.6
Purchase of property, plant and equipment		**(237.7)**	(195.0)
Purchase of intangible assets		**(33.5)**	(25.0)
Grants and contributions received		**16.1**	16.7
Net cash outflow from investing activities		**(251.3)**	(197.7)
Net cash flow before financing activities		**(37.9)**	42.5
Cash flows from financing activities			
Long term loans received		**70.0**	-
Repayment of borrowings		**(36.9)**	(80.4)
Term loan repayments		**(20.3)**	(46.6)
Finance lease principal payments		**(9.3)**	(51.4)
Other loan repayments		**(0.1)**	(0.2)
Net cash flow from financing activities		**3.4**	(178.6)
Decrease in cash and cash equivalents	20b	**(34.5)**	(136.1)
Cash and cash equivalents at 1 April		**135.1**	271.2
Cash and cash equivalents at 31 March	13	**100.6**	135.1

PARENT COMPANY CASH FLOW STATEMENT FOR THE PERIOD ENDED 31 MARCH 2017

	2017 £m
Cash flow from investing activities	
Dividend received	**30.2**
Investment in subsidiary company	**(0.1)**
Net cash flow from investing activity	**30.1**
Net increase in cash and cash equivalents	**30.1**
Cash and cash equivalents at incorporation	**-**
Cash and cash equivalents at 31 March	**30.1**