GLAS CYMRU

PRELIMINARY RESULTS

2023

Dŵr Cymru Welsh Water

COMPANY NUMBER: 09917809

CONTENTS

FOREWORD TO THE PRELIMINARY RESULTS ANNOUNCEMENT

Basis of Preparation

The following announcement of preliminary results includes information which has been extracted directly from the Glas Cymru Holdings Cyfyngedig (Glas Cymru) Annual Report and Accounts for the year ended 31 March 2023, approved by the Board on 16 June 2023.

The audited Annual Report and Accounts will be received by Members at the Glas Cymru Annual General Meeting on 7 July 2023. The Annual Report and Accounts will also be made available online at dwrcymru.com. 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 auditor, KPMG LLP, have given an unqualified report on the consolidated financial statements for the year ended 31 March 2023. The auditor's report did not include reference to any matters to which the auditor 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 following 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 not a guide to future performance and persons needing advice should consult an independent financial adviser.

References to Glas Cymru and the Group in this document refer, respectively, to Glas Cymru Holdings Cyfyngedig and the group of companies of which it is the parent; references to Welsh Water relate to Dŵr Cymru Cyfyngedig, the principal operating company in the Group.

CHAIR OF THE BOARD'S STATEMENT

“CLIMATE CHANGE AND PROTECTING THE ENVIRONMENT REPRESENT OUR GREATEST CHALLENGES IN THE DECADES TO COME.”

Alastair Lyons CBE
Chair of the Board

My message in the FY 22 Strategic Report talked of characterising the year as a perfect storm with our business and our people in the eye of the storm. I then spoke about abnormal hot weather with the consequent stressed availability of water, exacerbated by staycation tourism; supply issues, particularly of chemicals; the disruption caused by major storms; soaring energy prices; and greater than ever societal focus on the environment and river quality.

As you will see from Peter Perry's Chief Executive's Message that follows my own, I could write the same headline about FY 23, and highlight the same issues. It is unfortunately the case that the exceptional now has to be regarded as commonplace. If we are to realise our Vision 'to earn the trust of our customers every day' we have to plan to be able to handle the exceptional without these issues and events disrupting the lives of either our customers or our people, these being our principal stakeholders. Our business has to operate at a higher level of resilience than was necessary in the past. We cannot continue to ask our people to make unremitting exceptional contributions of their time and effort no matter how generously they have given, and continue to give, of both. Last year, as Peter recalls, the challenges of maintaining our normal services during, and then recovering from, the long dry summer that lasted into the autumn passed almost seamlessly into handling the December freeze/thaw. Many of our people volunteered in the run-up to and over Christmas to help mitigate the impact of this on those of our customers who lost supply as a consequence. My sincere thanks, personally and on behalf of the Board, go to everyone who worked so hard to deliver the quality of service we aim to provide.

Our Vision: To Earn the Trust of Our Customers Every Day

We are also very conscious that it took us longer than we would have wanted to restore normal service for some of our customers. My apologies go to them. We have taken on board the lessons learned to be able to respond better next time this happens, as it most surely will. Wherever we fall short of our own standards and the expectations of our stakeholders, in particular of our customers, which in turn erodes their trust, we will always hold up our hand, apologise, make amends in the most appropriate way, and work hard to improve so it doesn't happen again.

As a case in point, our internal assurance processes that govern our regulatory reporting have found that for the two financial years FY 21 and FY 22 we misstated the leakage from our networks, in particular from our trunk mains. This should not have happened and our Board has decided to apply a £10 refund to every customer as an apology for the misreporting causing us not to recognise earlier that we need to do more to reduce leakage. Ofwat has announced an investigation - the timing of which is uncertain - and we will of course cooperate fully.

We are now significantly increasing our investment in trunk mains leakage detection so as to get us back on track as rapidly as possible. We recognise that we cannot ask customers, whether households or businesses, to reduce their use of water if they cannot trust us to ourselves do whatever we can to ensure the water we produce is available to supply to our customers.

The same applies to our environmental record: we share fully the public concern relating to the health of our rivers and coastal waters and are always very sorry for any environmental harm that we cause linked to our wastewater services. Our Manifesto for Rivers in Wales sets out the investment we have planned in this AMP and the next to tackle first where we can make the biggest difference to water quality. By being completely open about our plans and sharing with our customers the scale of what we will invest we hope we can earn their trust that we are doing everything we can as fast as we can.

Doing everything we can to earn the trust of our customers is engrained in our not-for-shareholder culture and all culture starts at the top of an organisation. It was, therefore, entirely consistent with our culture that Peter Perry and Mike Davis should say that they would not accept any variable pay in respect of FY23. I and my colleagues very much respect this decision on their part and thank them for it.

Price Review 2024 (PR24)

As we prepare our plans for the next price review, encompassing both our detailed plan for the next five- year

price control from 2025 to 2030 and our Long Term Delivery Strategy out to 2050, we are planning against the backdrop of major challenges to our business from climate change, continuing economic and national/global political uncertainty, and changing expectations of our sector on the part of society as a whole. In so doing we are far from starting the process from cold. Welsh Water 2050, that we first published in 2018 and updated in FY 22, sets out the key trends and challenges that we see ourselves facing over the long term, and our strategic responses to these trends and challenges. We are also not planning alone. The challenges to which I refer are societal, not purely corporate, and how best to address them will most effectively be developed in partnership with our principal stakeholders. The PR24 Forum, chaired by the Welsh Government and comprising the Welsh water companies, our environmental, economic, and water quality regulators, and our Independent Challenge Group, enables a societal view of priorities to be taken, not just our own perspective on where we should focus. And that is critically important: to determine a plan that is deliverable, affordable and financeable we will have to agree priorities with our stakeholders. We will not be able to deliver, or afford, or finance everything that we and our stakeholders would like us to achieve over either the next or the following price control periods. There is also no certainty as to how these challenges will play out over the longer term. Our planning assumptions are just that – assumptions – and we have to be prepared to adapt our plans as we see the future more clearly and as events unfold. While we must avoid committing to a course that may not turn out to be the right one, we must equally avoid not taking action now that is needed to prepare for what is likely to happen. We, therefore, fully support the Ofwat PR24 methodology of a No Regrets core long-term pathway with alternative scenarios that identify what decisions may need to be taken, and when, if those core planning assumptions need to be flexed.

Taking each of these principal challenges in turn.

Climate change

This is causing, and will continue to cause, records to be broken on a regular basis. Last year it was highest ever temperatures, lowest levels in some of our reservoirs, and the fastest rise in winter temperatures in one day since 1947. We also saw the highest recorded level of the river Wye in Hereford. Many of the assets that are the backbone of our water and sewerage systems were designed with different conditions in mind.

With higher average air temperatures supporting great moisture content rain, when it falls, and it does frequently in Wales, will be more intense which creates greater run-off from impermeable surfaces and housing. This in turn overwhelms sewers that date back 50-100 years, leading to storm overflows of diluted sewage into rivers. The only alternative at present is for the sewer to back up into peoples' gardens and houses, and other buildings such as schools and hospitals. To change this the storm water either has to be prevented from entering sewers in the first place, or has to be captured and stored to be discharged when the flow through treatment works returns to normal. At present there are two such forms of storage – large concrete tanks with an attendant large carbon footprint, and nature-based solutions such as reed beds which filter the outflow before it reaches the river. To prevent rainfall entering sewers would require changing the current combined drainage system that services most of our housing stock to separate rain water from foul, and investing significantly in highway and surface water drainage to pipe rainfall straight into watercourses while avoiding just moving the risk of flooding elsewhere. All solutions come, therefore, at a very high cost, and with around 2,500 Combined Storm Overflows (CSOs) in Wales this has to be tackled progressively over an extended timescale if the investment is to be affordable, deliverable and financeable. While we will prioritise where we invest to tackle first those carrying the greatest ecological risk to water quality, we are very clear that any pollution of our rivers and coastal waters is unacceptable. If we are the cause it is always a matter of deep regret and raises our determination to learn so as to avoid it happening again.

> “WE ARE VERY CLEAR THAT ANY POLLUTION OF OUR RIVERS AND COASTAL WATERS IS UNACCEPTABLE.”

We have 91 reservoirs, many of which were built, as were our sewers, 50-100 years ago when design parameters envisaged a different level of stress event. Now reservoirs have to be equipped with spillways that can handle a 1:10,000 year storm requiring significant investment at many of our dams. As an example, the new spillway we are constructing at Llyn Celyn near Bala will cost £29 million.

CHAIR OF THE BOARD'S STATEMENT CONTINUED

Prolonged periods of dry weather require our water distribution network to have greater resilience. This can be achieved by increasing local storage, typically constructing new service reservoirs such as the one just completed at Pengarnddu outside Merthyr Tydfil which has cost £9 million. One can join up what have typically in Wales been source-to-tap water zones so as to provide alternative routes of supply if a particular reservoir runs low or the amount that we can abstract from a watercourse such as the Wye is restricted by the environmental regulator. We have plans to install an east-west connection in south Wales at a cost of £21 million. With dry weather comes ground movement which increases the frequency of mains bursts particularly affecting certain constructs of pipes such as those that predominate in West Wales – to replace these entirely would cost £1 billion.

Alongside prioritising the investments we make to ensure that they remain within what our customers can afford, and that we can physically deliver, we have to resource our business so it can respond to the inevitable asset failures and local emergencies that are the consequence of not being able to invest in everything immediately. That means increasing our ability to respond rapidly on the ground without making unsustainable demands on our people. In turn we must look to innovation to help us to become more efficient, allowing us to put extra resources into teams while reducing the need for activity elsewhere. Making the most of data science is critical here. We capture huge amounts of data from our own operations and have available to us supplementary data from external sources. Using this data to identify where to focus our efforts, both in response to events and in preparation for what may happen, allows our teams to be considerably more productive.

Uncertainty and Volatility

These have dominated personal lives and business since early in 2022 following the economic and geopolitical challenges brought about by Russia's invasion of Ukraine. For the two years before that we all suffered similar uncertainties caused by the Covid pandemic. In our planning and the way in which we manage the business we must, therefore, be prepared to handle uncertainty and volatility as the norm, rather than the exception, whether that is reflected in high inflation creating a cost-of-living crisis, turbulence in financial markets, shortages of supplies of chemicals key to the treatment process, or the uncertainty of what challenges will be created by changing weather patterns.

In times of uncertainty effective two-way communication is vital. We need to understand how the uncertainty impacts our principal stakeholders and they what we are doing to respond, and why this represents the most effective way we can mitigate its impact on them. Two of our six company values are to be Open with Everyone and to be Honest with Everyone. By living these values we aim to realise the third of our values, to be Trusted to Do the Right Thing.

Engagement drives understanding which creates trust that the organisation will always set out to do the right thing albeit, in an uncertain world, circumstances may work against us. Hence over the last year we have, as Peter outlines, sought to engage with our trade unions and our people to reach a mutually fair pay settlement for our business and people against a difficult economic backdrop. We have reached out to the various groups that are seeking to protect the quality of our rivers to explain the impact of our operations and the steps we are taking to reduce this. Similarly, we have engaged closely on these issues with our environmental regulators and with the Welsh Government, and we explained at first hand to the First Minister's Phosphate Summit the actions we as a company are taking as our contribution to tackle failing Special Areas of Conservation rivers and restart housing development in these catchments. Where the unforeseen creates problems for our customers, as during the recent freeze/thaw, we will aim to be visible in the affected communities advising the steps we are taking.

Key to addressing uncertainty is to understand clearly how resilient one is at present. As part of our preparation for the forthcoming price review we have built a new asset planning capability that has a much stronger understanding of our current asset resilience, is able to assess the impact on it of different scenarios, and can evaluate the resulting risk applying a multi-capitals, rather than purely financial, approach. As far as our financial resilience is concerned, we have assessed the impact on our key financial ratios of alternative bill profiles and investment plans and sought to identify the right balance between delivering against the objectives we have agreed with our stakeholders and creating an overall plan that is affordable by our customers and financeable in debt markets. In an uncertain world we have to be confident in our ability to access these markets as there is no equity backstop within our not-for-shareholder constitution. We were, therefore, very pleased to have Fitch Ratings recently affirm the A rating of our Senior Debt with a Stable Outlook.

In the recent "Your Water Your Say" open challenge session on our plans for the next price review, we identified investment we are proposing to make over the next 5 years to enhance our assets at a cost of £3.1 billion. That will be over £1 billion more than the considerable investment we have made during the current 2020-25 price control period and will mean that we will not be able to achieve our aim of keeping increases in bills below the rate of general inflation, something we delivered from 2010 until 2021/22. To deliver our long-term plan for the environment, in particular to avoid any ecological harm being caused to rivers by our assets, will, we project, cost in excess of £5 billion over the next 25 years. This will mean bills rising by around 5% above inflation every year of the next price control period. It is up to society – our customers and the Government – to determine what we should aim to achieve on the basis of society's priorities. The research we have undertaken with our customers tells us that they are prepared to have bills increasing if the money raised is invested in the right things, in particular to protect the environment, but how much they are prepared to spend on this has not yet been fully tested. The debate to date has been about substantially increasing investment, but only latterly are the balancing factors of the impact on bills and over what timescale should the investment be made beginning to emerge. What we do know is that customers also expect us to seek to ensure our bills are affordable for all, supporting those who would have difficulty paying the full amount through schemes such as HelpU, now proportionately the largest social tariff scheme in the sector, and our new Cymuned (Community) scheme to help those in work but who are struggling to make ends meet. Our not-for-shareholder model means this is something we have consistently front of mind in both the Boardroom and our business.

Society's Changing Expectations

This is something to which businesses must respond if they are to remain relevant and trusted. One can view the pandemic as creating a sea change in peoples' priorities and behaviours. This has been given considerable momentum by the force of social media creating a world where communication and reaction is instantaneous. One now looks for flexibility in all three aspects of life – work; family; social – with an expectation that there should be give and take in each to meet the needs of each. Hence, we have moved to hybrid working wherever it is practical but recognising that social cohesion also requires physical contact to create and bond teams. Long periods of home working during the pandemic would appear to have made people much more sensitive to, and appreciative of, the environment, this in turn reinforced by the recognition of the threat to the environment posed by climate change. Given our not-for-shareholder constitution we exist to deliver our customers' expectations, hence we need to take the most effective action we can to protect the environment, in particular to avoid pollution. We strongly support the Welsh Government's emphasis on preventing ecological harm to our water bodies. Our Drainage and Wastewater Management Plan, which we will be publishing later this year, is prioritised on this basis of avoiding harm. Similarly, there is full alignment between the Government's long-term focus as articulated in the Wellbeing of Future Generations Act and our long-term vision as set out in Welsh Water 2050. Without the short-termism that is inevitable in equity markets we can also determine what we do by considering the long-term interests of our customers and society.

We recognise that our customers' expectations are driven by the best service that they experience regardless of sector. If one can track a parcel from the moment it is ordered through to its delivery and know to within an hour or two when that is going to happen, why shouldn't one be able to do the same when requesting a meter? We have now introduced a workflow tracking portal so that customers can track the progress of their meter application, as well as checking the status of the work we are doing for them. People do not want to hang on waiting for a call centre to answer to change personal details, find out the balance on an account, or settle bills – our digital systems need to match our customers' expectations and each year we expand the range of services available online – next to come will be a customer mobile app to make it easier to pay a bill, and an online service for our non-household customers. If one does need to speak to someone about a problem one does not want to be passed from pillar to post having each time to repeat the same story: we now have a complex case team giving customers a named contact who owns their case through to resolution, linking in with the relevant operational teams and giving the customer regular updates.

Customers now expect businesses to make a positive contribution to society and the environment, and to mirror the diversity of the customers they serve. They expect high responsiveness and full transparency. With only our customers' interests to serve we are ideally placed to deliver against these expectations. Later this year we will be making available real time data on the operation of storm overflows as a further development of the real time data we already publish on the operation of overflows close to bathing beaches.

On the theme of diversity, we are actively seeking to increase the proportion of our colleagues who are female or from an ethnic minority. Currently just under 30% of our workforce are women, and just under 4% are from an ethnic minority compared with 5% for the Welsh population as a whole. We have increased to 35% the proportion of our Executive Team who are female and were pleased to see the median gender pay gap fall to 3.6% compared with a UK national average of 14.9%. Our aim is to attract and recruit more female and under-represented groups and we were delighted to welcome both Lila Thompson and Barbara Moorhouse to join our Board last year – 50% of our Board is now made up of women. Our targets are that 35% of those colleagues in our talent pipeline for senior roles are women, and to make a 5% improvement each year in under-represented groups applying for roles.

In his report Peter discusses in detail both what we achieved, and where we struggled, last year. While we have performed well in some areas such as overall customer satisfaction and relative environmental performance, we recognise we have significant ground to recover in others such as customer acceptability, supply interruptions, leakage, and water quality. Our plans for the final 2 years of this price control period, and for the next, focus our management efforts on achieving sustained improvement in these areas, supported by the necessary investment. These were set out in the Performance Plan published in March this year, (https://dwrcymru.com/ourplans) against which we are making good progress. As befits a long-term business we have long-term objectives in respect of the quality of the services we provide our customers and our impact on the environment. We recognise that to deliver these we will need to work in partnership. To deliver improved water quality in our catchments and our rivers we need the support of agriculture and local authorities. To reduce sewer blockages we need households and businesses to take action to change what they put into the system. To reduce leakage we need to work with our customers to identify where we are losing water, in both our network and their premises. To reduce the use of water we need to support and incentivise behavioural change by our customers. To achieve all these things we need, and commit to, a Team Wales approach, earning the trust of our partners to justify their participation. As I said earlier, trust is built by openness and honesty and being seen to care about the contribution we make to the communities of which we are a part.

Thank you

To finish where I started, thank you to everyone in the business, and to our partners, for having supported our customers and their communities through a very challenging year. My personal thanks to our management team and my colleagues on the Board for their commitment and sound advice as we have sought to navigate the best possible path through these challenges.

Alastair Lyons CBE
Chair of the Board

CHIEF EXECUTIVE OFFICER'S MESSAGE

WE RESPONDED DECISIVELY TO EXTREME WEATHER EVENTS IN THE YEAR TO LIMIT DISRUPTION TO OUR SUPPLY AND WASTEWATER SERVICES.

Peter Perry
Chief Executive Officer

Key Challenges in FY 23

2022 presented us with some very challenging operating conditions linked primarily to the weather. This is indicative of the climate change impact we have begun to experience, though perhaps with a frequency we weren't expecting to see quite as early as it is actually materialising.

The drought of 2022 was a significant event for us and has stretched us like no other similar event in the history of the business. As we approached the beginning of the new financial year all of our reservoirs were full, with many overflowing. However, in April 2022, as the Meteorological Office started to predict a dry spring, we acted swiftly to set up a weekly director-led review of water resource planning. Having experienced the impact of 'staycations' on water demand in the preceding two years, especially in the coastal tourist areas, we also began to implement targeted 'use water wisely' messaging to customers in these areas during April. We sustained this throughout the summer and into the autumn.

The Bank Holidays from Easter through to Whitsun saw very little rain being forecast, and we could see the prospect of a long dry summer ahead of us. This came to pass, with what turned out to be the hottest and driest period of weather seen across Wales in over 50 years. Guided by our water resource and drought plans, we implemented actions from spring onwards to mitigate the impact on customers and the environment.

In previous drought years, such as 2018, 2003 and 1995, peak summer demand lasted a few days or perhaps a week at most. In 2022 we saw sustained peak demand over several weeks during the summer. On 18 July, the highest temperature ever recorded in Wales at 37.1°C occurred in Hawarden, Flintshire. In this period we increased by an average of 20% the water put into supply across our operating area. In some locations, especially those in tourist areas, the increase was in excess of 30%.

With our increased level of supply and mitigation oversight in place, in late August we identified the potential for supply problems emerging in our Llys y Fran supply system serving much of Pembrokeshire (60,000 properties). In accordance with our Drought Plan, we activated a Temporary Use Ban – more commonly known as a hosepipe ban – in this area on 19 August. A combination of low rainfall, high temperatures and increased demand, in part worsened by staycation tourism, led us to act. This was the first time for over 30 years that any form of water restriction had been deployed in Wales. We introduced the restriction to preserve water for public supply and also to environmentally protect the Cleddau, a Special Area of Conservation river in the south of Pembrokeshire.

I take this opportunity to acknowledge the great support we received from the Welsh Government and Natural Resources Wales, our environmental regulator, in working with us to sustain the Llys-y-Fran system. During and immediately after lifting the restrictions we undertook independent research in the affected area to gauge customer reaction. The majority supported our approach to implementing the restrictions and it was humbling to learn how much understanding there is of climate change risk and a willingness to cooperate with us in these circumstances.

Over the last 2 years I have noticed how staycation holidays have stretched our services in a number of tourism areas and this again took place during the summer and autumn of 2022. In fact, due to the drought and high temperatures, the period of staycation lasted much longer into the autumn than we have seen before. It was encouraging to see that the investment we made over the winter of 2021-22, to strengthen our resilience in Pembrokeshire, mitigated problems of distributing water through our network serving the St Davids area. Without this investment the drought impact in this area would have been much more challenging. More widely, through the summer and early autumn period we had our entire water tanker fleet (40 vehicles) deployed for much of the period. In May we took the decision to add a further 10 hired vehicles to the fleet, and this served us well in increasing the level of tanker support we had available in rural and tourism areas over that period to deal with peak demand. In west Wales in particular, the hot and dry conditions caused significant soil moisture deficit, resulting in a 30% increase in burst mains due to ground movement. We plan to mitigate similar future risk in the area through our PR24 investment plans.

While the focus during a drought tends to be on our drinking water activities, we should not overlook the impact that sustained dry conditions have on our wastewater business. Low water levels in our wastewater network increase the incidence of blockages and mean that sewage is less diluted and, therefore, is more difficult to treat when it arrives at our treatment works. It also means we see increased production of wastewater sludge, which places additional risk on maintaining compliance at our sewage works. In 2021 we invested in additional sludge treatment capability in west Wales, and this proved invaluable in 2022, especially under increased loading due to the staycation impact.

The hot weather saw a sustained period of very low river levels across our operating area and this increased the potential for any incidents at our treatment works or in our sewer network to have a greater impact. Through the great effort of our people this was minimised by increasing the levels of operational monitoring and maintenance.

The drought had its most significant impact for us in the west, although as we moved through summer into early autumn, rainfall there eased the situation, and we lifted the restrictions in Pembrokeshire at the end of October. However, through this period there was little rainfall in south-east Wales and we worked hard and acted decisively to move water around this largely urban area to sustain supplies and protect the environment, and to limit disruption to our customers. This continued into November until the onset of normal levels of rainfall saw the risk diminish. The very low reservoir levels reached at this time also made the remaining raw water incredibly difficult to treat, so over the summer we bought every portable carbon dosing rig available in Europe at that time to deal with this unprecedented challenge. Never before have we seen the impact of drought last so long and I cannot over-emphasise the gratitude I have for our operational teams who worked around the clock to deliver our services in these unprecedented circumstances.

With the drought recovery still very much fresh in our minds, we faced a further significant weather challenge in December. For much of the month we experienced sub-zero temperatures across our operating area. We knew that a thaw would mean significant potential impact on our water infrastructure. With this in mind, and with a Meteorological Office forecast that the thaw would occur on 17-18 December, we deployed our Gold level command structure on 12 December along with establishing our company-wide regional Silver centres at the same time. In the event, the thaw arrived slightly earlier than predicted, on 16 December, and in the west a temperature swing of 6.7°C saw the fastest rise in winter temperature in a single day since the record-breaking winter of 1947.

The western county of Ceredigion, along with parts of Powys in mid Wales and rural Herefordshire, saw the lowest mean temperatures recorded by the Meteorological Office across the UK for December 2022. Only the Scottish Highlands were colder. When the thaw arrived in these parts of Wales and England, starting on 16 December, the ensuing level of bursts in our network and in customer premises saw probably the fastest depletion of water in our distribution system that we have ever experienced.

While we maintained supply to over 99% of our customers across our whole operating area, these rural communities saw c.15,000 properties lose supply for a sustained period: in the worst cases, for up to four days. We implemented our full incident response, including deployment once again of our entire fleet of water tankers, mobilisation of over 500 people to find and fix leaks, and provision of over 1 million litres of bottled water. Due to the length of time for which some customers lost supply we made the decision to ensure they were speedily compensated and I am pleased to report all those affected received £70 per day when supply was lost. We made c.15,000 automated payments to these customers by the end of February 2023.

This was a significant operational incident and we acknowledge the impact on our customers, particularly those who were most affected. We have learnt lessons to help us improve our future response in similar circumstances. This includes keeping customers better informed during incidents, and deployment of alternative water supplies in large rural areas. I would like also to recognise here the effort of my operational colleagues again for their commitment during this period. Many of them had worked tirelessly in response to the drought only to be called on again to deal with further challenging operational conditions soon afterwards. The response this time spanned the Christmas holiday period, with many staff foregoing time with their families to help with this emergency; and for this I am hugely grateful.

FY 23 has also been a challenging year for our customers due to the cost-of-living crisis. We have put considerable effort into promoting how those who are struggling to pay can access help and support from us. We are working with over 300 organisations across our operating area to reach people and communities worst hit by the current tough economic circumstances. Proportionately, we have the largest social tariff schemes (HelpU and WaterSure Wales) of any water company, helping around 129,000 customers with discounts of up to £209 off their bills. We have made provision in the year to add a further 50,000 new participants to the schemes. In January 2023 we also launched the first scheme of its kind in the sector to help people who are not on means-tested benefit but who have negative budgets, more commonly known, sadly, as the working poor. We have launched this as the Cymuned (Community) scheme in two areas – Denbighshire and Rhondda Cynon Taff, and will be rolling it out more widely across our operating area.

As Alastair has mentioned in his statement, after a difficult year for the business and customers, Mike Davis, CFO, and I thought it appropriate not to take our variable pay for FY 23.

While not on the scale of the two major weather events we faced in the last year, I want to mention a very different type of risk we faced in July 2022, when we experienced a distributed denial of service (DDoS) cyberattack on our website. The attack originated from Russia and, thankfully and due to our preparedness, did not penetrate our perimeter defences. We took our website down overnight to ensure it remained secure and to restore it with the optimal protection in place. In line with relevant protocols, the incident was communicated to the National Cyber Security Service and details were also shared with other water companies. We have not seen any subsequent attacks of similar scale or ferocity, but this was a timely reminder to us, as an operator of national critical infrastructure, of the ongoing risk and threat level at a time of world crisis. We have invested heavily in recent years to bolster our capability and defences in this critical area and will continue to do so.

CHIEF EXECUTIVE OFFICER'S MESSAGE CONTINUED

I was very pleased that we were one of the few commercial organisations to be invited to participate in the NATO Marvel cyber exercise in early 2023, where we achieved a third place ranking for our defence capability, out of more than 30 organisations involved.

River and Coastal Water Quality

The momentum behind public interest in river and coastal water quality has grown further and faster over the last year. Since the Covid-19 pandemic, interest in rivers has become a national topic and in 2022 this has culminated in more political and environmental attention. We are acutely aware of this and are committed to being open and transparent about our impact and the role we play to improve water quality across our operating area.

Circumstances in the rest of the UK are different to those in Wales, where the Welsh Government recognises that nutrient pollution, and in particular phosphate, is the greatest threat to river quality. That is why in July 2022 we were pleased to support the First Minister at his 'Phosphate Summit' which brought together government, regulators, water companies and representatives from the agricultural sector to develop a joint action plan to reduce phosphate in Welsh rivers, particularly targeting the 5 failing Special Area of Conservation (SAC) rivers across the country: the Cleddau, Dee, Teifi, Usk and Wye. We are investing around £100 million in AMP7 to reduce phosphate on these rivers and are planning to bring forward a further £60 million to accelerate investment on them by FY 26. More broadly, we fully support the Welsh Government's policy of prioritising investment to reduce environmental harm as a meaningful way to target the fastest improvement and ensure best value for our customers.

Over 40% of Welsh rivers have 'good' ecological status (as measured under the EU Water Framework Directive) compared with 14% in England. In Wales, 60% of our sewerage network is combined (among the highest levels in the UK) and we have some of the heaviest rainfall. This results in relatively high numbers of CSO spill events. In the vast majority of instances, the environmental impact is not as acute as that from nutrient pollution. Our focus on reducing nutrient pollution will provide the greatest opportunity for further improvement. For example, our detailed modelling of the rivers Usk and Wye shows that only 1% and 2% respectively of pollution impacts on these rivers is due to overflows. Nevertheless, we share the public concern over river quality, and are absolutely committed to reducing the impact of storm overflows on rivers and coastal waters. We are spending around £100 million in the current regulatory period to do this, tackling spill numbers from CSOs as well as nutrients effects.

The improvement of overflow performance, alongside other actions to improve river quality, has to be a long-term programme due to the scale and configuration of our sewerage system. The costs will be substantial and we will need to consider carefully the affordability of this long-term plan and the impact on future customer bills.

With this as a clear focus to improve river quality we are also pleased to be supporting the wider action plan from the Phosphate Summit and are working with regulators and the Welsh Government to progress these. As part of this programme, we are keen to support the Nutrient Management Boards (NMB) set up to cover the SAC rivers. We have supported the longest-established NMB in Herefordshire, focused on the river Wye. In addition to our substantial investment programme to improve this river, we are helping establish innovative sustainable solutions to tackle phosphate, such as wetlands, in the north of the county, working jointly with Herefordshire Council and the agricultural sector. We expect this work to provide a useful blueprint for us to establish across Wales.

The level of interest in our activities linked to water quality has seen us continue to undertake considerable stakeholder engagement over the last year. This has involved meeting politicians, river users and community groups across our operating area. It has also involved attendance at some challenging public meetings where we are doing all we can to show that we are taking extensive action to improve the water quality environment. I do not underestimate that public sentiment will remain potentially hostile towards the sector. However, we will embrace all the opportunities we get and seek to transparently explain how we recognise there is more to do and that we are committed to achieving that.

To help with this, we have appointed 3 dedicated River Liaison Managers whose sole remit is to work closely with river users and communities to understand their concerns, and to inform them of our impact and our proposed improvements. Their role is long-term, and is aimed at building open and transparent relationships so we can demonstrate our commitment to making improvements. This year, as an example of this, our River Liaison Managers have engaged all the river and coastal bathing groups in Wales known to us to identify where they swim and to understand where new bathing locations can be identified and potentially supported. During last summer, largely driven by CSO spills during storms on the south coast of England, we saw an increase in public interest in a very low number of short-duration events at 6 of our coastal outfalls at bathing beaches. Each instance saw our respective assets operate to a standard comparable to the latest EU requirements. I flag this to illustrate how sensitive society is becoming to any form of overflow and in this instance to show this is the case even when we match a recognised leading standard.

Ensuring we maintain the maximum transparency of our environmental activities is important and we continue to have one of the the highest levels of monitors on our overflows with over 99.5% coverage. We were among the first companies to make this information publicly available and in 2022 we made mapping information of our overflows available in the same way. In 2025 we intend to provide a public real-time data service showing overflow operation. In the meantime, we continue to provide real-time alerts for bathing beaches via the Surfers Against Sewage App service and have in place similar alerts with a number of bathing groups across Wales.

We have an investment programme of £840 million for wastewater infrastructure in AMP7. Ensuring that we engage and communicate how this is benefiting our customers and their environment is essential in demonstrating we are doing all we can to achieve continuous environmental improvement.

In May 2023, Water UK coordinated a sector-wide 're-set' in England which included an apology for the environmental performance of the sector and a commitment to accelerate investment in CSOs. Although we were not directly involved, because we are not affiliated to Water UK, we did use it as an opportunity to apologise and to reiterate our commitment to safeguarding the environment, and to share the plans outlined in Our Manifesto for Rivers in Wales (https://dwrcymru.com/rivermanifesto).

Our Performance

I have already outlined how challenging a year this has been for us and this has resulted in some impact on our overall performance. However, I am pleased that we achieved 4th place for water and sewerage companies in the Ofwat overall customer satisfaction ranking, C-MeX, this year, bearing in mind we experienced extreme weather events in the year which were particular to Wales. Similarly, we were encouraged to achieve the highest level of business customer satisfaction in the Consumer Council for Water assessment 'Testing the Waters'. The survey was conducted in 2022 and reported in 2023.

We have been encouraged by improvement in our water quality performance after a dip in 2021. Our bacteriological performance that year saw minor coliform failures at 6 treatment works and 14 service reservoirs. In 2022 this improved to 3 treatment works and 3 service reservoirs. This turnaround moves us back to the industry upper quartile for bacteriological performance, which we achieved for many years prior to 2021. However, while our overall Drinking Water Inspectorate (DWI) measure on the Compliance Risk Index has improved to 5.4 in 2022 compared to 9.77 in 2021, our water network quality, covering iron compliance and instances of discolouration, remains a challenge for us. This is influenced by the predominance of soft upland waters in our operating area and a high proportion of cast iron water mains in our network. We are investing over £150 million to improve network quality in AMP7 and this will be repeated in our PR24 plans.

While we have seen improvement in drinking water quality, our supply interruption performance has deteriorated. This is a challenging measure for us due to our topography, which results in a large number of discrete supply zones, (making it more difficult to move water between areas when there is, for example, a trunk main burst) and in the need for high operating pressures in our water network. FY 23 was also impacted by the freeze/thaw incident highlighted earlier in my statement. We have reported 44 customer minutes lost, largely as a result of the impact of the drought and freeze/thaw events in 2022.

Restatement of Regulatory Reporting for Prior Years

In last year's Annual Report and Accounts we disclosed that we were reviewing our reported performance data for leakage and per capita consumption. This review was necessary because our independent annual assurance processes identified potential issues with the application of the methodology used for calculating these measures in FY 21 and FY 22. The review concluded that these key measures have been inaccurately reported in those two financial years, with actual leakage being higher than reported during this period, and actual per capita consumption being lower than previously reported.

This mistake should not have happened, and we apologise unreservedly. While our robust assurance process identified the issue, there were failures in our governance and management processes that should have identified the issue sooner. We have made changes to how we manage our leakage reduction activities and strengthened our reporting and governance processes; and we are investing an additional £54 million to identify and reduce leakage as quickly as possible. Every Welsh Water customer will receive £10 automatically credited to their account due to this error, as compensation for our misreporting and its effects.

On 25 May 2023 Ofwat announced it is launching an investigation into our reporting of leakage and per capita consumption. We have shared with Ofwat the findings of our internal investigations, the remedial actions we have taken and our customer redress proposals. The timing of the investigation is uncertain, but we will of course cooperate fully.

Our environmental performance has remained positive despite the challenging conditions linked to the summer drought commented on above. We expect to achieve a 2-star rating in the annual Environmental Performance Assessment, which is lower than our performance in 2022.

Despite the challenging summer, it was good to see our annual measures for wastewater treatment works compliance improve slightly to 98.49% from 98.32% in 2022 our overall number of pollution incidents remained broadly the same as 2021, which is the 2nd lowest level of incidents for any company in England and Wales last year. Our environmental performance should be viewed in the context of the very difficult operating conditions touched on earlier, with higher-strength influent treated at our works, more blockages in our sewerage system due to low flows in them, and lower river levels meaning any incident had the potential to cause more harm than in normal conditions.

Our internal sewer flooding performance, (the worst service failure that our customers can experience), also improved, with 169 incidents compared to 201 in 2022. The unusually dry conditions over much of the year influenced this but it has been encouraging to see the development of our smart sewer network plan helping us target improved maintenance and to predict potential problems before they impact customers or cause pollution.

Retail performance in FY 23

In my report to you last year, I touched on the financial uncertainty that many of our customers were facing, and the situation has not improved in the 12 months since then. Despite these difficulties, we have not yet seen any deterioration in the overall ability of customers to pay their bills, and levels of arrears are very similar to last year. Our social tariff and financial assistance schemes are now supporting 129,000 households, a small increase over last year.

We recognise that the current cost-of-living crisis is very different to previous financial shocks. With unemployment levels at record lows, fewer customers are seeing their incomes reduced, but instead face rising household bills resulting in negative budgets. These customers are generally not served by typical financial assistance schemes and a different approach is needed. In response to this, we introduced in December 2022 an innovative scheme in Rhondda Cynon Taff and Denbighshire with the aim of helping working households with negative budgets. This scheme, named Cymuned, will be available more widely across our supply area later in 2023.

CHIEF EXECUTIVE OFFICER'S MESSAGE CONTINUED

Our ability to introduce this innovative support so quickly is testament to the strength of our network of partner organisations, now some 300 strong. This year we launched a new way of working with these partners via our mobile Community Hub, where the Welsh Water team, accompanied by organisations such as Warm Wales, local authorities, Job Centre Plus, visit locations across the country to speak to people about household bills, debt advice and accessibility of services. This has allowed us to speak to 4,000 people who otherwise might not contact us directly. It was really pleasing to get external recognition in February 2023 of the good work that we are doing to support customers in vulnerable circumstances, with our accreditation under BS 18477, 'Inclusive Service Provision'.

Moving onto our overall levels of customer service, despite the efforts of teams across the business, the loss of supply and low network pressure resulting from the severe drought in the summer, followed by the freeze/thaw event over the Christmas period, has impacted on satisfaction with our water service, highlighted by the 78% increase in complaints in this area.

Against our industry measure of household customer satisfaction, C-MeX, we have seen our performance maintained around the industry average, reflecting the improvement plans that we put in place over the last year. A key area of focus for us for the year ahead is to improve our online digital customer experience.

Capital programmes improve services and resilience for now and the future

The capital programme in Year 3 of AMP7 has invested around £400 million as we deliver against our regulatory and stakeholder commitments and maintain our asset base. We completed some significant schemes in the last financial year, including bringing online a newly constructed service reservoir at Pengarnddu; providing an additional 10ML/d of storage to improve the resilience of water supply to our customers in Merthyr Tydfil and the Aberdare Valley. We continue to invest to bring our impounding reservoirs up to the highest industry standards. We have completed works at Upper Carno in the year, with a new spillway and draw-off arrangements, and work at Nant Moel and Llandegfedd reservoir. We held an event for the formal opening of our new raw water pumping station at Prioress Mill, giving local customers and stakeholders the opportunity to see the improvements we are making in our asset base.

In our wastewater estate we are well underway with our programme of environmental improvements. In the year, we have completed a nutrient removal scheme at Weobley WWTW to reduce the level of phosphate entering the river Wye. We have commissioned a new CSO and storm screen on the river Usk to improve river water quality. We have completed a programme of safety works at our Cog Moors and Five Fords advanced sludge digester sites to improve gas safety. We have improved our resilience to the potential for sludge spills to the environment by completing schemes to bring our larger sludge centres into compliance with the Industrial Emissions Directive (IED) with schemes at Cardiff, Queensferry and Afan; and we have improved the performance of our wastewater treatment works through maintenance schemes to replace the inlets and screens at Ganol and Dolgellau.

We are making good progress on enhancing our visitor attractions with the new visitor centre sited on Llanishen and Lisvane Reservoirs, which is scheduled to open in the summer of 2023. We continue to make good progress on our net zero carbon strategy, specifically with renewable energy schemes, completing new solar installations at Chester and Llanelli and installing energy-efficient blowers at Cog Moors and Cardiff WWTW.

We take opportunities to improve performance seriously and over the past 12 months we have made good progress delivering the agenda set out in our refreshed Innovation Strategy. We have worked with over 100 academic and other institutions, technology specialists, and global innovation concerns to drive the innovation agenda forward. In 2022, we progressed 46 technology-related projects from a total of 179 proposals which were submitted to our web-based innovation portal. We have also been awarded funding for ,or are part of, innovation projects worth £35.7 million, via the Ofwat £200 million innovation fund. Our research programme, which includes our biodiversity projects and others targeted at informing regulatory and policy change, has so far in this AMP committed £3.3 million which is leveraged to £32 million by third-party investments, mostly from the EU LIFE fund, UK Research and Innovation (UKRI), and the Welsh Government. Such projects and initiatives continue to be reviewed through our now well-established iLab process and support both our AMP7 targets and Welsh Water 2050 strategy to ensure that our investment remains appropriately focused.

In our retail services work for customers, we have continued to grow our digital services in line with our Digital Strategy. Automation on our main billing forms continues to grow with around 302,000 webforms submitted last year: 73% of these were automated directly into our back end systems which is an 11% increase over last year's automation. We went live with our new upgraded 'moves' webform and a 'My Account' service for the main billing forms, which allows customers to log in to My Account and not need to re-enter further identification details when transacting with us, giving a more personalised and improved service with increased automation. We currently have 34% of our customers signed up to My Account. This year we have also rolled out our 'agent portal' service which allows agents to sign customers up to My Account while they are on calls with them. We are also very active in supporting Spring Innovation Ltd, the centre of excellence for innovation in the water sector which was formed in 2022. We hope to see the new company flourish and enable us to more efficiently undertake trials of treatment processes as well as share knowledge more effectively across the whole sector.

People

In FY 23 we achieved our best ever safety performance with a total of 5 reportable injuries and 18 less serious lost-time incidents. This continues a trend of progressive reduction over the last decade. Significant effort goes into achieving this high standard of safety performance and I am very grateful to our managers, our safety professionals and indeed all of our workforce for their dedication and contribution to these results. Our 'Safety Takes Every Person' (STEP) training programme is well established and continues to be used to engage our people in contemporary health, safety and wellbeing best practices. STEP also supports our safety culture and long-standing elements of our improvement plans, such as our quarterly executive-led 'Safety Days', the 'Take 5' personal risk assessment process and our monthly 'Safety Conversation' engagement plan; all of which are helping us further embed a safety-first mindset in our people and our contract partners.

Alongside our direct safety plan, we expend a lot of effort on occupational health and wellbeing. We have retained our RoSPA Gold Award and the Welsh Government Platinum Award for occupational health. Through the Covid-19 pandemic period we recognised the whole-life impact it had on our people and we have sustained our focus on mental wellbeing, with provision of free services such as our Employee Assistance Programme which is available to all colleagues. We have also recognised the impact of the cost-of-living crisis and have sought to implement support that especially helps those colleagues who may have some personal difficulties at this time.

In addition to enhancing our support services for colleagues during a period of economic difficulty, we acted earlier than usual to implement our pay deal for 2023. With the full support of our trade unions, in December 2022 a one-off cost-of-living payment of either £1,000 or £2,000 was made to all eligible colleagues (with the lower paid receiving the higher amount), and we committed to a 6.2% annual pay award effective from April 2023. At a time of wider industrial unrest it was rewarding to see us being able to agree a mutually fair settlement for the business and our people.

After a difficult year dealing with the drought and winter freeze/thaw, it was good to see the positive results of our most recent Employee Engagement Survey. We achieved an overall satisfaction score of 75% (up from 69% in 2021), with some other very positive highlights, including:

- 87% of our people are proud to work for Welsh Water.
- 80% would recommend working for the business.
- 98% understand their role in creating a safe work environment.
- 95% agree there is a strong emphasis on customer service at Welsh Water.

Looking Ahead

Although it has been a challenging year, we have continued to make good progress in developing our long-term plans, including a review in 2022 of our Welsh Water 2050 strategy. We wanted to ensure the key priorities are as relevant now as in 2018 when we originally identified them within our long-term view of the future. It will probably come as no surprise that key risks, such as climate change, have come more to the fore. This review is more broadly helping us settle on the pertinent elements of our draft PR24 plan covering the 2025 – 2030 regulatory period, where issues such as resilience to deal with future challenges are immensely important.

The Welsh Government has set up a dedicated forum for the current price review to ensure the right priorities are captured in the PR24 process (PR24 Forum). We have fully embraced this new structured approach and have welcomed the opportunity it has provided for early and regular dialogue with government and regulators. This engagement is set against a difficult backdrop on many fronts, such as the cost-of-living crisis, the demand for increased environmental investment and the risks that lie ahead of us, with climate change front of mind.

Within the business, our PR24 plan is progressing well. Our newly-formed Asset Planning team is now firmly established and is bringing increased rigour to our investment plan and our approach to delivery of our long-term goals. Along with guidance from our Executive Team, in our 3 main business areas – drinking water, waste water and retail activities – there is considerable constructive engagement within the organisation to develop a strong PR24 plan. We have also had regular interaction and input from our Board as we develop our plans.

We are constructing our PR24 plan with the three key pillars of Financeability, Affordability and Deliverability. These primary elements of the plan are being challenged and adapted to converge on a plan we will, as usual, share with stakeholders at an appropriate time. Using this as the foundation of the plan, we have in place all the fundamentals to submit a credible draft plan to Ofwat in October 2023. We are attempting to balance the external factors, linked to the cost-of-living crisis and the stakeholder driver for increased environmental investment, with the internal considerations of being able to finance and deliver the plan.

The lead-up to the submission of the draft PR24 plan in the autumn will undoubtedly require a continuation, arguably with more intensity, of the dialogue we have in place with the Welsh Government and our regulators. We are prepared for this and the most challenging area is likely to be the final scope of the National Environmental Plan (NEP), the capital investment requirement linked to our wastewater infrastructure. However, we are confident we will gain the support of the Welsh Government and other stakeholders to agree on a NEP we can all support.

The continued high media profile of sewage discharges will mean no let-up in the stakeholder and customer engagement we undertake on this matter across our operating area. We have developed our messaging over the last two years and have been grateful for the support of the Welsh Government. This underpins our strategy of focusing our investment on reducing phosphate pollution linked to our wastewater infrastructure as our critical path to improve river quality in Wales. This approach does not place the same level of focus as there is in England on overflows. We must be able to communicate this difference and especially the benefit to Wales of maintaining this approach; while at the same time being committed to reducing the impact of CSOs affordably and over an acceptable timescale. Maintaining a fully transparent and open approach on how we seek to improve the environment, how we report our environmental impact and how we act when things go wrong will all be essential elements of our plan for engagement with our customers and stakeholders.

Similarly, with an eye on the year ahead, I am pleased, for obvious reasons, to report that our water resources have recovered to normal levels over the recent winter and we are in a good position to face the summer ahead of us.

Peter Perry
Chief Executive Officer

CHIEF FINANCIAL OFFICER'S REVIEW

IN THESE ECONOMICALLY CHALLENGING TIMES OUR LIQUIDITY AND CREDITWORTHINESS REMAIN STRONG. WE ARE FULLY FUNDED TO THE END OF THE CURRENT AMP, ENABLING US TO INVEST FOR THE LONG TERM AND SUPPORT OUR VULNERABLE CUSTOMERS.

Mike Davis
Chief Financial Officer

Maintaining our investment-grade credit ratings and promoting our green agenda leave us well placed to raise funds at an appropriate time to support our future investment plans.

During the first two years of AMP7, the pandemic presented many challenges and, while the immediate impacts of Covid-19 have diminished, FY 23 has brought new challenges in the form of tough economic conditions. We have not been immune to rapidly rising inflation, driven largely by the war in Ukraine, and have seen significant increases in costs for energy, chemicals and materials, as well as higher interest charges.

We recognise that these are difficult times for our customers and we have continued to expand our range of support for those who are struggling to pay their bills. In FY 23 we contributed £12 million to provide tariff support to our customers.

Our balance sheet remains strong, with gearing at 58% and liquidity of £579 million. We are fully financed to the end of AMP7. Our financial forecast stress testing indicates that, while we are exposed to inflation and rising interest rates, we are well placed to withstand material cost shocks that could occur in the coming years.

We have successfully retained our credit ratings at A3, A- and A from credit-rating agencies Moody's, S&P and Fitch respectively. These continue to be among the best in the UK utility sector.

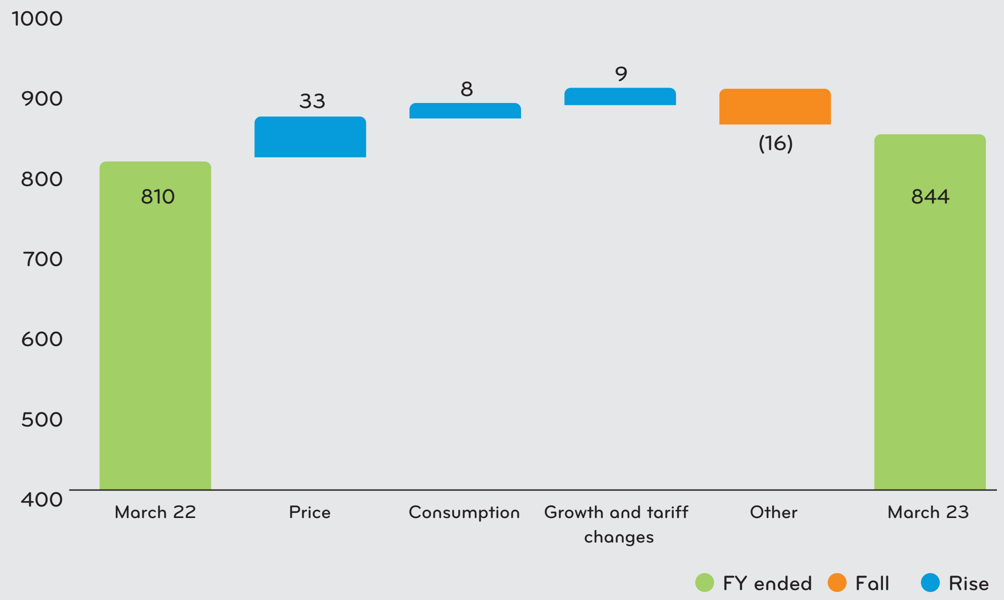
Financial KPIs (see Glossary for definitions)

In £ millions unless otherwise indicated	FY 23	FY 22
Net debt (CTA basis)*	4,162	3,722
Regulatory capital value	7,161	6,460
Gearing	58%	58%
Adjusted interest cover ratio (AICR)	0.3x	1.0x
FFO/net debt	(3.7%)	3.4%

*Common terms agreement (CTA)

We monitor our financial performance using measures which focus on the covenants included in our whole-business securitisation documentation and on the measures required to preserve our credit ratings. Gearing remains low and one of the market leaders at 58%, well within covenant and credit rating thresholds. The pressure on our adjusted ICR is principally caused by sustained high inflation throughout the year; and, while we recognise pressures will persist throughout the remainder of AMP7, recovery is anticipated by AMP8. Both Moody's and S&P have confirmed our ratings during the year, with S&P placing us on a negative outlook citing high inflation weighing on the credit metrics of UK water and wastewater service providers, together with a large capital expenditure programme. Nevertheless, S&P expects our financial metrics will gradually recover by the end of the current AMP7 regulatory period.

Year-on-year revenue movements (£m)



Revenue

Our revenue mainly comes from the water and wastewater services we provide to customers. Our prices are set every five years by Ofwat's price review process and this, to a large extent, determines how much we can invest in our services and infrastructure.

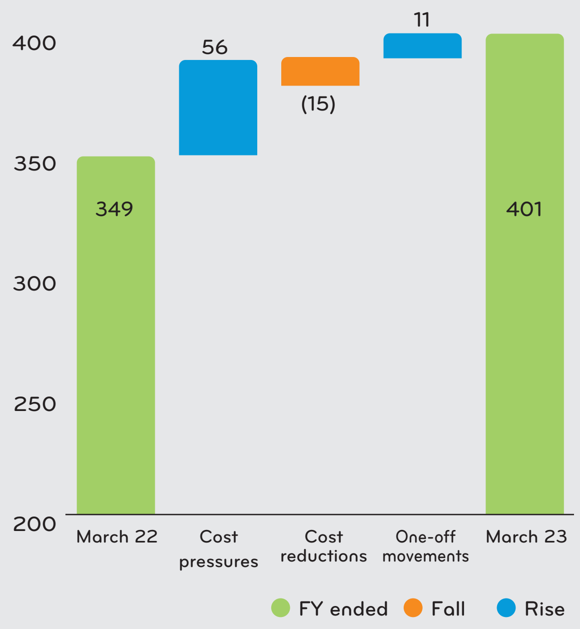
Revenue in FY 23 was 4% higher than in FY 22, mainly due to price rises, which were in line with Ofwat's allowance but notably well below headline inflation in the period, partly offset by a £15 million reduction in respect of our restatements for leakage and Per Capita Consumption (PCC) data.

We are acutely aware of the pressures the current cost-of-living crisis is having on our customers. We continue to expand our range of customer assistance tariffs, with 129,000 customers now getting help to pay their bills..

Operating Expenditure (Opex)

99% of our cost base relates to regulated activity and is therefore funded as set out in Ofwat's price determination. In this way, inflationary increases are also funded, although there is a timing difference as costs are reflected in customer bills the year after the higher costs are incurred.

Year-on-year Opex movements (£m)



CHIEF FINANCIAL OFFICER'S REVIEW CONTINUED

Energy

Our high levels of energy consumption have exposed us to the recent volatility in wholesale energy prices, although this has been partly mitigated by our power hedging policy and our self-generation capability. A combination of forward purchases, derivatives and exporting to grid of our self-generated electricity typically sees us around 90% hedged on electricity costs at the start of each financial year. Our electricity bill for FY 23 was £69 million but it would have been up to £155 million without hedging and our own renewable generation.

In early 2020, we forward purchased around 60% of our gas requirement for the five years to March 2025. The remainder is hedged by the export of biomethane from our gas-to-grid plant.

We continue to invest to increase our capacity to generate our own energy. In FY 23 we produced 22% of our total consumption requirement, and we aim to increase this to 35% by 2025. While we have mitigated much of the energy cost pressure to date, we have paused power hedging activity while underlying prices, and the costs of hedging, are high. We are currently reviewing our purchasing strategy for the next price review period to 2030.

Bad debt

Bad debt charges result from customers not paying their bills, because they are either unwilling or unable to do so. We offer a broad range of assistance to customers struggling to pay their bills, but it is inevitable that some of the bills we raise will not be paid.

In FY 23, bad debt charges rose by 4% year-on-year to £25 million. The main driver was a price increase (see 'Revenues' above). Our bad debt provision includes an estimate of the future effects of the cost-of-living crisis on the collection of debt outstanding at the year-end, equivalent to a further 1% fall in collections.

To help us focus on the challenges the current economic environment poses to our customers, we monitor closely a set of measures, including:

- The proportion of customers paying by direct debit.
- The number of customers we actively monitor on our debt management system.
- The percentage of customers on track with payment terms.
- The volume and value of receipts in advance.

These indicators have remained strong throughout the past year and we do not anticipate any significant deterioration in the short term. Our bad debt as a proportion of our revenue remained stable at c.3%.

Climate change

Climate change is having a significant effect on our business. In recent years, we have experienced extreme weather events which have had a material detrimental effect on our operations and required significant remedial expenditure. During the summer of 2022, the warmest since 1976, our operating area experienced a prolonged period of hot, dry weather. It meant we had to impose a temporary hosepipe ban in parts of Pembrokeshire and a small area of Carmarthenshire. We had to spend more on tankering and redoubled our efforts to minimise leakage at a total cost of £42 million this year. During winter, we also experienced a freeze/thaw event which led to additional maintenance costs and compensation of £3 million to customers for supply interruptions.

Leakage and per capita consumption restatement

We have restated performance data for leakage and per capita consumption which was reported to Ofwat for the financial years FY 21 and FY 22. On 25 May 2023, Ofwat announced an investigation into our reporting of leakage and per capita consumption. We have informed Ofwat that we intend to action a customer redress package of £29 million, representing approximately 3.7% of Welsh Water's regulatory revenue of £793 million in FY 22.

The redress package consists of two elements:

- Customer rebates of £15 million to be credited to customers' accounts as soon as possible in FY 24. With 1.4 million customers, the rebate will amount to just over £10 per customer.
- We have proposed that at PR24 we will voluntarily forego recovery of that element of regulatory overspend during FY 21 and FY 22 that is attributable to leakage expenditure. This amounts to £14 million.

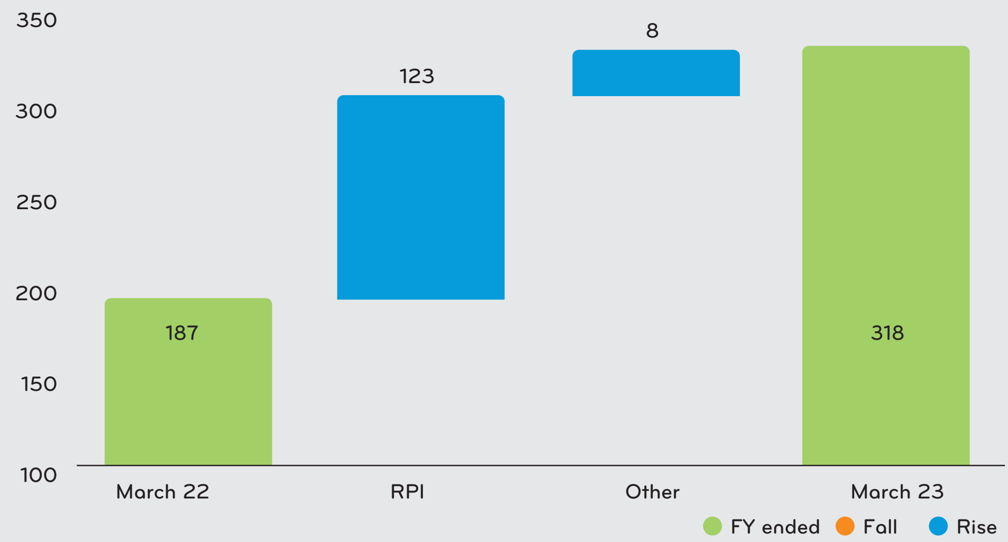
Under normal circumstances, overspends during the AMP are partially recovered from customers at the next Price Control through an adjustment to the Regulated Capital Value (RCV). This would ordinarily allow 43% - amounting to £14 million - of this overspend to be recovered. The decision has been taken to forego these recoverable costs and the regulatory capital value will not be uplifted at the next Price Control.

In our FY 23 financial statements, we have provided for the £15 million to be refunded to customers in FY 23. The forgone overspend recovery of £14 million will manifest itself in a lower Regulatory Capital Value (RCV) at 1 April 2025 than would otherwise be the case. As it is not appropriate to set a provision in the financial statements for future changes to RCV, this element of the customer redress package is disclosed only in the notes to the financial statements.

We believe we are proposing an appropriate package of customer redress for our regulatory misreporting in FY 21 and FY 22, and its effects. However, the final decision rests with Ofwat and will not be known until their investigation is completed, the timing of which is uncertain.

Furthermore, we now expect to spend an additional £54 million in the remaining two years of the AMP (2024-2025) to reduce leakage as quickly as possible.

Year-on-year interest movements (£m)



Underlying profit/(loss)

We define underlying profit/(loss) as profit/(loss) before taxation less fair value movements on derivative financial instruments, thus excluding the non-cash impact of market movements, which better reflects the elements within our control. Our underlying loss increased to £311 million compared to prior year (£102 million) principally caused by a year-on-year increase of 70% in finance costs to £318 million (FY 22: £187 million) due to higher indexation charges on our index-linked debt, the recognition of an exceptional charge of £31 million representing the award of pension increases in line with RPI and an increase in depreciation and amortisation, which rose by 5% to £347 million (FY 22:£329 million), as a result of revaluing the asset base to the regulatory capital value (see financial statement notes 7 and 8).

We use a range of financial instruments to help finance our operations. These include fixed-rate and index-linked bonds as well as fixed, variable and index-linked loans and finance leases. All of our index-linked debt is linked to Retail Price Index (RPI) inflation, which rose significantly during FY 23 from 9% in March 2022 to 14% by March 2023. Inflationary increases have added £123 million to our financing costs this year, of which we paid out £17 million in cash and £94 million has been accrued on the balance sheet and will be paid when the associated debt matures.

The total net finance expense of £304 million in the income statement is higher than the £149 million net cash interest paid per the statement of cash flows. The difference is largely due to non-cash indexation charges £195 million, offset by £28 million of capitalised borrowing costs.

Interest rate management

Our primary financing objective is to secure the right amount of funding at the lowest cost. The more efficient our funding, the lower our customers' bills. We aim to have sector-leading credit ratings and gearing at around 60%, as well as considering the timing of financing activity.

Just over half of our debt, on a pre-hedged position, is index-linked to RPI inflation (31 March 2023: 54%, 31 March 2022: 51%) and this provides a natural hedge to our asset base (as measured by Ofwat's regulatory capital value) and our inflation-linked revenues. Including the impact of inflation, our average cost of debt for the year was 7.7% (FY 22: 5.0%).

Gains and losses on derivative financial instruments

We manage our interest rate exposure using derivative financial instruments. We have also swapped some of our floating-rate debt to fixed-rate debt and some of our fixed-rate debt to index-linked rates using 'swaps.' After taking into account the effect of these swaps, 84% of our debt is index-linked, with the remainder at a floating or fixed rate. We also use derivatives to hedge the cost of some of our power requirements. We do not undertake any speculative trading, which is specifically prohibited under our Treasury policy established by the Board.

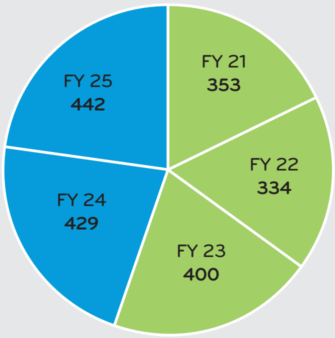
Unlike debt, which is included in 'borrowings' in the balance sheet, our swaps are classified as 'derivative financial instruments' under International Financial Reporting Standards and valued at fair market value at the balance sheet date. Fair values fluctuate in line with market movements, which can be volatile, and this can give rise to significant gains and losses in the income statement.

During FY 23, the movement in the value of swaps was a non-cash gain of £160 million (FY 22: loss of £114 million), driven mainly by changing market expectations of interest and inflation rates. See financial statements note 15 for further information.

We invested £400 million of capital in the year as part of our record £2.0 billion AMP7 planned investment programme.

CHIEF FINANCIAL OFFICER'S REVIEW CONTINUED

Capital investment (£m)



During FY 23, we invested a total of £400 million in our water and wastewater assets. Over the five years to 2025, we will invest a record £2.0 billion to deliver improved resilience and environmental improvements in line with Ofwat's 2019 Final Determination (FD) and our other regulatory obligations. Our total investment is split between capital additions of £322 million (these are added to the balance sheet and depreciated over the assets' useful lives) and infrastructure renewals expenditure of £78 million (maintenance costs which are fully expensed to the income statement upon scheme completion).

We will invest an additional £100 million in river water quality improvements, most of which we plan to deliver during AMP7. This is available to us from the advantage of our Glas Cymru non-shareholder business structure.

Loss before tax

The Loss before tax was £151 million, a decrease of £64 million on last year (FY 22: £215 million), as a result of the factors outlined above.

Net debt

We fund our day-to-day operations and our capital investment programme from a combination of customer bills and borrowings from financial markets and institutions. Our net debt (total borrowings less cash and equivalents) on our common term agreement basis at 31 March 2023 amounted to £4,162 million, an increase of £440 million on the prior year. Almost 90% of this increase was caused by the indexation of RPI-linked debt.

We aim to ensure that enough funding is available to meet our forecast financial needs as well as having an adequate level of headroom for reasonably plausible contingencies.

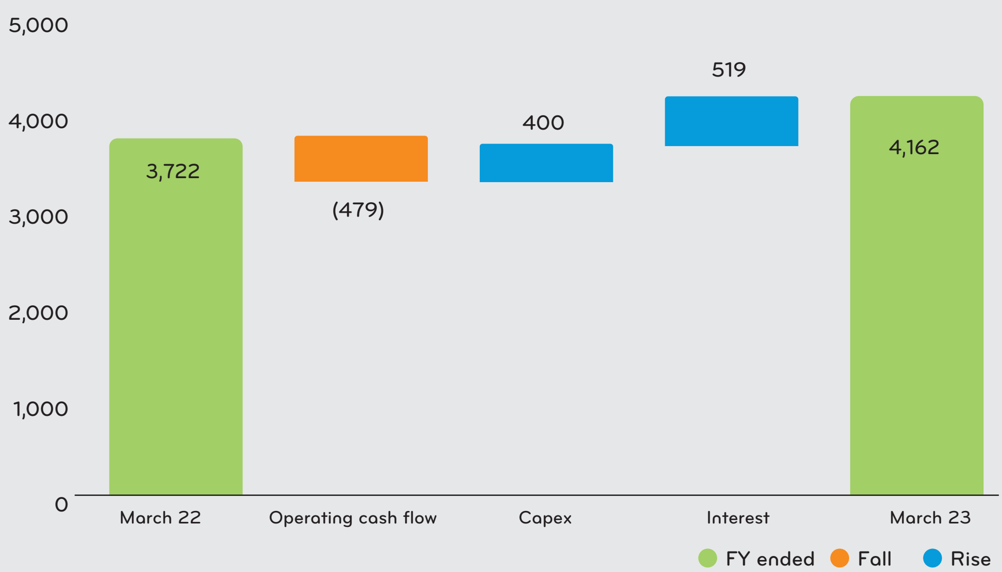
Our average debt maturity is relatively long, at 10.4 years (31 March 2022: 11.2 years), reflecting the long-term nature of our asset base. Under the terms of our whole business securitisation, no more than 20% of our debt can fall due within a rolling 24-month period. Details of our assessments of interest rate and inflation risk are provided in financial statements note 16.

We are now working on our refinancing strategy for AMP8, the five-year period from 2025 to 2030, during which we have around £2 billion of debt maturing.

Liquidity

At 31 March 2023, total liquidity stood at £579 million FY22: £515 million), comprising cash and equivalents of £379 million and undrawn facilities of £200 million. We invest cash prudently, depositing for a maximum of three months, and only with highly rated banks and liquidity funds.

Year-on-year movement in net debt (£m)



We achieved an average deposit yield of 3.86% during the year, which compares favourably with the BlackRock ICS Sterling Liquidity Fund yield of 2.00%.

We also have bilateral revolving credit facilities of £200 million (all of which are currently undrawn) with a group of four key relationship banks. For further details, see financial statements note 16D.

Credit ratings

Our creditworthiness is assessed by three separate rating agencies, giving an independent external opinion on the quality of our debt. Our ratings (Moody's A3; S&P A-, and Fitch A) are among the highest in the UK utilities sector. Investment-grade credit ratings promote investor confidence and help us secure financing at the lowest cost, which in turn helps to keep customer bills as low as possible.

Among other requirements, our governing documents require us to maintain an investment grade-credit rating. We review all key indicators regularly to identify early visibility of risks and opportunities and to ensure we remain compliant with our borrowing covenants. We remain in frequent contact with our rating agencies.

In November 2022, S&P confirmed our Class B debt rating at A- and our Class C subordinated debt at BBB, and revised the outlook from stable to negative. The Class A bonds, which are subject to a financial guarantee from Assured Guaranty UK Ltd, are unaffected by this action. S&P cited the impact of inflation on the Group's index-linked debt portfolio and our high level of capital expenditure as the reasons for the change in outlook from stable to negative, but stated that they expect the relevant ratios to recover by the end of AMP7.

In February 2023, Moody's updated credit analysis confirmed the Class B debt at A3 and the Class C at Baa2, both with a stable outlook.

In March 2023, Fitch affirmed the Class B debt at A and Class C at BBB+, both with a stable outlook.

Gearing

UK water companies express their regulatory gearing as the ratio of net debt to regulatory capital value, to show a measure of the company's indebtedness relative to the value of the business recognised by Ofwat.

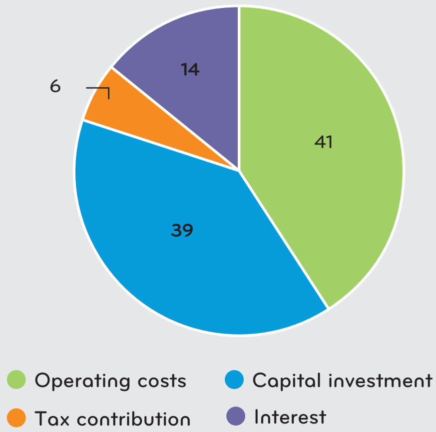
Since Glas Cymru was established in 2001 with gearing at 93%, we have consistently de-leveraged, i.e. reduced our proportionate level of debt, with gearing standing at 58% at 31 March 2023, in line with the Board's policy to maintain gearing at around 60%.

Under the terms of our whole-business securitisation structure, we must maintain gearing below 85%. We therefore have significant headroom to deal with emerging risks.

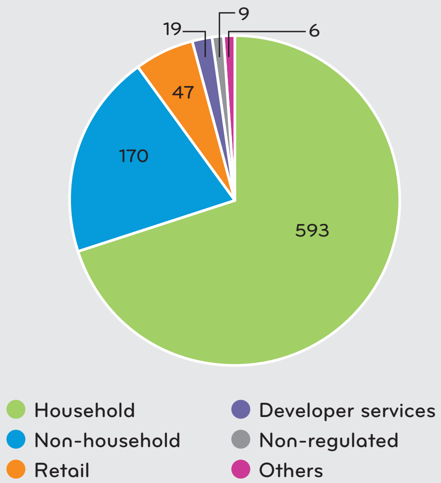
Dividends

As a company limited by guarantee, no dividends were paid during the year (FY 22: none). No intra-group dividends have been declared and surpluses in the regulated business have been retained for the benefit of our customers.

What we spent in FY23 (%)



Where the funding came from (£m)



Taxation

We aim for compliance and transparency in our tax affairs and hold the Fair Tax Mark accreditation. As an organisation with a large capital investment programme, we receive capital allowances. These have the effect of deferring some of our corporation tax liabilities to future periods and help to keep customers' bills lower.

Further details of our corporation tax and deferred tax charges are provided in financial statement notes 5 and 6, and our tax strategy is available at https://dwrcymru.com/taxstrategy.

We were not required to pay any corporation tax in FY 23. We pay all of our taxes when due and our total tax contribution, including business rates and employment and environmental taxes, amounted to £63 million.

Mike Davis
Chief Financial Officer

CONSOLIDATED INCOME STATEMENT

For the year ended 31 March

Continuing activities	Note	2023 £m	2022 £m
Revenue	2	**843.8**	810.2
Operating costs:			
Operational expenditure	3	**(376.1)**	(324.9)
Impairment of trade and other receivables	3	**(24.8)**	(23.7)
Other operating income	3	**5.3**	6.0
Exceptional item	3	**(30.8)**	3.8
Infrastructure renewals expenditure	3	**(78.0)**	(61.8)
Depreciation and amortisation	3	**(346.8)**	(328.9)
	3	**(851.2)**	(729.5)
Operating (loss)/profit		**(7.4)**	80.7
Profit on disposal of fixed assets		**0.3**	0.6
(Loss)/profit before interest		**(7.1)**	81.3
Financial expenses:			
Financial income	4a	**14.9**	4.1
Financial expenses	4a	**(318.5)**	(187.1)
Fair value gains/(losses) on derivative financial instruments	4b	**160.2**	(113.5)
		(143.4)	(296.5)
Loss before taxation		**(150.5)**	(215.2)
Taxation	5	**25.8**	(8.4)
Loss for the year		**(124.7)**	(223.6)

The Company has taken the exemption under section 408 of the Companies Act 2006 not to present a parent company income statement. The profit of the parent company for the year to 31 March 2023 was £1.5 million (2022: £1.2 million).

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 March

	Note	2023 £m	2022 £m
Loss for the year		**(124.7)**	(223.6)
Items that will not be reclassified to profit or loss			
Actuarial gain recognised in the pension scheme	21	**124.5**	10.5
Related deferred tax	6	**(31.1)**	2.7
Revaluation of property, plant and equipment	7	**593.4**	448.4
Related deferred tax	6	**(148.4)**	(192.3)
Total items that will not be reclassified to profit or loss		**538.4**	269.3
Total comprehensive gain for the year		**413.7**	45.7

CONSOLIDATED BALANCE SHEET

As at 31 March

	Note	2023 £m	2022 £m
Assets			
Non-current assets			
Property, plant and equipment	8	**6,970.2**	6,275.4
Intangible assets	9	**202.6**	203.6
Trade and other receivables	11	**0.7**	0.7
Other financial assets:			
– derivative financial instruments	15	**318.5**	344.0
– employee benefits	21	**12.0**	–
		7,504.0	6,823.7
Current assets			
Inventories		**5.3**	4.3
Trade and other receivables	11	**648.6**	594.0
Cash and cash equivalents	12	**379.4**	515.1
Other financial assets:			
– derivative financial instruments	15	**27.1**	84.1
		1,060.4	1,197.5
Total assets		**8,564.4**	8,021.2
Liabilities			
Current liabilities			
Trade and other payables	13	**(685.8)**	(614.1)
Provisions	17	**(17.8)**	(2.8)
Other financial liabilities:			
– borrowings	14	**(94.7)**	(85.3)
– derivative financial instruments	15	**(26.3)**	(56.7)
		(824.6)	(758.9)
Net current assets		**235.8**	438.6
Non-current liabilities			
Trade and other payables	13	**(540.8)**	(447.2)
Employee benefits	21	**–**	(80.7)
Provisions	17	**(5.4)**	(5.7)
Other financial liabilities:			
– borrowings	14	**(4,090.9)**	(3,981.2)
– derivative financial instruments	15	**(753.9)**	(966.2)
Deferred tax – net	6	**(822.1)**	(668.3)
		(6,213.1)	(6,149.3)
Total liabilities		**(7,037.7)**	(6,908.2)
Net assets		**1,526.7**	1,113.0
Reserves			
Revaluation reserve	7	**1,692.0**	1,339.7
Retained earnings		**(165.3)**	(226.7)
Total reserves		**1,526.7**	1,113.0

The financial statements on pages 20 to 22 were approved by the Board of Directors on 16 June 2023 and were signed on its behalf by:

P Perry
Chief Executive Officer

M Davis
Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN RESERVES

For the year ended 31 March

	Revaluation reserve £m	Retained earnings £m	**Total reserves £m**
At 1 April 2021	1,157.1	(89.8)	**1,067.3**
Loss for the year	–	(223.6)	**(223.6)**
Actuarial gain net of tax	–	13.2	**13.2**
Revaluation net of tax	256.1	–	**256.1**
Transfer to retained earnings	(73.5)	73.5	**–**
At 31 March 2022	1,339.7	(226.7)	**1,113.0**
Loss for the year	–	(124.7)	**(124.7)**
Actuarial gain net of tax	–	93.4	**93.4**
Revaluation net of tax	445.0	–	**445.0**
Transfer to retained earnings	(92.7)	92.7	**–**
At 31 March 2023	**1,692.0**	**(165.3)**	**1,526.7**

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 March

	Note	**2023 £m**	2022 £m
Cash flow from operating activities			
Cash generated from operations*	18a	**380.1**	429.3
Interest paid	18b	**(149.6)**	(116.6)
Income tax received received		**0.6**	2.3
Net cash flow from operating activities		**231.1**	315.0
Cash flow from investing activities			
Interest received		**13.4**	4.0
Purchase of property, plant and equipment		**(296.6)**	(237.1)
Purchase of intangible assets		**(38.6)**	(37.3)
Proceeds from sale of plant and equipment		**0.4**	0.8
Grants and contributions received		**30.5**	23.1
Net cash outflow from investing activities		**(290.9)**	(246.5)
Net cash flow before financing activities		**(59.8)**	68.5
Cash flows from financing activities			
Bond issue		**–**	300.0
Bond issue costs		**–**	(2.9)
Term loan repayments		**(58.4)**	(55.8)
Payment of lease liabilities		**(17.5)**	(15.6)
Net cash flow from financing activities		**(75.9)**	225.7
(Decrease)/increase in cash and cash equivalents	19b	**(135.7)**	294.2
Cash and cash equivalents at 1 April		**515.1**	220.9
Cash and cash equivalents at 31 March	12	**379.4**	515.1

* Exceptional items are excluded from cash flows generated from operations, per note 18.