

June Return 2006 Overview



Dŵr Cymru
Welsh Water

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Summary

for the year

This report provides an overview of our performance in the year to 31 March 2006 and accompanies our annual June Return. It covers levels of service and outputs for our water and sewerage activities, environmental performance, financial performance and overall progress against targets established at the last price review in 2004.

Customer service delivery

- Compliance with drinking water quality standards 'at the tap' as measured by the Operational Performance Index (OPI) was best ever level achieved at 99.82%.
- Leakage targets achieved and over the last 10 years we have reduced leakage by almost half.
- Properties at risk of low pressure (DG2) reduced from 0.018% to 0.016% (221 as opposed to 235 last year).
- Unplanned interruptions to supply (DG3) reduced from 0.06% to 0.04%.
- Properties at risk of sewage flooding (DG5) reduced from 573 at the start of the year to 514 at the end of the report year.
- High level of performance in meter reading (DG8) and customer contact maintained.
- Compliance with environmental quality standards (numeric consents) at Wastewater Treatment Works (WwTWs) was 96.49%.
- Bathing Water Quality standards improved. 100% of EEC designated beaches achieved the mandatory standard, of which a record 91% (i.e. 73 beaches) achieved the higher guideline standard leading to 47 Blue Flag Beach/Marina awards in 2006, six more than 2005.
- The number of 'Category 1 & 2' sewage related pollution incidents increased to 17 from 8 in 2004 of which 9 were compliant.

Overall performance assessment

- Our estimate for OPA this year is 407.
- Best ever water performance.
- Some deterioration on sewerage performance which will be an area of particular focus for the business.
- If confirmed this would be the fourth consecutive year we have achieved over 400 points out of a possible 437.5.

Financial performance

- Customer dividend increased this year to £19, up from £18 in 2005.
- Glas Cymru's financial reserves (RCV less net debt) of £683 million, up from £538 million in 2005.
- Glas Cymru's financial gearing reduced to 78%, down from 93% in May 2001.
- Profit before tax of £63 million to be retained for the benefit of customers.
- Finance substantially in place to 2010 to fund the capital programme.
- Two credit rating upgrades (Moody's and Fitch Ratings).
- Operating costs of £205 million were down 3%, largely due to the successful retendering of the main operations contracts in 2005.
- Power costs increased by £9 million (54%).

AMP4 Investment Programme

- Capex outputs largely achieved, although the S.19 Mains Replacement Programme, was 52km behind the projected output.
- Year 1 expenditure is below the Final Determination (FD) but we anticipate spend over the 5 year period to be in line with FD and re-profiling will offer better value for customers.
- 407km of water mains renewed or relined in the year to improve water quality.
- 72km of water mains in poor condition renewed to maintain burst levels and reduce frequency of interruption to customer supplies.
- 1 Water Treatment Works (WTW) scheme completed in the report year in line with the undertaking target agreed with the DWI.
- 81 WwTWs improvement schemes completed (Monitoring Plan target is 80).
- 82 intermittent discharge schemes completed (Monitoring Plan target is 61).
- 89 internal flooding problems tackled.
- 85 external flooding problems tackled.
- Odour projects re-phased to align with Defra Guidance and Code of Practice.

Competitive Procurement Plan

In January 2005, after a highly competitive procurement process, we appointed the following organisations to provide services for Asset Operations and Asset Investment from April 2005:

- United Utilities Operational Services (UUOS) to undertake water activities and services for the whole of our area and waste water activities and services for north Wales.
- Kelda Water Services Limited (Kelda) to undertake waste water activities and services for south Wales and Herefordshire.
- Laing Utilities Limited, Amec Group Limited, Costain Limited and Morrison Construction Services Limited to undertake civil engineering works.
- Black & Veatch Contracting Limited and Meica Process Limited to undertake process engineering works.

Similarly, in March 2005 we appointed Thames Water Services Limited (Thames Water) to undertake Billing and Income services.

In addition, we are well in advance of the process for selecting Information, Communication and Technology (ICT) partners and have commenced the process of selecting the best laboratory and sampling providers.

Once the ICT process has been completed, we will be resubmitting our Procurement Plan to Ofwat as required under Condition F of our licence.

Performance

against the Monitoring Plan

In our Monitoring Plan, published in April 2005, we set out our commitments on the work to be done. This Overview provides a summary of our progress against this Plan.

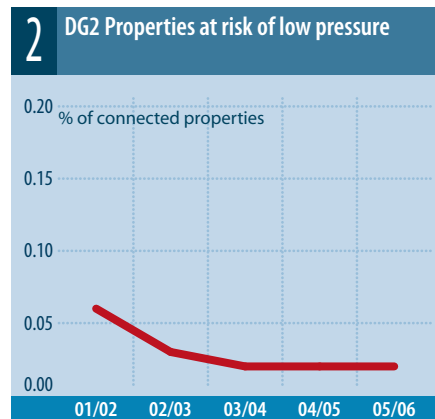
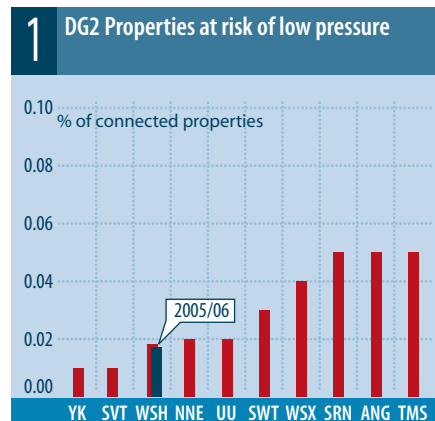
Water Service				
Performance Measure	Units	The Monitoring Plan Target	Previous Performance 2004-05	Actual Performance 2005-06
DG2 Properties below reference level for low pressure	No.	242	235	221
DG2 Properties at risk of receiving low pressure	%	0.02	0.02	0.02
DG3 Overall performance score (interruption to supply)	No.	0.08	0.06	0.04
DG4 Restrictions on water supply	No.	0	0	0
Trend in burst mains per 1,000km of main	No.	194	173	171
Distribution input not covered by S19 undertakings	%	64.10	99.97	62.00
Water quality mean zonal compliance	%	-	99.96	99.95
Iron compliance 'at the tap'	%	98.90	98.87	99.16
Operational Performance Index (OPI)	%	-	99.73	99.82
Operational Performance Index (TIM)	%	-	99.52	99.74
Customer Service				
Performance Measure	Units	The Monitoring Plan Target	Previous Performance 2004-05	Actual Performance 2005-06
DG6 Billing contacts responded to within five days	%	100	99.99	99.97
DG7 Written complaints responded to within 10 days	%	99.9	99.90	99.40
DG8 Bills based on Company or customer meter readings	%	99.96	99.97	99.97
DG9 telephone handling satisfaction	%	-	-	4.59*

* New measure (score out of maximum 5)

Sewerage Service				
Performance Measure	Units	The Monitoring Plan Target	Previous Performance 2004-05	Actual Performance 2005-06
Properties flooded internally (excluding extreme/severe weather)	No.	256	247	231
Total properties subject to internal flooding (excluding extreme/severe weather)	%	0.019	0.018	0.017
Properties at risk of flooding	No.	528	[245] ¹	514 ²
Trend in sewer collapses per 1,000km of sewer	No.	27	29.20	28.90
Combined sewer overflows satisfactory	%	87.90	86	88.5
<p>1. Figures are not on a like for the basis 2. Classification changed in 2005, resulting in increase in numbers</p>				
Quality and Environmental Compliance				
Performance Measure	Units	The Monitoring Plan Target	Previous Performance 2004-05	Actual Performance 2005-06
Percentage population equivalent served by compliant works (LUT)	%	100	99.94	99.91
Sewage sludge disposed of satisfactorily	%	100	100	100
Wastewater Treatment Works complying with numeric consents	%	97.70	97.80	96.49
Bathing waters - compliance with mandatory standards	%	100	100	100
Bathing waters - compliance with guideline standards	%	Stable	86	91
Number of pollution incidents at CSOs and sewers (cat. 1 & 2)	No.	6-12	6	11

Key outputs and service delivery

Over the last year we have generally maintained our levels of service to customers, and overall we are meeting our targets for water and wastewater quality improvements. We carry out regular research with customers to understand their satisfaction with the services we provide. Latest research shows that overall satisfaction with our levels of service remains high.



Water Service

Low pressure DG2

Our strategy is to strike a balance between preventing problems occurring and thereafter controlling the position so that performance remains in the top quartile for the sector.

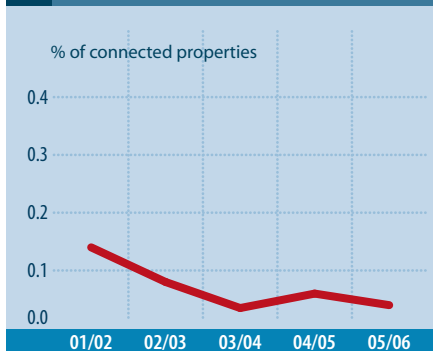
A total of 221 properties remained on the low pressure register at the end of this report year compared with 235 properties in 2004-05 and the AMP4 Monitoring Plan target of 242 properties. This represents 0.016% of our connected properties which remains ahead of the sector average of 0.03%. **1 2**

We have continued our pressure logging programme to identify properties experiencing low pressure during the year and especially during the summer months when demand is higher. A total of 1,784 properties were added to the register during the year from this logging programme, but as a result of company action such as mains replacement, improved pressure control and operational changes or identification of pressure problems on the customers' supply pipes, 1,798 properties were removed from the register during the report year.

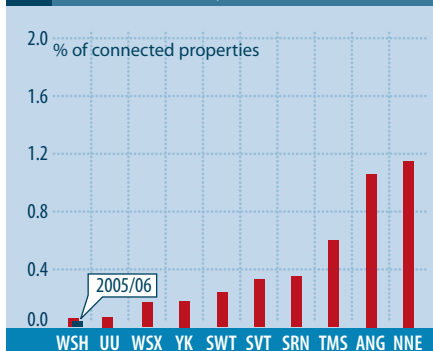
Interruptions to supply DG3

We have continued to sustain the low levels of unplanned supply interruptions lasting more than 6 hours, with the number of properties affected falling from 770 in 2004-05 to 454 in the report year. Our performance as measured by Ofwat's overall performance score was 0.04% compared to 0.06% last year. The number of unplanned supply interruptions lasting more than 12 hours was 80 compared to 73 properties last year. **3**

3 DG3 Unplanned interruptions to supply



4 DG3 Unplanned interruptions - Across the industry



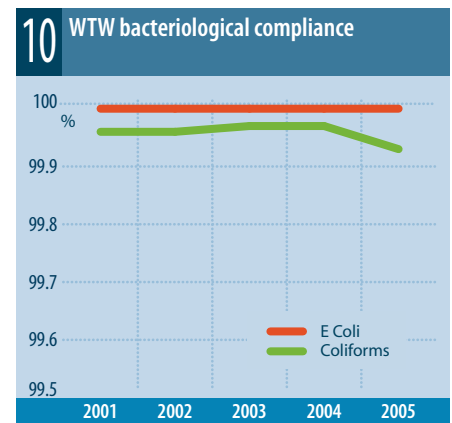
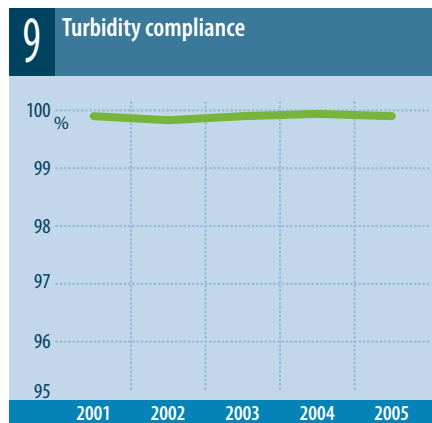
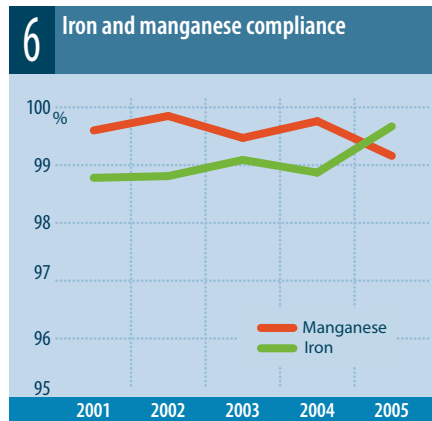
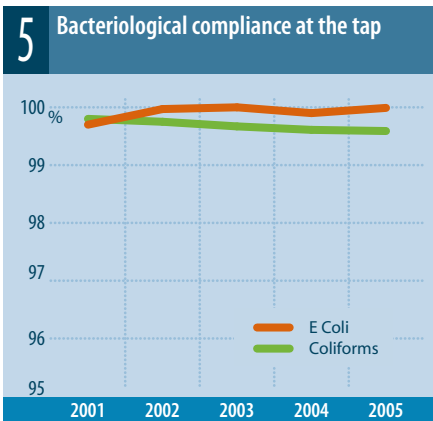
This performance remains amongst the best in the industry notwithstanding our relatively high burst rate. We have revisited our operational procedures throughout the supply chain and focused on responding quickly to supply interruptions so as to minimise interruption periods. These include improving asset records, obtaining advanced warning of asset failure through use of low flow alarms and extending the use of rapid response repair gangs and using better equipment. [4](#) [11](#) [12](#)

We have continued to maximise the use of techniques to reduce the disruption to customer supplies during planned work. While the rate of asset renewals has remained high, the number of advanced warnings of interruptions lasting more than 12 hours due to planned work has reduced significantly from 6,694 properties last year to 1,642 properties in the report year. Of these planned interruptions there were no properties affected by overruns of the warned period of interruption.

Drinking water quality

During 2005, in terms of drinking water quality compliance, we maintained the high level of performance achieved previously. On some measures, we continued to build on previous success and achieved a best ever level. This performance reflects the continued improvements, both within the distribution system and at WTWs, as part of our capital investment programme. Also key in driving improvement in quality measures is the review and enhancement of operational processes and procedures. This initiative is supported by our Business Management System (BMS), which during 2005-06 successfully maintained registration to the ISO standards 9001: 2000 and 14001:1996. Operational Performance Index (OPI) is an aggregate statistical rating of six different parameters which reflect quality and operational performance of distribution networks at zonal level. During 2005 DWI proposed changes to the traditional OPI basket of measures. Based on customers' expectations and concerns regarding discoloration of their drinking water, the DWI considered that the measure could be improved. Consequently, the new measure OPI (TIM) takes into account performance against the principal parameters responsible for discoloration problems, namely Turbidity, Iron and Manganese (TIM).

OPI performance was the 'best ever' level achieved by the company (99.82%). This reflects the focus and investment by the company to prevent discoloration events and minimise the number of customers suffering from discoloration problems by continuing to work on the distribution system improvement programme and by managing our supply arrangements proactively. Performance against the six main parameters which comprise the original OPI are shown in the charts on the next page. Our performance against the new OPI (TIM) measure for 2005 was 99.74%.



The bacteriological compliance at WTWs has remained high with all samples from WTWs being free of E.Coli. However the performance with regard to coliform failures deteriorated marginally during 2005, when 0.07% of samples taken from WTWs contained coliforms, as compared to 2004 when 0.06% of samples contained coliforms. This deterioration can be attributed to one WTW at Alaw, where a specific problem was identified and remedial action taken.

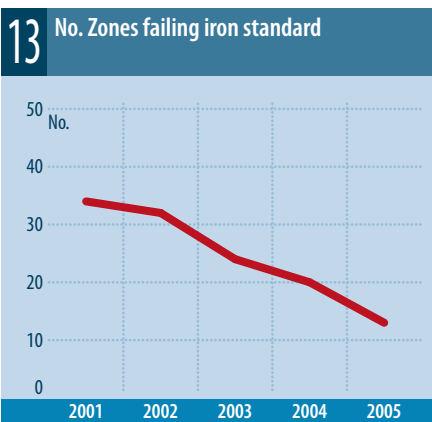
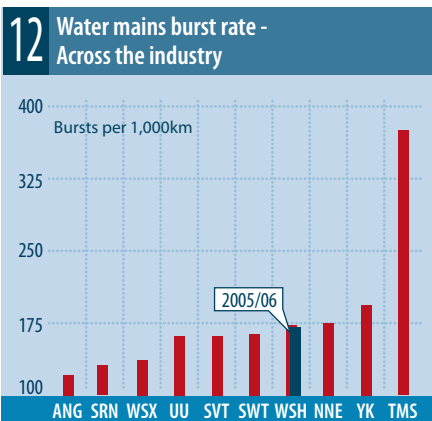
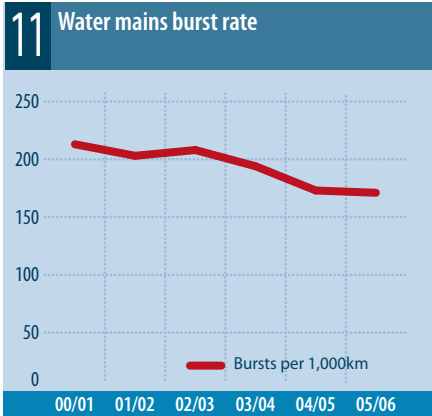
An improvement in bacteriological quality at our Service Reservoirs was achieved during the year, with 0.06% of samples containing coliforms and no samples containing E-coli.

The bacteriological quality as measured at customers' taps was marginally lower during 2005 (99.59%) than it had been in 2004 (99.61%). Because samples at nearby properties were satisfactory, we suspect that 18 of the 32 samples that contained coliforms were attributable to the unsatisfactory condition of the household tap. [5](#) [6](#) [7](#) [8](#) [9](#) [10](#)

Cwellyn WTW

Following an unusually high incidence of cryptosporidiosis in Anglesey and parts of Gwynedd, an Outbreak Control Team (OCT) was established in November 2005 to investigate all possible causes of the incident. The OCT, which comprised mainly of public health experts concluded that, in the absence of definitive causal links, the public water supply was the most likely cause of the outbreak. During the period in question, a 'boil water order' was issued affecting some 30,000 customers. Some 230 cases of illness were reported to and investigated by the OCT. Throughout the period we fully cooperated with the OCT in taking measures to protect public health. Ultra violet treatment equipment was added to the Cwellyn WTW and the boil water order was lifted at the end of January 2006.

Bacteriological Compliance - 2005		
	Coliforms	E. Coli
WTW	99.93%	100%
Service Reservoirs	99.94%	100%
Zones	99.59%	99.99%



Maintaining serviceability to customers

In addition to minimising the duration of supply interruptions, we have a programme of work targeted at reducing the frequency of supply interruptions to worst served customers. Our zonal approach to improving performance seeks to maximise the value from our water quality mains rehabilitation programme and prioritise the installation of pressure reducing valves and replacement of those water mains in a poor condition. This has maintained the reducing trend of burst rates on our water mains, although unacceptable local clusters of high burst rates occur on our older plastic and asbestos cement water mains in some areas.

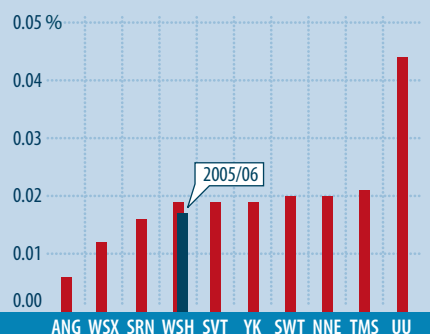
Colder weather conditions meant that higher burst rates were observed during the winter months. However the overall burst rate during the year was 171 bursts per 1,000km compared with 173 in the previous year. This is below our Monitoring Plan target of 194 per 1,000km, and this, together with our sustained levels of service performance, indicates stable serviceability to customers. [11](#) [12](#)

Delivering improved drinking water quality

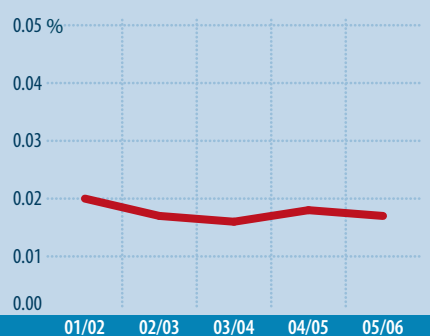
We have sustained our improving trend in iron compliance at customers' taps as a result of our ongoing mains refurbishment programme and the introduction of the revised Distribution Operations and Maintenance Strategy. In 2005 mains refurbishment is 52Km less than the projected output agreed with DWI under the Section 19 mains renovation undertaking. This is mainly due to the increase in work within difficult urban areas over and above that anticipated in the Final Business Plan and an increase in the amount of trunk mains renovation. We will undertake further water quality assessments during 2006 to verify the future programme of work with the DWI. 13 out of 91 zones experienced sample failures against the water quality standard for iron, which compares favourably to 2004 when 20 zones experienced iron failures. [13](#)

Also, 99.16% of samples taken from customer's taps were compliant with the required water quality standard for iron, demonstrating another improvement against 2004, when 98.87% of samples were compliant.

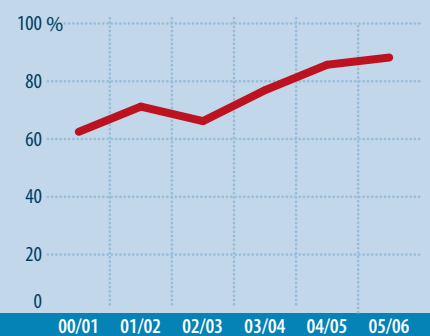
14 % Properties flooded (all causes)



15 % Properties flooded (all causes)



16 % Satisfactory Intermittents



Sewerage Service

Sewer flooding DG5

The DG5 'at risk register' was rebased at the start of AMP4 to include properties whose exposure had previously been considered to be of lesser severity and to be in line with revised Ofwat methodology, which classifies the risk by frequency rather than storm return period. We continue to prioritise our work to address problems at properties where flooding has occurred most frequently.

Reducing the number of incidents and the risk of sewage flooding remains a priority for us. In the AMP4 period we will be investing £51.5 million to tackle current and new hydraulic overload problems and also containing the number of incidents of flooding from other causes (such as blockages, collapses and equipment failure) to that achieved during the AMP3 period. Our target is to tackle a total of 1,165 flooding problems made up of 736 internal problems and 429 external problems. The outcome of this is expected to be a net reduction of 548 properties on the 'at risk register' by 2010.

During the report year we carried out investment schemes to remove the risk of sewage flooding from 82 properties on the 'at risk register', and a further 7 from the '1 in 20 register'. We removed a further 61 sites of 'area' flooding from the external flooding register through capital schemes. A total of 24 external 'areas' were also removed as a result of better information. During the year a total of 23 properties were added to the 'at risk register' and a further 98 added to the '1 in 20 register'.

Although we are addressing the issues around properties that we know to be at risk, each year new incidents occur where flooding has not been experienced before. We are actively pursuing initiatives to identify these vulnerable areas in advance of problems occurring, and we are actively setting up flooding forums in vulnerable areas in order to engage all parties including regulators and the other authorities that have responsibilities for flooding.

The percentage of properties that experienced flooding (all causes) was 0.017% in 2005-06 a reduction from 0.018% last year and ahead of the Monitoring Plan target of 0.019%. [14](#) [15](#)

We have seen an increase from 108 to 150 properties experiencing 'other cause' flooding in the year. The number of incidents rose from 110 to 166. Analysis of historic trends shows that significant year on year variations can occur, and we believe that this is a normal divergence from the mean, as opposed to an indicator of a marked deterioration in performance.

Nevertheless the associated data will be analysed to determine what lessons can be learned to reduce the number of repeat incidents and assist in the targeting of pre-emptive measures.

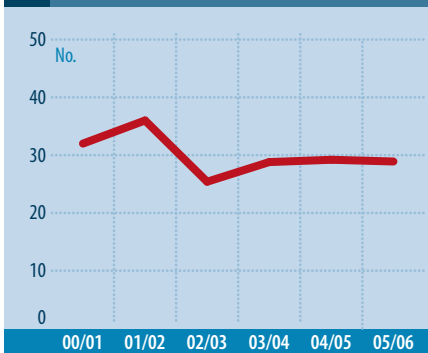
Delivering the quality enhancement programme

Our target during the AMP4 period is to tackle 446 intermittent discharges, achieve improvements at 135 WWTWs, carry out 77 environmental investigations and provide First Time Sewerage to 519 properties.

During the report year we have dealt with 82 intermittent discharges against a Monitoring Plan target of 51. This includes the completion of improvements at 20 assets originally identified in AMP3. This increases the proportion of 'satisfactory' intermittent discharges to 88.2%, 0.3% ahead of our Monitoring Plan target. [16](#)

We have carried out improvements at 81 WWTWs against a target of 80. This includes the completion of improvements at 72 assets identified within AMP4 and included in our Final Determination and a further 7 assets originally identified for improvement in AMP3. Two AMP4 schemes were delivered in year 5 of AMP3. Improvements at 6 sites were not completed by the statutory Urban Waste Water Treatment Directive (UWWTD) deadline of 31st December 2005 due to access to land and planning issues. Enforcement notices have been issued by Environment Agency Wales (EAW) and revised completion dates have been agreed. 2 additional schemes for which no provision was made in the FD were also delivered.

17 Number of sewer collapses per 1,000km



Maintaining Serviceability to Customers

In the AMP4 period our target is to maintain stable serviceability to customers. The main Ofwat measure of serviceability is the number of collapses on the sewer network. In AMP3 we targeted a reduction of 25% in the sewer collapse rate. In AMP4 we will target an average collapse rate of around 27 per 1,000km. The collapse rate remains higher than the sector average (approximately 13 per 1,000km) although as chart 17 illustrates the position has improved since 2000.

In the report year the collapse rate has decreased from 29.2 per 1,000km to 28.9 per 1,000km.

In the year there was a significant and environmentally sensitive sewer collapse on the Northumberland Pumping Station main in Llanelli. Due to the inaccessibility and the size of the main, effecting a repair was a major exercise and involved consultation with regulatory bodies and the local authority.

In the AMP4 period we plan to renovate or replace 123km of sewers. In the report year we renovated or replaced 13km of sewer against a Monitoring Plan target of 29.6km. Targeting the most vulnerable assets remains a priority.

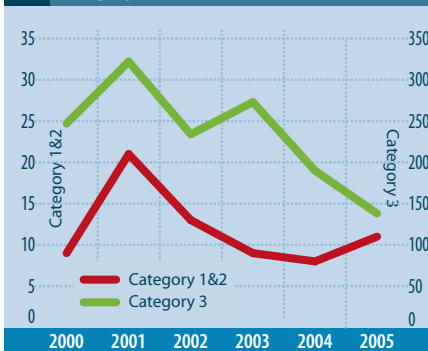
We have reported a total of 17 Category 1 and 2 pollution incidents of which 11 were associated with CSOs and foul sewers.

With the inclusion of 194 Category 3 incidents, the total number of sewage related incidents was 211 for the year. Of this total, 149 were caused by CSOs and foul sewers, which compares to a figure of 198 for 2004. 18 19

Our programme of desilting, cleaning and inspection continues. A total of 72km of sewers has been inspected by CCTV in the report year giving us a better understanding of asset risk, the condition of the sewers and helping to direct investment.

We have developed plans to address odour issues at the 33 sites identified in our AMP4 plan.

18 Number of pollution incidents at CSOs Category 1, 2 and 3



19 Number of pollution incidents associated with CSOs and foul sewers during 2005

Incident Category	No. of incidents associated with CSOs	No. of incidents associated with foul sewers
1	2	1
2	7	1
3	81	57
Total	90	59

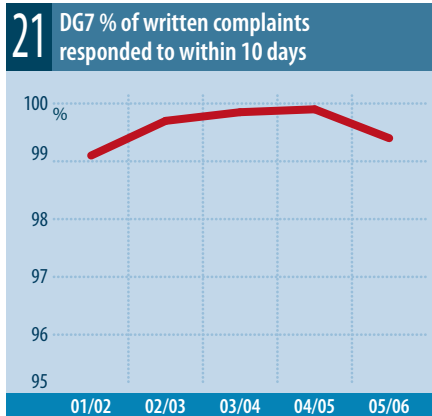
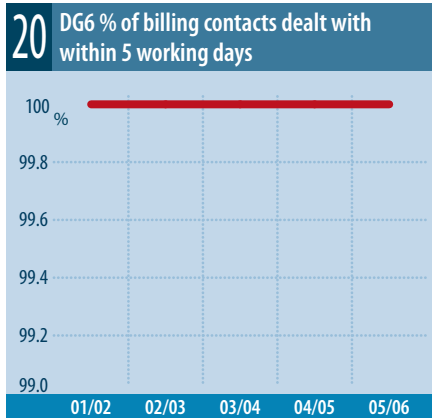
We have carried out 21 environmental investigations against a target of 9 investigations in our Monitoring Plan. The 'First Time' sewerage programme has been reviewed to confirm the benefits of carrying out some of the projects. Of the original 23 projects for the AMP4 period our detailed reassessment indicates that only one project meets the cost and environmental benefit criteria. We will be pursuing this project and five other projects where a commitment already exists for us to provide public sewers.

Customer Contact

Billing contacts DG6

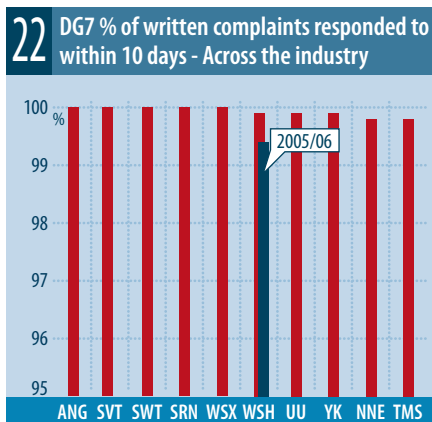
During the report year, we handled over one million queries and requests concerning bills, an increase of 2% compared with 2004-05. Of the total, almost 143,000 were written contacts and just over 892,000 were telephone contacts. We dealt with 99.97% of these within a five-day period. This is a slight decrease on the 2004-05 figure and arose mainly from a problem with a particular server in July 2005 which briefly affected e-mail contact.

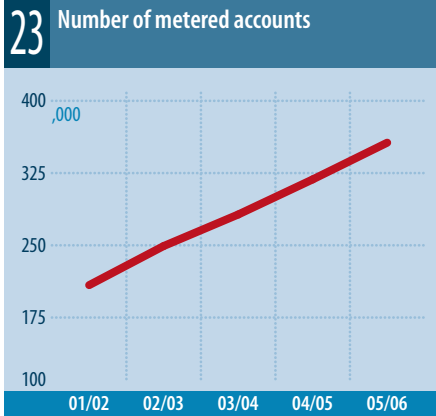
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Written complaints DG7

In the report year we responded to 9,691 written complaints compared with 8,108 on 2004-05 – an increase of 19.5%. The increase in the number of complaints was mainly attributable to the overall price increase at the start of the current investment period, changes to our tariff structure, sewer flooding and the cryptosporidium outbreak in late 2005. We answered 99.4% of these complaints within 10 days which is a slight decrease on the 2004-05 figure, partly as a result of the server problems identified in the last paragraph. 21 22

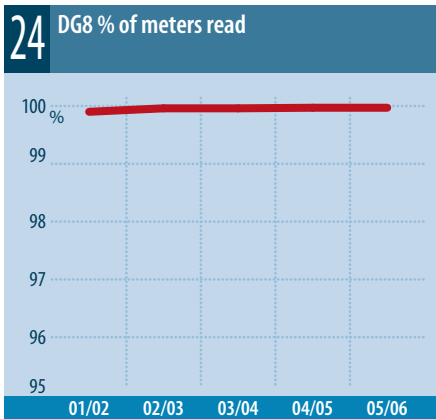




Meter reading DG8

During the report year, we maintained our DG8 performance, with 99.97% of metered accounts being read during the year. In this period the number of metered accounts rose by 38,666 to 384,916. Despite this increase, only 116 meters have not been read by either ourselves or the customer during the year.

The problems associated with reading internal meters continues to be a challenge, but we have adopted flexible working arrangements to improve performance and meet customer requirements. [23](#) [24](#)

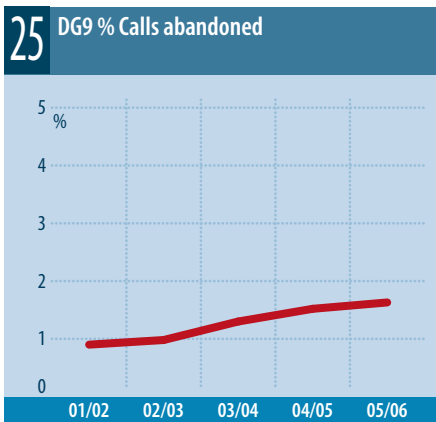


Telephone contact DG9

During the report year we received over a million calls on our principal advertised lines, which represents a 6% increase on the previous year

Performance against the new combined DG9 measure for the reporting year was good, with only 1.6% of calls being abandoned. [25](#)

Almost half of these were abandoned in the first 10 seconds, with 0.3% of calls receiving the engaged tone. This slight reduction in performance is partly attributable to a single incident on Sunday 17 July 2005, when a third party damaged a key trunk main in Cardiff, prompting some 7,000 calls. Performance against the new call handling satisfaction measure was 4.59 out of a possible maximum score of 5.



Health & Safety

performance in 2005-06

Our health and safety management system applies to all contract partners who work with us to deliver services to water and sewerage customers and is described in our annual health and safety report. The 2006 Health and Safety Report will be published on our website on or shortly after 8 July 2006.

We assess the health and safety competence of contractors before appointment. We set proactive performance targets and monitor against those on a monthly basis to promote continuous improvement and robust health and safety practice. Furthermore, we operate an innovative process of internal cross auditing in addition to external and independent auditing of health and safety performance. Under our management system, all incidents and 'near hits' are investigated, and this informs our setting of targets to drive continuous improvement in health and safety performance. 2005-06 was the second year in which we captured performance data not just from contract partners, but also for their lead subcontractors.

Performance in 2005-06

On a like for like basis, and including lead subcontractors, reportable incidents fell by 7½% and non reportable incidents fell by over 28%. This continues a steady improvement year on year and encourages us to focus on this important area of our business.

In 2005-06 we set 200 individual health and safety targets of which over 74% were met during the year. A further 16% of these targets are more than 80% complete. We are on course to achieve outstanding targets in the first quarter of 2006-07. In particular, and reflecting the benefit of a focus last year in raising awareness of muscular-skeletal risk, we managed to reduce the number of incidents arising from manual handling and lifting. In addition, we saw a fall in the number of

	2002-03	2003-04	2004-05	2005-06
Reportable incidents				
Exc. subcontractors	57	32	28	-
Inc. subcontractors	N/A	N/A	40	37
Non-reportable incidents				
Exc. subcontractors	402	345	263	-
Inc. subcontractors	N/A	N/A	343	245
Dangerous occurrences				
Exc. subcontractors	2	4	3	-
Inc. subcontractors	N/A	N/A	3	0

incidents arising from slips, trips and falls, or from individuals being hit by a moving object or by hitting a stationary object, which we also identified in the 2005-06 roadmap targets. However, these aspects still give rise to 73% of all incidents and remain the main causes of safety incidents and will continue to feature prominently in our targets for the year ahead.

During 2005-06 we also undertook a number of other health and safety initiatives, and in particular, we:

- Reviewed on site electro-chlorination generation plants following the reporting of a fatal accident in Northern Ireland.
- Introduced training initiatives to increase the competency of staff in investigating health and safety incidents.
- Revitalised our arrangements for the sharing of best practice between ourselves and individual contract partners.
- Refreshed and improved our innovative approach to internal cross-audit of health and safety performance.

Monitoring of days lost related to accidents and staff ill health (including non-work related absence) shows that in 2005-06 we lost around 2.35% of available man-working days. Although this compares well with industry benchmarks, it is an increase from 2% in 2004-05, and our challenge for 2006-07 is to reverse this increase.

In 2006-07, our general focus will be to drive further improvement in health and safety performance, including a particular focus on the behavioural aspects of health and safety management.

Financial Overview

Financial results

Welsh Water's appointed business turnover in the year to 31 March 2006 was £545 million (2005: £486 million) – an increase of 12%. The increase broadly reflects the price increase of 12.6% in the year. The effect of 'customer dividends' in the year was that turnover was some £23 million (2005: £12 million) below the level that would have resulted from the full price control allowed by Ofwat. The rate of customers switching voluntarily to metered charging in the year slowed somewhat to nearly 27,000 customers (2005: 31,000 customers), whilst some 10,000 new customers were added during the year, who are all metered.

There was continuing success from various income initiatives, which have added some £2 million this year to the revenue base, largely by ensuring that customers are being charged correctly for all the services that they receive from the company.

The current cost depreciation charge was £122 million (2005: £104 million). The increase is due to additional charges arising on the £107 million of above ground capital expenditure during the year and the acceleration of depreciation on certain assets, notably assets identified for disposal.

The infrastructure renewals charge was £50 million (2005: £50 million). The charge reflects the medium to long-term maintenance needs of the infrastructure network and is based on expected maintenance expenditure over the period 2001 to 2015.

Net interest charges for the year were effectively unchanged at £151 million (2005: £144 million - including a profit of £6 million on the termination of a finance lease) despite the increase in net debt during the year. This was achieved in part by successful re-financing over the year which will help keep down customer bills over the long term.

Profit before tax was £63 million (2005: £26 million). This profit was made after funding the 'customer dividend' of £18 for customers receiving both water

and wastewater services. The Board of Welsh Water has decided to increase the 'customer dividend' for 2006-07 to £19, and intends to maintain the 'customer dividend' at least at that level until 2010.

The current tax charge for the period was £4 million (2005: nil) off set by £4 million deferred tax credit (2005: £10 million).

Continued focus on cost control

Welsh Water's appointed business operating costs (excluding depreciation and infrastructure renewals charge) were £205 million (2005: £213 million). This reduction in costs reflects primarily the success of the retendering of the major operations contracts in 2005. In addition, the level of operating costs in the year benefitted from the cessation of certain one-off activities in 2004-05 (including the price review and the retendering exercises) and certain one-off benefits such as a rates rebate. The business is experiencing significant upward cost pressures notably energy costs, which were some £9 million (or 54%) higher than in the previous year. The costs of the £25 ex gratia payment to some 30,000 customers in north west Wales affected by a boil water notice are included in operating costs.

Around 70% of operating costs were incurred under outsourced service contracts, including the contract with UUOS for the operation of the water network and the wastewater network in north Wales and with Kelda, for the operation of the wastewater network in south Wales and Herefordshire both effective from 1 April 2005. These new contracts operate on a target cost basis which are designed to incentivise further improvements in operating efficiency in the period up to March 2010.

Customer debt recovery remains subject to very close attention by Welsh Water and by Thames Water, our service provider. Despite a difficult environment, (in so far as water companies are not allowed to disconnect supplies to domestic customers

due to non-payment of charges), cash collection performance was ahead of target. The bad debt charge for the year of £8 million (2005: £8 million) represents less than 2% of annual turnover.

Capital expenditure during the year (before capital grants and developer contributions and including infrastructure renewals expenditure) was £238 million (2005: £239 million), which is broadly in line with the expected average rate of expenditure over the five-year AMP4 period. Since 1 April 2005, Welsh Water has been working with a new alliance of capital investment partners (Laing Utilities Ltd., Morrison, AMEC, Costain, Meica and Black and Veatch) with the aim of delivering the AMP4 investment programme at the best value for money for customers. A priority during the first year of the programme has been to reappraise rigorously the design of certain key schemes with a view to achieving the reductions in unit costs assumed by Ofwat in the 2004 Price Review. At this relatively early stage, it is expected that investment expenditure over the AMP4 period as a whole, of some £1.2 billion, will be broadly in line with the allowance made by Ofwat in the Final Determination.

Financing strategy

The Board considers that it is in the best long-term interests of Welsh Water's customers to continue to reduce the level of gearing, with a view to achieving further reductions in its average cost of finance. Following extensive financing activity during the year, funding is now largely in place to 2010 for the AMP4 Programme.

The two credit rating upgrades (Moody's and Fitch Ratings) during the course of the year reflected, at least in part, the strengthening balance sheet of the group and will help to fund future financing costs, and reduce customers' bills in the long term.

Future prospects

The objective of the Board will be to continue to improve the financial performance of the company during the period to 31 March 2010, whilst seeking to at least maintain the current level of 'customer dividend'. The Board believes that its financial strategy will put the company in a strong position to raise the funding for the following five-year investment programme in the period to 2015 on efficient terms, which is an important part of the company's strategy to keep down customers' bills in the long-term.

The main risks to the achievement of this financial objective involve upward cost pressures. Most notably, power costs have increased dramatically over the last two years and are expected to increase further in 2006-07 and Welsh Water, like all water and sewerage companies, has a large energy requirement, notably for pumping and treatment processes. The increase in power prices can be only partially offset by improved working practices and investment in energy efficiency schemes.

The unit costs of investment schemes have been under upward pressure and face further risks, for example from increasing materials costs. Welsh Water is seeking to mitigate these cost increases and risks by securing the resources for a long-term programme of work with its partners and by revisiting designs and working methods to secure offsetting efficiency improvements. Welsh Water and its partner, Thames, also maintain a tight focus on customer cash collection and have introduced a new debt recovery system for metered customers, in recognition of the continuing risk to cash collection posed by increasing water bills and the absence of a disconnection sanction. Under the target cost arrangements, these upward cost pressures are shared only to an extent between Welsh Water and its relevant partners.

The company does not expect to pay tax on its trading profits during the year to 31 March 2007, due to the availability of tax allowances on its investment programme. Future tax liabilities beyond that date will also be primarily influenced by this factor.

key supporting

information

Water Service

Water capital outputs

During the report year we delivered the following major outputs from our water service investment programme:

Water Treatment Works (WTWs):

- One scheme completed at Strata Florida in line with the agreed undertaking with DWI.
- Scheme design commenced at 2 other WTWs.

Water mains programme:

- 407km of unlined iron water mains refurbished to improve water quality and iron compliance at customers' taps (52km behind the output agreed with DWI).
- 72km of water mains causing frequent supply interruptions to customer supplies replaced.
- 19km of water mains relined under maintenance programmes.
- 120km of mains cleaned for water quality improvements and ongoing maintenance of the distribution system.

Water supply asset maintenance

We are required to identify any WTWs where maintenance investment in the year has exceeded £5m or is over £100k and is 10% or more of the Gross Modern Equivalent Asset (GMEA) value of the works. This threshold of investment is high and does not reflect the amount of capital maintenance actually carried out by the company.

During the report year we have carried out planned capital maintenance work at 83 of our 91 WTWs (77 operational and 14 stand-by), with 24 works having more than £100k invested in the report year. However expenditure did not exceed the £5m or the 10% GMEA value for any single WTW.

Planned maintenance work has been undertaken, during the year, at 51 Service Reservoirs and 45 Water Pumping Stations with 3 single sites incurring investment of over £100k and 10% of GMEA.

During the report year we renewed a total of 315km of water mains which

included 231km of water mains renewed to meet the DWI S19 undertaking. A total of 72km of water mains were renewed under prime purpose maintenance, and 12km were replaced as a result of diversions. Although this represents a 1.1% asset renewal rate, the majority of this renewal was concentrated on unlined iron mains. Renewal of asbestos cement and older plastic mains remains at a low rate and is confined to short lengths of high bursting mains. This is unsustainable over the longer term, as it will take approximately 200 years to replace all asbestos cement and old plastic mains at the current renewal rate.

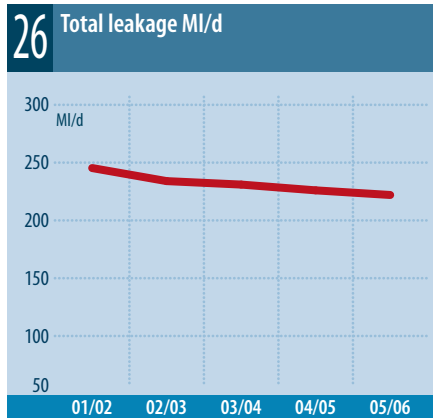
Capital expenditure water

Actual expenditure during the year was £104 million, £18 million lower than the £122 million allowed in FD (inflated at RPI). This 'underspend' may be explained as follows:

- Some £11 million relates to maintenance expenditure, where late changes to the early start programme meant that the FD maintenance programme was front-end loaded and, the first year spend could not be achieved efficiently.
- A further £3 million due to a delay at a WTW.
- Circa £2 million on the security programme as the priority of schemes were re-evaluated in view of the loss in grant.
- £2 million on New Development and Growth reflecting the cost of particular schemes in the year.

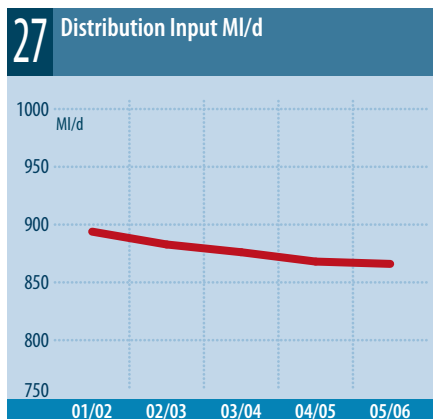
Capital expenditure by purpose water service		
£m	Previous year Capex 2004-05 (Outturn)	Actual Year Capex 2005-06 (Outturn)
Base - Infrastructure	24.9	31.1
Base - Non infrastructure	19.1	27.4
Enhanced service	0.0	0.0
Supply & demand and IDOK	13.9	8.8
Quality and IDOK	24.1	36.8
Total water service (£m)	82.0	104.1

*Total Capex for water and sewerage (2005-06) was £238 million gross of infrastructure contributions + third party costs.



Leakage reduction

- Continuation of leakage identification, repairs and prevention work resulting in a reduction in leakage from 226 MI/day to 225 MI/day.
- The rate of leakage was 8.2m³/km/day, down from 8.3m³/km/day in the previous year. This performance is in line with the rest of the sector and efforts continue to meet the zonal Economic Level of Leakage targets. [26](#)



New assets for development and growth:

- 58km of new water mains laid to serve new development and 12km of mains diverted to accommodate new development, property extensions, and work in roads etc.

Distribution input and water delivered

The amount of water supplied from our WTWs (Distribution Input) has reduced again over the reporting year as a result of a reduction in the demand for water, which includes lower leakage. The average distribution input for 2005-06 was 866 MI/day. This has reduced by over 12% since 1998, or 120 MI/day. This puts us in a much better position to deal with prolonged drought periods, even one as severe as 1976, without the need for water restrictions. [27](#)

Metering

During the year, an additional 27,480 customers switched to a measured based charge. A total of 24,480 meters were fitted. Where meters could not practically be fitted (3,000 cases), customers were allowed an Assessed Measured Charge (AMC).

Since April 2000 we have dealt with 258,105 requests for information relating to meter options and 171,243 requests for meters to be fitted. In total, 153,318 meters have been installed and 17,925 customers moved on to AMCs. We now have over 24% of total households on metered charges (of which 1.5% are on AMCs).

GSS – Payments

The total number of payments made in the reporting year relating to the water service, both automatically generated and claimed, was 27 (excluding Enhanced GSS payments).

Sewerage Service

Capital outputs

In the report year we delivered the following outputs from our sewerage service investment programme.

Wastewater Treatment Works

- 72 identified AMP4 outputs have been delivered against a Monitoring Plan target of 80.
- 2 identified outputs were delivered in year 5 of AMP3.
- An additional 2 schemes not funded within the FD have also been delivered.
- A further 7 AMP3 identified outputs were also completed.

Sludge/Biosolids

- Continuing work at our 36 sludge centres to maintain compliant sludge for agricultural disposal.
- Developing a programme of work to install CHP plants at all suitable digestion sites.
- The total sewage sludge disposed of in the year was 82.2 ttds, including grit and screenings. All sludge was disposed of satisfactorily, and 75.3% was treated to the enhanced standards.

Section 101A

- In the report year, we have reviewed the benefits of the 23 schemes in our Monitoring Plan.
- The assessment has concluded that we will be progressing with only 6 of the 23 schemes, one of which demonstrates positive cost benefit and the other 5 where we have a commitment to provide a public sewer.

Intermittent Discharges

- 62 schemes completed in the report year against our Monitoring Plan target of 51 schemes.
- A further 4 schemes were delivered in year 5 of AMP3 with major schemes undertaken in the Afan/Baglan and Cog Moors catchments linked to bathing water improvements at Aberafan and Barry.
- Improvements at a further 20 AMP3 identified assets were also completed.

Environmental Investigations

- 21 investigations for Groundwater and Habitats Directives were completed against a Monitoring Plan target of 9 investigations.

Sewer Flooding

- 82 properties were removed from the 'at risk register', and a further 7 from the '1 in 20 register'.
- We also tackled 61 external flooding problems (53 'serious external flooding' problems (SEF) and 8 'other external flooding' (OF) problems).
- A further 24 properties were removed from the 'external flooding register' through better information (8 SEF, 16 OF).

New sewers and other sewer refurbishment

- 70km of new sewers were laid and 13km of sewers were refurbished in the report year.
- A programme of CCTV surveys continues with 41km of critical sewers and 31km of other sewers inspected in the report year.

Sewerage Asset Maintenance

Work was carried out at over 500 sites to improve or maintain asset serviceability and ensure compliance with consents.

We are required to identify where maintenance investment in the report year has exceeded £5m or is over £100k and 10% or more of the GMEA value of the asset. However, this is a very high threshold and is unlikely to reflect the amount of capital maintenance carried out by the company. There were only 4 WwTWs sites where these parameters were exceeded. Over £100k of capital maintenance has however been carried out at 6 WwTWs, 3 Sludge Centres, 5 Pumping Stations and 1 Outfall during the report year.

Capital expenditure

Actual expenditure during the year was £128 million, £48 million lower than the £176 million allowed in FD (inflated at RPI). This 'underspend' may be explained as follows:

- £6 million relates to sewer rehabilitation expenditure, where late changes to the early start programme meant that the FD maintenance programme was front-end loaded and the first year spend could not be achieved efficiently.
- £5 million due to delays to Odour schemes whilst awaiting DEFRA guidance.
- £4 million on sludge schemes whilst we review our overall strategy to mitigate increased power and fuel costs.
- £20 million relating to 6 UWWTD schemes and 3 intermittent schemes rephased to later years due to land and planning issues and revised completion dates agreed with the Environment Agency.
- The balance principally relates to non-delivery of shellfish early start schemes that were not approved by ministers and the difference in costs between the 15 intermittent schemes brought forward from future years and the 19 schemes rephased to later years.

Capital expenditure by purpose sewerage service		
£m	Previous year Capex 2004-05 (Outturn)	Actual Year Capex 2005-06 (Outturn)
Base - Infrastructure	16.9	17.0
Base - Non infrastructure	24.1	29.4
Enhanced service	2.2	3.6
Supply & demand and IDOK	3.6	5.5
Quality and IDOK	107.0	72.4
Total water service (£m)	153.8	127.9

*Total Capex for water and sewerage (2005-06) was £238 million gross of infrastructure contributions + third party costs.

Sustainable procurement

With effect from April 2005, UUOS and Kelda were appointed to undertake our asset operations activities. Laing Utilities Limited, Amec Group Limited, Costain Limited and Morrison Construction Services Limited were appointed to undertake civil engineering works and Black & Veatch Contracting Limited and Meica Process Limited to undertake process engineering works.

The appointments were made following a detailed review of a number of key performance criteria including quality, value, environmental policies and health and safety.

An Asset Management Alliance (AMA) has been formed, which includes the partners listed above, with the objective of improving performance and efficiency. A number of Business Support Teams (BSTs), including one concentrating on Supply Chain matters have been formed, comprising of members of Welsh Water and its partners.

The Supply Chain BST is responsible for setting the standard for best practice Supply Chain Management across the AMA. Its vision is to be recognised as a leading supply chain alliance.

There is a detailed focus on health and safety throughout the supply chain.

The team has developed common procedures and documents for use with

partners across the supply chain. These cover such areas as pre-qualification criteria and processes, invitation to tender procedures, tender assessment methods and award. These documents and processes embody the key principles outlined in the Guide to Sustainable Procurement published by British Water.

Common suites of terms and conditions are being developed. The aim is to simplify and expedite the processes and to secure the optimum supply chain benefits for ourselves and the AMA.

A number of significant procurement exercises have been undertaken in relation to civil materials, pipe rehabilitation, land agents, panel, pumps and mechanical fabrication. We are keen to select Supply Chain partners who will work proactively with us further up the value chain and are prepared to work collaboratively to identify opportunities for cost and process efficiencies.

Additionally, having established the new agreements with our main partners, we wish to ensure that these new relationships are properly supported. A series of monthly meetings have been held to review performance, identify issues and potential resolutions.

Efficiencies

Cost Comparisons 2005-06						
£m (2005-06 prices)	JR 2006.	JR 2005	Change	%	FD	Variance
Water	107.6	117.1	(9.5)	(8.1)	119.5	(11.9)
Sewerage	97.6	100.9	(3.3)	(3.3)	105.2	(7.6)
Total	205.2	218.0	(12.8)	(11.4)	224.7	(19.5)

Operating Expenditure

This is the first June Return since the new contracts with operating partners were awarded. The new contract regime has resulted in an overall improvement in efficiency this year; with both services having a real reduction in costs. The table above shows this year's costs as compared to the figure last year and also compared to the FD.

The reduction in costs has been achieved despite a £9 million (54%) increase in energy costs and above inflation increases in Governmental charges. We have also incurred additional costs due to the Cwellyn incident and the Albion Water Competition Appeals Tribunal case.

Our 2006 Business Plan currently forecasts that operating expenditure for 2006-07 will be around £220 million (at 2005-06 prices), broadly in line with the forecast in the Final Business Plan.

Efficiencies

The retendering of the main operations contracts in 2004-05 was extremely competitive and resulted in a significant overall improvement in efficiency.

The most significant change in contracts shape has been the awarding of the southern region integrated sewerage service to Kelda and UUOS similarly taking responsibility for all of the northern region sewerage area, thus generating synergy savings as against the previous model in which responsibility for the sewerage service was split between several service providers.

As well as the reduction in cost achieved by the start of the new operating agreements, further efficiencies are being achieved as result of the implementation of bid initiatives by all three successful main partners UUOS, Kelda and Thames

Water. These new contracts operate on a target cost basis which are designed to incentivise further improvements in operating efficiency in the period up to March 2010.

There are over 75 bid initiatives in the arrangements with the two operating partners, ranging from restructuring and integration, through chemical optimisation to site specific projects. Voluntary severance programmes have reduced manpower numbers by around 70. Within the Billing and Income contract, Thames Water have been able to absorb the additional costs of serving the large increase in metered customers through improved working practices. A new debt management IT system has also been implemented for measured customers, which will help to maintain current good collection performance.

As well as the partners' own initiatives, there is a major Business Transformation Programme of IT enabled change being undertaken throughout the enterprise led by Welsh Water. This programme will form the basis of initiatives designed to achieve future efficiency savings through the AMP4 period. We are looking to upgrade and replace legacy, IT systems and business processes to deliver increased efficiencies and also to improve service to our customers.

A competitive retendering exercise for ICT Services is due to be completed in July 2006, with a retendering of the laboratory and sampling services contract taking place later in the year. Again it is expected that improved operating costs will result.

Capital expenditure

The capital programme for AMP4 allowed in the FD is around £1.3 billion (inflated at RPI). At this early stage in the AMP4 period, our ambition is to deliver the investment programme at a cost broadly in-line with this FD allowance.

The costs of investment schemes are under upward pressure with unit costs on Year 1 schemes being above forecast levels. These cost pressures are partly reflected in the COPI inflation factor. We plan to achieve efficiency savings in the delivery of the programme by absorbing the difference between COPI inflation and RPI inflation. Currently, we estimate that over AMP4, this would amount to some £100 million in efficiency savings. This is a challenging target and requires a rigorous reappraisal of the design and planning of schemes and programmes to achieve reductions in unit costs.

Competition

Water Act 2003

Modifications were made to our Instrument of Appointment in September 2005 with the addition of the provisions in Conditions R and S, which set out new requirements arising from the introduction of the Water Act 2003 competition regime. We published our Access Code in September 2005 and it was revised in November 2005. We will be reviewing, and if necessary, amending it again in September 2006. Our Indicative Access Prices were published in August 2005. Indicative Access Prices will be published again for September 2006. We are currently negotiating a master wholesale agreement with a licensed water supplier. At every stage we have followed the Ofwat Guidance.

Albion Water

In May/June 2006, the Competitions Appeal tribunal heard Albion Water's appeal against the decision of Ofwat that we had not infringed a provision of the Competition Act 1998, in offering a price for the common carriage of non-potable water across part of our network. We are expecting judgement to be delivered before the end of the year.

Inset Appointments

There have been no new inset appointments during the report year.

Board endorsement

On 2nd June 2006, the Board of Welsh Water duly endorsed this Overview of the June Return 2006. The Reporter attended the Board Meeting for this matter.

The Board were also briefed on the quality assurance processes summarised below and were satisfied with the measures outlined.

- All staff contributing to the Return have been reminded of their obligation to provide information that is reliable, accurate and complete in accordance with MD209 and all key staff attended a briefing where the topic was addressed;
- Data is analysed and compiled into the required format of the Annual Return tables by named individuals each following Ofwat's reporting definitions;
- Due diligence is undertaken wherein the information is challenged by the Economic Regulation team and other Senior Managers;
- Where appropriate, data is verified by either a relevant Director or Senior Manager;
- There is appropriate sign off by individuals responsible for producing reporting information;
- The Return is certified by our external Reporter and Auditors.