

Financial performance and expenditure of the water companies in England and Wales 2008-09

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About this report

This report examines the operating profits, cash flows and balance sheets of the regulated water and sewerage companies and water only companies in England and Wales for the financial year 2008-09. It also provides information about each company's day-to-day running costs (operating expenditure) and the investment it carries out to maintain and upgrade the pipes, sewers and treatment works (capital investment). This is the fourth year of the period 2005-10 for which we set price limits in 2004.

Most of the regulated companies are part of larger groups. Each company has a statutory duty to trade at arm's length with associate companies and with its parent company. This report considers only the regulated businesses. However, we have included an analysis of the trade that each company carried out with its associate companies in 2008-09.

The information in this report is drawn from the June returns and regulatory accounts that each company submits to us. Copies of the regulatory accounts are available from individual company websites. They include an independent accountant's report, which explains the responsibilities of the independent accountant.

We provide the information in this report on a current cost basis. We have rebased historic information to 2008-09 prices using the Retail Price Index (RPI).

During the period covered by this report, the names of Folkestone & Dover Water, Tendring Hundred Water and Three Valleys Water changed to Veolia Water South East, Veolia Water East and Veolia Water Central, respectively. We have used the original company names in this report for ease of reference.

We have not included the performance of exceptionally small companies, such as Cholderton and Albion, in this report. This has no material impact on the information in the report.

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Headline issues

Financial performance

The companies' operating profits increased by 7% to £3.2 billion in 2008-09.

Operating profits were higher than in 2007-08 because of higher revenues and a reduction in capital maintenance charges. This has caused the interest cover ratios to rise slightly.

The companies' overall return on capital for 2008-09 was slightly higher (6.8%) than in 2007-08 (6.5%) and also lower than our expectation of 7.3% assumed in price limits.

The companies' pre-tax profits decreased by 22% to £1.8 billion in 2008-09. This is despite the 7% increase in operating profits, which has been more than offset by a lower financing adjustment. The financing adjustment reflects the impact of inflation on the value of debt. This fell in 2008-09 as the March 2009 RPI was lower than the March 2008 figure. Therefore, the value of the debt has increased in real terms rather than the usual decrease.

Operating expenditure

Total operating expenditure for the water and sewerage sectors in 2008-09 was £3.6 billion (excluding exceptional items). This is 2% more, in real terms, than in 2007-08. It is in line with what we assumed in price limits for 2008-09, but still £325 million (9%) less than the companies set out in their 2004 business plans.

There were significant increases in energy costs in 2008-09, averaging 25% compared with 2007-08. This is because the large energy price increases in 2007 and 2008 are now being reflected in companies' energy bills.

Investment

At the 2004 price review, the water and sewerage sectors were expected to deliver a large programme of capital investment between 2005 and 2010 to improve and maintain assets.

Overall, the companies invested £4.6 billion in 2008-09. This is 14% more than we assumed in the 2004 price limits, although it is 6.8% lower than in 2007-08.

The businesses invested 4.8% less overall than we expected over the first four years of the current price limit period. Of this, the companies report that 3.3% was the result of efficiencies, which we welcome. Some companies reported delays in obtaining planning consent, which contributed to delays in delivering some schemes. We will continue to monitor each company, and where a company fails to deliver schemes, we will take this into account in future price limits so that its customers do not pay for improvements that have not been delivered.

Over the same period, investment in quality enhancements was 24% lower than we expected, because of a combination of efficiency savings and some delays. While the companies sometimes need additional time to find the best solutions, they have made only limited progress in catching up with outstanding work from the first three years. Despite these delays, the companies report that they are on target to meet their statutory obligations. We are monitoring delivery against statutory deadlines in conjunction with the appropriate quality regulator.

Investment to balance supply and demand for sewerage services was 32% lower than expected, because of efficiency savings, lower than expected development activity and some delays in investment at treatment works.

In other areas, capital investment is ahead of our projections over the four-year period. Maintenance spend is 10% higher than our projections over the four-year period. Similarly, expenditure on enhanced service levels is 17% higher, and expenditure to balance supply and demand in water services is 22% higher. This increase is mainly because of additional work done to alleviate flooding from sewers, higher optional metering and more expenditure on leakage control.

The companies' final business plans show that they expect to continue investing more in maintaining and improving their assets than we had assumed in price limits. For 2009-10, this will be more than £4 billion. Our draft determinations also expect the companies to deliver a similar sized investment programme in 2010-11, maintaining a flow of work to the supply chain and continued improvement in the sectors' assets and services.

1. Financial performance

The way we regulate the water and sewerage sectors in England and Wales – through limits on prices charged to customers rather than by limits on profits or rates of return – gives the sectors incentives to finance their functions as efficiently as possible. The companies need to make a return so that they can finance their functions and attract additional investment.

When we set price limits in 2004, we expected that the companies' revenue in 2008-09 would need to increase by inflation plus an average of 2.5%, compared with the previous year. In 2008-09, revenue growth was 2.3% higher, in real terms, than in 2007-08.

The companies' current cost operating profits were 7% higher compared with 2007-08. They increased by £214 million to £3.2 billion. This reflects increased turnover and lower capital maintenance charges. Although the companies' profits are at the highest levels for the past five years, they are still marginally lower than the peak seen in 1999-2000 (after adjusting for inflation).

Current cost profits before tax actually fell by 22%. They totalled £1.8 billion in 2008-09, down by £503 million compared with 2007-08. This was because of a much smaller financing adjustment, which is determined by RPI.

Table 1 shows the industry aggregate current cost profit and loss account for 2008-09 and the previous four years.

Table 2 shows some of the key financial indicators for the sectors as a whole, for each year over the five years between 2004 and 2009, including those that we considered as part of our 2004 price review. These indicators provide a snapshot of the companies' financial health. Two ratios in particular (cash flow:capital expenditure and retained cash flow:debt) fell slightly in 2008-09. One reason for this is that the companies resumed special dividend payments in 2008-09. (There were none in 2007-08.) Current cost dividend cover, the long-term measure of the security of dividends, fell significantly below 1.0 for the same reasons.

Higher operating profits have caused the interest cover ratios to rise slightly.

Table 1 Current cost profit and loss account

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09	2007-08 to 2008-09 change
	£m	£m	£m	£m	£m	£m
Turnover	8,365	9,153	9,308	9,514	9,735	221
Operating expenditure	(3,399)	(3,556)	(3,707)	(3,626)	(3,625)	1
Capital maintenance charges:						
– Current cost depreciation	(2,045)	(2,036)	(2,084)	(2,123)	(2,099)	24
– Infrastructure renewals charge	(520)	(716)	(747)	(830)	(793)	37
Working capital adjustment ¹	6	(3)	41	22	7	(15)
Other operating income	36	25	68	76	21	(55)
Current cost operating profit	2,441	2,867	2,879	3,033	3,247	214
Other income	15	12	10	9	8	(1)
Net interest	(1,290)	(1,434)	(1,251)	(1,456)	(1,471)	(15)
Financing adjustment ¹	761	616	951	690	(12)	(702)
Current cost profit before tax	1,928	2,061	2,589	2,275	1,772	(503)
Current taxation	(71)	(331)	(394)	(519)	(445)	74
Deferred taxation	(216)	(281)	(0)	225	(186)	(411)
Dividends reported	(1,398)	(1,827)	(3,361)	(1,510)	(2,275)	(765)
Current cost profit retained	243	(379)	(1,166)	471	(1,135)	(1,606)

Note:

1. The working capital adjustment accounts for the impact of general inflation on the real value of working capital to the business. The financing adjustment accounts for the impact of general inflation on the real value of net finance for the business.

Table 2 Financial indicators

	2004-05	2005-06	2006-07	2007-08	2008-09
Cash-based indicators					
Cash interest cover (net) ¹	3.5	3.6	4.5	3.8	4.6
Cash interest cover (gross) ²	3.2	3.2	3.7	3.3	3.6
Adjusted cash interest cover I ³	1.5	1.5	1.7	1.6	1.8
Adjusted cash interest cover II ⁴	2.1	2.0	1.9	1.8	2.2
Debt payback period (years)	5.2	4.9	5.3	5.5	5.8
Cash flow to capital expenditure	60.8%	67.0%	28.7%	67.2%	55.1%
Funds from operations:debt	13.4%	14.3%	13.2%	12.5%	12.5%
Retained cash flow:debt ⁵	8.7%	8.0%	2.6%	8.2%	6.2%
Accounting-based indicators					
Historic cost dividend cover ⁶	1.1	1.0	1.5	1.3	1.2
Current cost dividend cover ⁶	1.2	1.0	1.7	1.3	0.7
Interest cover	1.9	2.5	2.3	2.1	2.2
Gearing⁷					
Gearing – net debt/RCV	61.2%	58.5%	62.2%	66.0%	71.8%

Notes:

1. Cash interest cover (net) is calculated as: net cash flow from operating activities/net interest.
2. Cash interest cover (gross) is calculated as: funds from operations/gross interest.
3. Adjusted cash interest cover I is calculated as: (funds from operations less capital maintenance charges)/gross interest.
4. Adjusted cash interest cover II is calculated as: (funds from operations less capital maintenance expenditure)/gross interest.
5. Retained cash flow:debt is calculated as: (funds from operations less dividends paid)/net debt.
6. Dividend covers exclude capital restructuring dividends. Dividend covers will not reconcile to those reported in table 12. Dividend covers in the table above additionally exclude all special dividends, thereby eliminating distortions to the industry trend.
7. Net debt and gearing excludes loans to group companies for the purposes of capital restructuring.
8. For 2005-06 onwards, we have adjusted the indicators to exclude the effect of arrangements where inter-company payments of dividends are made effectively in lieu of interest.

Table 3 shows current cost turnover and operating profit by service for each year over the period 2004-09. The proportion of revenue collected from metered customers (including large users) rose from about 40% in 2004-05 to 46% in 2008-09. This reflects the increase in the number of households with meters.

Current cost operating profits were higher for the sewerage service than for water, with profit margins of 37% and 29% respectively. The profit margins reflect the relative size of the asset base for each service.

Table 3 Current cost turnover and operating profit by service

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09	2007-08 to 2008-09 change
	£m	£m	£m	£m	£m	£m
Water service						
Turnover:						
– Metered water revenue	1,474	1,670	1,780	1,888	1,976	89
– Unmetered water revenue	2,268	2,463	2,429	2,436	2,421	(16)
– Large users	205	310	257	256	253	(3)
– Other	154	113	153	151	140	(11)
Total turnover – water	4,101	4,556	4,619	4,730	4,789	59
Operating expenditure	(1,845)	(1,959)	(2,047)	(1,986)	(1,995)	(10)
Capital maintenance charges:						
– Current cost depreciation	(863)	(862)	(871)	(892)	(876)	17
– Infrastructure renewals charge	(388)	(470)	(471)	(520)	(522)	(2)
Working capital adjustment	2	(2)	21	13	4	(9)
Other operating income	22	20	25	44	11	(32)
Current cost operating profit	1,030	1,283	1,275	1,389	1,412	23
Sewerage service						
Turnover:						
– Metered sewerage revenue	1,490	1,669	1,788	1,905	2,039	134
– Unmetered sewerage revenue	2,436	2,541	2,531	2,532	2,566	33
– Large users	160	237	229	220	223	4
– Trade effluent revenue	101	91	91	90	83	(7)
– Other	78	57	50	37	35	(2)
Total turnover – sewerage	4,264	4,596	4,688	4,783	4,946	163
Operating expenditure	(1,556)	(1,596)	(1,659)	(1,640)	(1,630)	10
Capital maintenance charges:						
– Current cost depreciation	(1,182)	(1,174)	(1,213)	(1,230)	(1,223)	7
– Infrastructure renewals charge	(132)	(246)	(276)	(310)	(271)	40
Working capital adjustment	3	(1)	21	9	4	(6)
Other operating income	13	5	43	32	10	(22)
Current cost operating profit	1,411	1,584	1,604	1,644	1,835	192

Tables 4a and 4b show the turnover and current cost operating profit for each company for each year over the period 2004-09.

Table 4a Turnover by company

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09
	£m	£m	£m	£m	£m
Water and sewerage companies					
Anglian	901.1	953.0	975.3	985.3	1,024.7
Dŵr Cymru	555.2	606.0	610.4	632.5	650.3
Northumbrian	556.6	591.8	601.3	613.0	614.4
Severn Trent	1,131.0	1,254.2	1,282.3	1,294.2	1,309.5
South West	340.4	378.3	400.9	425.5	424.7
Southern	533.7	593.9	607.8	628.0	667.7
Thames	1,303.6	1,503.2	1,486.1	1,497.6	1,537.0
United Utilities	1,285.4	1,356.7	1,404.9	1,460.3	1,496.5
Wessex	342.5	375.3	387.6	402.3	416.6
Yorkshire	730.6	771.9	794.5	808.3	828.2
Total WaSCs	7,680.0	8,384.2	8,551.0	8,747.0	8,969.6
Water only companies					
Bournemouth & W Hampshire	34.2	38.4	37.4	38.0	37.5
Bristol	77.9	88.7	89.7	90.4	93.4
Cambridge	17.4	19.5	20.0	21.3	19.3
Dee Valley	19.2	20.3	19.8	19.5	19.9
Folkestone & Dover	16.2	17.1	17.5	18.1	18.1
Portsmouth	35.7	35.7	35.1	34.9	35.4
South East	153.0	174.6	164.5	168.9	168.1
South Staffordshire	70.5	77.4	78.1	78.8	78.5
Sutton & East Surrey	45.7	51.1	51.0	51.3	51.4
Tendring Hundred	15.5	15.9	15.4	14.4	14.4
Three Valleys	199.1	229.6	228.2	231.0	230.0
Total WoCs	684.6	768.3	756.5	766.5	765.9

Table 4b Current cost operating profit by company

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09
	£m	£m	£m	£m	£m
Water and sewerage companies					
Anglian	274.8	286.5	337.4	325.4	351.3
Dŵr Cymru	143.0	188.3	176.2	178.7	170.1
Northumbrian	161.6	190.8	187.4	185.2	185.8
Severn Trent	315.6	398.8	424.2	327.9	417.1
South West	101.7	108.6	139.4	153.1	162.5
Southern	146.3	181.3	204.8	180.5	239.9
Thames	342.6	429.5	348.7	473.6	513.6
United Utilities	414.0	458.4	490.8	540.6	568.1
Wessex	132.9	148.8	155.7	172.8	180.6
Yorkshire	246.2	260.4	230.4	307.8	282.2
Total WaSCs	2,278.8	2,651.5	2,695.1	2,845.6	3,071.1
Water only companies					
Bournemouth & W Hampshire	9.0	10.1	12.0	12.8	10.8
Bristol	12.7	19.8	17.3	17.4	21.3
Cambridge	5.2	4.4	4.9	4.6	4.0
Dee Valley	5.3	3.6	2.8	3.1	3.5
Folkestone & Dover	5.5	5.7	5.6	5.9	4.3
Portsmouth	9.5	6.3	8.4	5.7	5.4
South East	32.8	62.5	47.5	49.8	49.9
South Staffs	15.0	18.3	17.3	17.5	17.0
Sutton & East Surrey	10.4	10.9	11.1	10.4	9.8
Tendring Hundred	6.4	6.5	5.4	5.2	3.8
Three Valleys	50.6	67.1	51.4	54.4	46.2
Total WoCs	162.3	215.2	183.6	186.9	176.0

The cash flow statement in table 5 shows the industry aggregate cash position for 2008-09 and the previous four years, while table 6 shows the key cash flows by company.

The companies' capital investment was £4.7 billion for 2008-09. This is slightly lower than in 2007-08 because of lower levels of infrastructure renewals. Interest represents about 17% of net cash flow from operations. This in turn reflects the companies' continued large borrowing requirements to fund their capital programmes.

Table 5 Cash flow statement

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09	2007-08 to 2008-09 change
	£m	£m	£m	£m	£m	£m
Net cash flow from operating activities¹	4,972	5,366	5,516	5,798	5,903	105
Returns on investment and servicing of finance:						
– Net interest	(1,138)	(1,197)	(945)	(1,233)	(1,029)	204
– Dividends paid on non-equity shares	(48)	(29)	(27)	(21)	(29)	(9)
	(1,186)	(1,226)	(972)	(1,254)	(1,058)	196
Taxation paid	(76)	(215)	(395)	(428)	(410)	18
Investing activities:						
– Purchase of fixed assets ²	(3,236)	(2,837)	(3,387)	(3,850)	(3,871)	(21)
– Infrastructure renewals expenditure	(536)	(605)	(803)	(881)	(793)	88
– Disposal of fixed assets	53	61	105	188	36	(152)
– Movements on long-term loans to group companies	n/a	n/a	(33)	(1,182)	(25)	1,157
	(3,720)	(3,380)	(4,119)	(5,725)	(4,654)	1,072
Dividends paid on equity shares	(1,238)	(1,874)	(3,371)	(1,492)	(2,297)	(805)
Net cash flow before financing	(1,249)	(1,330)	(3,340)	(3,101)	(2,516)	585
Financing:						
– Net loans	1,529	452	4,714	2,981	3,662	681
– Finance lease capital payments ³	248	59	(152)	(9)	(86)	(77)
– Proceeds of share issues	13	417	(0)	5	38	32
	1,790	929	4,562	2,977	3,614	637
Management of liquid resources	(378)	99	(1,132)	449	(440)	(889)
Increase/(decrease) in cash and cash equivalents	162	(303)	90	325	659	334

Notes:

1. Net cash flow from operating activities is calculated by adjusting the current cost operating profit shown in table 1 for items that are not direct cash flows, that is, depreciation and the change in the components of working capital that are mainly debtors and creditors. It is also adjusted for infrastructure renewals expenditure (IRE), which is shown as an investing activity.
2. The timing of cash payments means that the amounts shown in the cash flow statement for purchase of fixed assets cannot be directly reconciled to the gross capital expenditure amounts discussed later in this report. This line includes any purchases of subsidiaries.
3. This includes the draw down of finance lease facilities net of finance lease repayments.

Table 6 Key cash flows by company

2008-09 prices	Net cash flow from operating activities					Net cash flow before financing					Net increase/(decrease) in cash				
	2004-05	2005-06	2006-07	2007-08	2008-09	2004-05	2005-06	2006-07	2007-08	2008-09	2004-05	2005-06	2006-07	2007-08	2008-09
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Water and sewerage companies															
Anglian	609.5	584.4	594.9	606.1	624.8	14.6	(4.9)	(323.3)	(149.8)	(89.6)	(129.3)	(5.4)	29.0	(0.8)	161.7
Dŵr Cymru	308.3	341.8	353.0	371.2	421.8	(162.5)	(45.9)	10.9	(111.1)	(56.8)	1.8	0.0	(0.4)	(0.8)	(0.1)
Northumbrian	294.5	329.0	323.1	343.0	354.2	(94.3)	(58.9)	(77.5)	(85.5)	(75.1)	(8.0)	(3.5)	(0.2)	(6.5)	(8.3)
Severn Trent	658.1	707.1	746.2	691.3	761.4	(89.6)	(126.8)	(606.7)	(332.8)	(194.8)	4.1	(256.1)	(178.0)	235.5	395.7
South West	221.5	205.6	248.6	267.6	234.3	(75.7)	(301.5)	(90.0)	(45.5)	(104.9)	6.3	18.4	9.6	81.0	(73.4)
Southern	340.0	364.2	360.2	373.2	437.7	(39.3)	(90.6)	(325.9)	(224.0)	(117.2)	164.5	(11.8)	(114.8)	83.2	159.1
Thames	784.1	841.8	807.1	951.5	909.9	1.0	(219.2)	(642.3)	(1,497.8)	(514.2)	(3.7)	15.2	83.0	(24.3)	138.4
United Utilities	694.2	873.5	970.8	986.5	993.8	(575.3)	(161.6)	(139.4)	(334.6)	(851.0)	20.3	(7.2)	38.2	(64.4)	78.3
Wessex	232.6	246.4	252.2	272.8	285.1	(73.6)	(21.6)	(84.2)	(126.3)	(161.9)	94.8	(64.2)	243.6	35.4	(250.5)
Yorkshire	490.7	483.0	460.7	532.5	502.4	(86.5)	(251.4)	(923.0)	(118.1)	(251.5)	8.4	2.2	(5.3)	(2.5)	20.4
Total WaSCs	4,633.4	4,976.7	5,116.7	5,395.7	5,525.3	(1,181.2)	(1,282.4)	(3,201.3)	(3,025.5)	(2,417.1)	159.3	(312.4)	104.7	335.8	621.3
Water only companies															
Bournemouth & W Hampshire	18.4	20.1	18.9	22.8	20.8	2.2	(18.2)	(35.2)	33.7	0.4	1.5	5.1	(5.7)	4.3	(4.9)
Bristol	38.8	37.3	45.4	49.2	47.0	1.7	(26.4)	(8.0)	(17.2)	1.0	0.0	(0.6)	1.9	(2.6)	1.0
Cambridge	6.4	11.9	8.1	6.1	9.5	(25.1)	2.1	(0.5)	(1.5)	(0.9)	0.0	0.5	0.7	(0.2)	(1.6)
Dee Valley	9.2	8.5	11.4	8.7	8.8	(1.5)	(0.2)	(2.9)	(2.1)	2.4	(0.1)	(0.0)	0.2	(0.5)	(0.7)
Folkestone & Dover	9.8	9.4	9.4	10.7	9.4	(1.3)	(7.0)	(2.6)	(0.7)	(3.0)	0.3	(1.0)	0.6	(0.5)	0.1
Portsmouth	17.9	18.0	19.5	16.2	16.7	(0.3)	5.0	1.3	(2.6)	0.2	(0.3)	0.1	2.8	(0.1)	0.2
South East	86.7	92.0	95.9	95.7	96.5	(31.6)	(43.7)	(44.1)	(33.6)	(18.6)	2.7	(23.4)	6.3	(3.6)	36.9
South Staffs	29.2	38.7	38.9	37.2	38.0	(3.7)	13.3	(14.2)	(7.5)	(23.7)	(1.1)	28.6	(15.1)	(8.3)	10.4
Sutton & East Surrey	26.7	22.6	26.7	29.1	22.3	(6.5)	2.7	(16.1)	(4.1)	(3.5)	(2.6)	1.9	(4.7)	0.3	(0.5)
Tending Hundred	11.0	8.9	8.9	8.1	7.7	2.2	(0.3)	(1.3)	(2.3)	(1.6)	0.5	(0.3)	(0.9)	0.2	0.0
Three Valleys	83.9	122.0	116.0	118.3	100.9	(3.5)	24.3	(15.5)	(37.9)	(51.4)	2.2	(1.3)	(0.8)	0.2	(3.5)
Total WoCs	338.1	389.5	399.0	402.2	377.6	(67.5)	(48.6)	(139.2)	(75.6)	(98.6)	3.0	9.4	(14.7)	(10.7)	37.4
Industry	4,971.4	5,366.2	5,515.7	5,797.9	5,902.9	(1,248.6)	(1,331.0)	(3,340.5)	(3,101.2)	(2,515.7)	162.3	(303.0)	89.9	325.0	658.6

Table 7 sets out the sectors' aggregate current cost balance sheet at 31 March for each of the past five years.

Table 7 Current cost balance sheet at 31 March

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09	2007-08 to 2008-09 change
	£m	£m	£m	£m	£m	£m
Fixed assets						
Tangible assets	246,081	246,858	248,264	250,029	251,689	1,660
Third party contributions since 1989-90	(4,581)	(4,916)	(5,174)	(5,429)	(5,710)	(281)
Net fixed assets	241,500	241,942	243,090	244,600	245,978	1,378
Total working capital						
Total working capital	265	(482)	(684)	(578)	(307)	271
Cash						
Cash	3,174	1,966	3,106	2,497	3,189	692
Borrowings						
Borrowings	(27,203)	(27,413)	(31,216)	(33,209)	(37,181)	(3,972)
Non-trade debtors less creditors						
Non-trade debtors less creditors	1,032	2,021	2,817	4,076	4,718	642
Provisions for liabilities and charges						
Provisions for liabilities and charges	(125)	(164)	(290)	(312)	(1,090)	(778)
Deferred tax provision						
Deferred tax provision	(3,213)	(3,634)	(3,410)	(3,033)	(3,221)	(188)
Net assets employed	215,431	214,236	213,413	214,040	212,086	(1,954)
Capital and reserves						
Called up share capital						
Called up share capital	6,077	6,175	5,891	5,663	4,658	(1,004)
Share premium						
Share premium	1,239	929	887	849	852	3
Profit and loss account						
Profit and loss account	(83)	(699)	(1,804)	(1,394)	(1,994)	(599)
Current cost reserve						
Current cost reserve	207,804	207,445	208,032	208,521	208,133	(387)
Other reserves						
Other reserves	394	385	407	403	436	33
Total capital and reserves	215,431	214,236	213,413	214,041	212,086	(1,955)

Net debt for the water and sewerage sectors now stands at £34.0 billion, an increase of £3.2 billion (11%) on last year. This is 36% higher than at 31 March 2004 and reflects the considerable cash outflows from both the capital investment and financial restructuring of the companies since then. This has driven a rise in gearing levels. Each company's net debt and gearing for this period is set out in table 8.

Table 8 Net debt and gearing by company at 31 March

2008-09 prices	Net debt					Gearing – net debt/RCV				
	2004-05	2005-06	2006-07	2007-08	2008-09	2004-05	2005-06	2006-07	2007-08	2008-09
	£m	£m	£m	£m	£m	%	%	%	%	%
Water and sewerage companies										
Anglian	4,349.1	3,834.0	4,239.3	4,470.8	4,627.6	89.7	78.6	85.5	88.1	89.8
Dŵr Cymru	2,443.2	2,430.4	2,541.6	2,504.8	2,612.7	79.6	73.7	74.3	71.2	73.1
Northumbrian	1,624.8	1,648.4	1,662.4	1,703.6	1,811.8	61.5	58.0	57.1	57.5	60.4
Severn Trent	2,647.3	2,692.5	3,225.2	3,467.0	3,696.6	48.2	47.2	55.1	57.8	60.6
South West	1,143.2	1,387.7	1,395.2	1,400.1	1,575.3	55.2	61.2	59.6	58.4	64.0
Southern	2,270.8	2,613.9	2,842.7	3,002.6	3,189.8	85.6	95.8	94.4	92.8	94.8
Thames	2,673.9	2,831.4	3,345.3	4,728.6	5,316.4	46.6	44.4	49.8	67.9	74.1
United Utilities	3,715.1	3,535.1	3,488.5	3,892.2	5,055.3	58.7	51.3	48.8	52.9	68.3
Wessex	1,261.9	1,253.8	1,277.3	1,353.2	1,520.2	70.0	63.1	62.2	64.3	71.2
Yorkshire	1,469.9	1,680.9	2,493.2	2,554.7	2,829.8	39.8	42.2	60.6	60.4	65.5
Total WaSCs	23,599.2	23,908.0	26,510.8	29,077.5	32,235.5	61.6	58.4	62.3	66.3	72.1
Water only companies										
Bournemouth & W Hampshire	23.0	70.0	102.9	69.2	71.9	18.2	52.3	78.0	52.6	54.5
Bristol	153.6	192.0	193.6	191.9	214.3	58.1	75.6	71.9	70.2	81.2
Cambridge	30.8	28.1	27.2	27.8	28.8	57.5	51.9	50.1	50.7	52.3
Dee Valley	29.0	28.8	31.1	32.4	36.9	55.2	48.6	49.7	53.8	64.5
Folkestone & Dover	20.8	27.0	27.6	27.2	30.3	34.3	42.4	40.4	40.6	46.2
Portsmouth	80.4	76.0	76.1	78.8	82.9	79.5	73.2	69.9	71.2	76.2
South East Water	573.4	630.7	660.4	688.0	679.5	78.9	80.8	81.5	85.0	84.4
South Staffs ¹	124.2	159.4	141.1	146.5	176.0	66.8	80.5	69.9	71.7	86.1
Sutton & East Surrey	78.9	91.7	107.8	112.8	123.3	52.9	59.4	68.2	71.4	77.3
Tendring Hundred	8.8	8.9	9.7	11.2	13.3	14.3	15.6	17.4	19.6	22.7
Three Valleys	243.4	227.1	220.9	248.8	299.8	36.0	32.5	30.3	33.4	39.7
Total WoCs	1,366.1	1,539.6	1,598.5	1,634.6	1,757.0	55.7	60.2	60.3	61.2	65.9
Industry	24,963.3	25,447.6	28,109.3	30,712.1	33,992.5	61.2	58.5	62.2	66.0	71.8

Note:

1. Net debt was £176.0 million at 31 March 2009. However, this includes a premium of £13.3 million in relation to the index-linked loan. For covenant compliance purposes net debt amounted to £162.7 million.

During the 1994 price review, we established the regulatory capital value (RCV) as a new measure of each company's capital base. This uses the companies' market valuation (including debt) at privatisation. We then adjust this to take account of the net new capital expenditure assumed at the time of initial price setting and at each subsequent price review (after allowing for current cost depreciation).

Table 9 shows each company's RCV and its return on capital measured by its RCV for each year over the period 2004-09. The pre-tax return on capital in 2008-09, based on the current cost operating profit and RCV, was 6.8%, compared with the 6.5% achieved in 2007-08. The pre-tax return assumed in price limits for 2008-09 was 7.3%. The infrastructure renewals charges are the single biggest cost variance compared with our expectation.

Table 9 Return on capital measured by regulatory capital value by company

2008-09 prices	Average regulatory capital value					Return on capital employed				
	2004-05	2005-06	2006-07	2007-08	2008-09	2004-05	2005-06	2006-07	2007-08	2008-09
	£m	£m	£m	£m	£m	%	%	%	%	%
Water and sewerage companies										
Anglian	4,968.8	4,952.5	4,998.8	5,099.2	5,198.0	5.5	5.8	6.7	6.4	6.8
Dŵr Cymru	3,089.5	3,278.4	3,414.8	3,526.0	3,604.0	4.6	5.7	5.2	5.1	4.7
Northumbrian	2,707.6	2,836.8	2,925.8	2,987.7	3,030.5	6.0	6.7	6.4	6.2	6.1
Severn Trent	5,551.8	5,759.3	5,870.4	6,022.6	6,148.5	5.7	6.9	7.2	5.4	6.8
South West	2,083.9	2,254.6	2,341.8	2,409.7	2,470.3	4.9	4.8	6.0	6.4	6.6
Southern	2,723.6	2,709.3	2,918.5	3,175.4	3,354.8	5.4	6.7	7.0	5.7	7.1
Thames	5,877.6	6,334.4	6,660.6	6,955.5	7,188.5	5.8	6.8	5.2	6.8	7.1
United Utilities	6,380.2	6,916.0	7,134.0	7,371.6	7,499.5	6.5	6.6	6.9	7.3	7.6
Wessex	1,847.3	1,982.4	2,054.0	2,114.8	2,156.2	7.2	7.5	7.6	8.2	8.4
Yorkshire	3,729.0	3,960.5	4,115.6	4,240.2	4,345.4	6.6	6.6	5.6	7.3	6.5
Total WaSCs	38,959.3	40,984.2	42,434.3	43,902.6	44,995.8	5.8	6.5	6.4	6.5	6.8
Water only companies										
Bournemouth & W Hampshire	127.8	136.8	135.0	133.9	133.9	7.0	7.3	8.9	9.6	8.0
Bristol	255.4	256.0	266.0	275.8	274.4	5.0	7.7	6.5	6.3	7.8
Cambridge	53.1	54.9	55.1	55.5	55.8	9.8	7.9	8.9	8.3	7.2
Dee Valley	54.5	57.9	61.9	62.4	60.3	9.7	6.3	4.5	4.9	5.8
Folkestone & Dover	61.5	62.5	67.1	68.8	67.4	8.9	9.2	8.3	8.6	6.4
Portsmouth	105.7	105.8	108.1	111.6	111.6	8.9	5.9	7.8	5.1	4.8
South East	742.2	775.2	808.7	823.7	821.3	4.4	8.1	5.9	6.0	6.1
South Staffs	189.9	198.8	203.3	206.5	207.8	7.9	9.2	8.5	8.5	8.2
Sutton & East Surrey	146.7	154.6	158.9	160.7	161.4	7.1	7.1	7.0	6.5	6.1
Tendring Hundred	63.0	58.2	57.1	57.3	58.6	10.1	11.2	9.4	9.1	6.5
Three Valleys	683.4	701.1	725.5	748.8	761.9	7.4	9.6	7.1	7.3	6.1
Total WoCs	2,483.3	2,561.8	2,646.7	2,705.0	2,714.3	6.5	8.4	6.9	6.9	6.5
Industry	41,442.5	43,546.0	45,081.0	46,608.3	47,710.1	5.9	6.6	6.4	6.5	6.8

Table 10 shows the returns that investors and lenders received (for example, dividends and interest as a percentage of the RCV). Returns on this basis are 7.9% this year. This is higher than the 6.4% seen in 2007-08, as two companies have paid special dividends (see table 13). Table 11 shows the returns on capital based on the average net modern equivalent asset (MEA) values for each year over the period 2004-09. An MEA value is the cost of replacing an old asset with a technically up-to-date asset with the same service capability, but allowing for the remaining service potential of the old asset compared with the new one. As part of the 2009 price review, we asked the companies to revalue the MEA values for all their capital expenditure. However, the results of this revaluation will not be reflected in the companies' regulatory accounts until the 2010-11 reporting year.

Table 10 Dividends reported plus interest payable as a percentage of regulatory capital value

2008-09 prices	Dividends reported					Interest payable					Dividends plus interest payable as a percentage of capital value				
	2004-05	2005-06	2006-07	2007-08	2008-09	2004-05	2005-06	2006-07	2007-08	2008-09	2004-05	2005-06	2006-07	2007-08	2008-09
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	%	%	%	%	%
Water and sewerage companies															
Anglian	286.4	335.0	472.3	294.0	289.5	73.1	69.6	62.6	105.0	132.1	7.2	8.2	10.7	7.8	8.1
Dŵr Cymru	16.0	0.0	0.0	0.0	0.0	163.9	168.3	163.6	194.6	167.2	5.8	5.1	4.8	5.5	4.6
Northumbrian	72.9	37.2	73.6	74.8	76.9	93.8	97.7	98.7	89.2	101.9	6.2	4.8	5.9	5.5	5.9
Severn Trent	167.9	170.0	699.1	268.7	151.9	149.3	143.9	154.1	171.8	187.3	5.7	5.5	14.5	7.3	5.5
South West	90.7	220.1	80.4	70.7	103.8	58.6	107.4	62.4	66.8	69.9	7.2	14.5	6.1	5.7	7.0
Southern	62.6	46.5	63.4	66.7	116.1	117.1	140.3	138.8	149.4	172.3	6.6	6.9	6.9	6.8	8.6
Thames	156.5	300.6	563.8	96.5	215.1	155.5	148.2	181.8	176.6	178.9	5.3	7.1	11.2	3.9	5.5
United Utilities	241.0	247.8	285.3	305.4	841.8	248.9	265.9	147.7	199.4	206.5	7.7	7.4	6.1	6.8	14.0
Wessex	48.1	58.1	93.9	107.1	81.1	77.3	76.0	69.7	71.5	84.7	6.8	6.8	8.0	8.4	7.7
Yorkshire	120.6	298.5	886.8	114.5	311.6	87.7	90.9	103.9	148.9	76.8	5.6	9.8	24.1	6.2	8.9
Total WaSCs	1,262.6	1,713.7	3,218.6	1,398.4	2,187.8	1,225.0	1,308.1	1,183.2	1,373.1	1,377.7	6.4	7.4	10.4	6.3	7.9
Water only companies															
Bournemouth & W Hampshire ³	5.5	4.5	6.0	5.9	5.2	1.3	19.8	4.2	4.7	5.8	5.3	17.8	7.6	8.0	8.3
Bristol	9.3	11.2	6.5	12.0	8.4	7.6	7.2	6.7	8.7	11.7	6.6	7.2	5.0	7.5	7.3
Cambridge	27.3	0.0	2.5	2.4	2.4	0.9	1.4	0.6	1.9	3.3	53.1	2.6	5.6	7.9	10.2
Dee Valley	1.5	1.4	1.4	1.4	1.4	2.2	2.1	2.2	2.4	3.8	6.8	6.1	5.7	6.1	8.7
Folkestone & Dover	3.6	4.3	3.3	3.5	3.5	1.4	1.0	1.2	1.5	1.2	8.0	8.5	6.7	7.4	6.9
Portsmouth	4.3	4.0	4.7	4.2	4.6	1.9	(0.6)	(1.0)	(1.0)	1.1	5.9	3.2	3.4	2.8	5.2
South East	32.3	40.5	49.1	29.7	11.7	20.8	36.1	26.1	36.3	30.2	7.1	9.9	9.3	8.0	5.1
South Staffs ⁴	9.5	6.7	19.8	12.3	7.3	7.7	38.3	7.0	7.5	9.6	9.1	22.6	13.1	9.6	8.2
Sutton & East Surrey	6.8	5.6	15.7	5.6	3.1	6.0	7.2	8.0	9.0	10.7	8.8	8.2	14.9	9.1	8.6
Tendring Hundred	4.3	3.9	4.1	3.3	3.8	0.6	0.4	0.5	0.5	0.7	7.9	7.5	7.9	6.5	7.6
Three Valleys	31.7	31.3	29.4	31.8	35.7	15.4	13.1	12.3	11.8	15.6	6.9	6.3	5.7	5.8	6.7
Total WoCs	136.0	113.3	142.4	112.0	87.2	65.8	126.1	67.6	83.4	93.7	8.1	9.3	7.9	7.2	6.7
Industry	1,398.7	1,827.0	3,361.0	1,510.4	2,275.1	1,291.1	1,434.2	1,250.9	1,456.4	1,471.4	6.5	7.5	10.2	6.4	7.9

Notes:

- From 2005-06 onwards, dividends are reported on a different basis because of a new UK accounting standard (FRS 21). Under this standard, any dividend declared post-year end, even if it relates to that year's performance, should not be recognised in the accounts for that year. Therefore, the 2005-06 dividend figure includes amounts relating to 2004-05 that were declared and paid in 2005-06.
- Dividends reported include special dividends.
- In 2005-06, interest payable includes £15.5 million relating to the premium paid on the redemption of its preference shares. If this were excluded, the return would be 6.6%.
- In 2005-06, interest payable includes £31 million relating to an exceptional refinancing loss. If this were excluded, the return would be 7.1%.

Table 11 Return on capital by service measured by average MEA – industry

2008-09 prices		2004-05	2005-06	2006-07	2007-08	2008-09
Water service						
Current cost operating profit	£bn	1.03	1.28	1.27	1.39	1.41
Average net MEA – infrastructure	£bn	77.60	77.75	78.24	78.48	76.43
Average net MEA – non-infrastructure	£bn	13.33	13.70	13.77	14.03	13.83
Average net MEA value – all assets	£bn	90.89	91.45	92.01	92.51	90.26
Return on capital employed	%	0.99	1.42	1.39	1.50	1.56
Sewerage service						
Current cost operating profit	£bn	1.41	1.58	1.60	1.64	1.84
Average net MEA – infrastructure	£bn	139.44	139.56	140.91	142.87	138.76
Average net MEA – non-infrastructure	£bn	19.84	20.21	21.03	22.15	21.82
Average net MEA value – all assets	£bn	159.28	159.76	161.94	165.02	160.57
Return on capital employed	%	0.87	0.87	0.97	1.00	1.14
Total						
Current cost operating profit	£bn	2.44	2.87	2.88	3.03	3.25
Average net MEA – infrastructure	£bn	218.51	220.29	221.17	221.35	215.19
Average net MEA – non-infrastructure	£bn	34.36	35.40	35.65	36.17	35.65
Average net MEA value – all assets	£bn	252.83	255.69	256.81	257.52	250.83
Return on capital employed	%	0.92	0.92	1.12	1.18	1.29

Dividends

Dividends represent the companies' largest cash flow after capital expenditure. Each company is required to set out its dividend policy in its regulatory accounts. Dividends declared in 2008-09 (excluding special dividends) were 2% higher at £1.54 billion than the previous year. Two companies paid special dividends in the year, totalling £730 million. Table 12 shows the related dividend covers on a current cost and historic cost basis. Table 13 sets out an analysis of special dividends paid by the companies over the period 2004-09.

Table 12 Dividend covers by company

	Dividend cover (current cost basis)					Dividend cover (historic cost basis)				
	2004-05	2005-06	2006-07	2007-08	2008-09	2004-05	2005-06	2006-07	2007-08	2008-09
Water and sewerage companies										
Anglian	1.0	0.7	0.5	0.7	0.7	1.0	0.8	0.7	1.0	1.0
Dŵr Cymru	3.3	n/a	n/a	n/a	n/a	1.9	n/a	n/a	n/a	n/a
Northumbrian	1.4	2.3	1.9	1.3	0.9	1.2	2.4	1.6	1.4	1.7
Severn Trent	1.5	1.4	0.5	0.8	0.7	1.2	1.2	0.4	0.6	1.1
South West	0.7	0.2	1.5	1.8	0.6	0.6	0.1	1.0	1.4	0.8
Southern	1.0	1.3	2.0	1.6	0.1	1.2	1.4	1.5	1.3	0.8
Thames	1.4	0.9	0.4	3.7	1.3	1.3	0.9	0.3	4.0	1.4
United Utilities	1.0	0.7	1.5	1.0	0.3	0.9	0.7	1.2	1.2	0.4
Wessex	1.9	1.4	1.4	1.0	0.8	1.2	1.2	1.0	0.9	1.1
Yorkshire	1.5	0.5	0.2	1.9	0.3	1.6	0.6	0.2	1.5	0.5
Total WaSCs	1.2	0.8	0.6	1.3	0.5	1.1	0.8	0.6	1.3	0.8
Water only companies										
Bournemouth & W Hampshire	1.2	(2.6)	1.5	1.6	0.5	1.6	(1.9)	1.4	1.3	0.9
Bristol	0.8	0.8	2.2	0.9	0.5	1.0	1.1	2.3	1.1	1.1
Cambridge	0.1	n/a	2.0	2.4	(0.2)	0.1	n/a	1.5	2.1	0.0
Dee Valley	0.5	(0.1)	(1.1)	1.3	(0.2)	2.0	1.6	1.0	2.5	0.8
Folkestone & Dover	0.9	0.8	1.3	1.5	0.6	1.0	0.9	1.2	1.4	0.9
Portsmouth	1.3	1.1	1.5	1.6	0.6	1.4	1.3	1.8	2.0	0.9
South East	0.3	0.5	0.5	(0.9)	1.0	0.5	0.6	0.6	0.8	2.3
South Staffs	0.8	(1.8)	0.3	0.6	0.6	1.0	(1.7)	0.5	1.0	1.1
Sutton & East Surrey	1.4	0.7	0.1	0.3	(0.2)	1.4	0.6	0.3	0.6	0.2
Tendring Hundred	0.9	1.1	0.9	1.1	0.5	1.0	1.1	0.9	1.2	0.7
Three Valleys	0.9	1.4	1.2	1.6	0.3	0.9	1.3	0.9	1.5	0.6
Total WoCs	0.7	0.7	0.9	1.2	0.4	0.8	0.7	0.8	1.2	0.9
Industry	1.2	0.8	0.7	1.3	0.5	1.1	0.8	0.6	1.3	0.8

Table 13 Analysis of special dividends

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09	Total
	£m	£m	£m	£m	£m	£m
Increased gearing						
Cambridge	24					24
South West		161	59			220
Anglian			227			227
Severn Trent			618			618
Thames			358			358
Yorkshire			769		180	949
Sutton & East Surrey			13			13
United Utilities					550	550
Efficiency savings						
Yorkshire		179				179
Proceeds from land sales						
South East		8				8
Total	24	348	2,044	0	730	3,147

Accounting charges

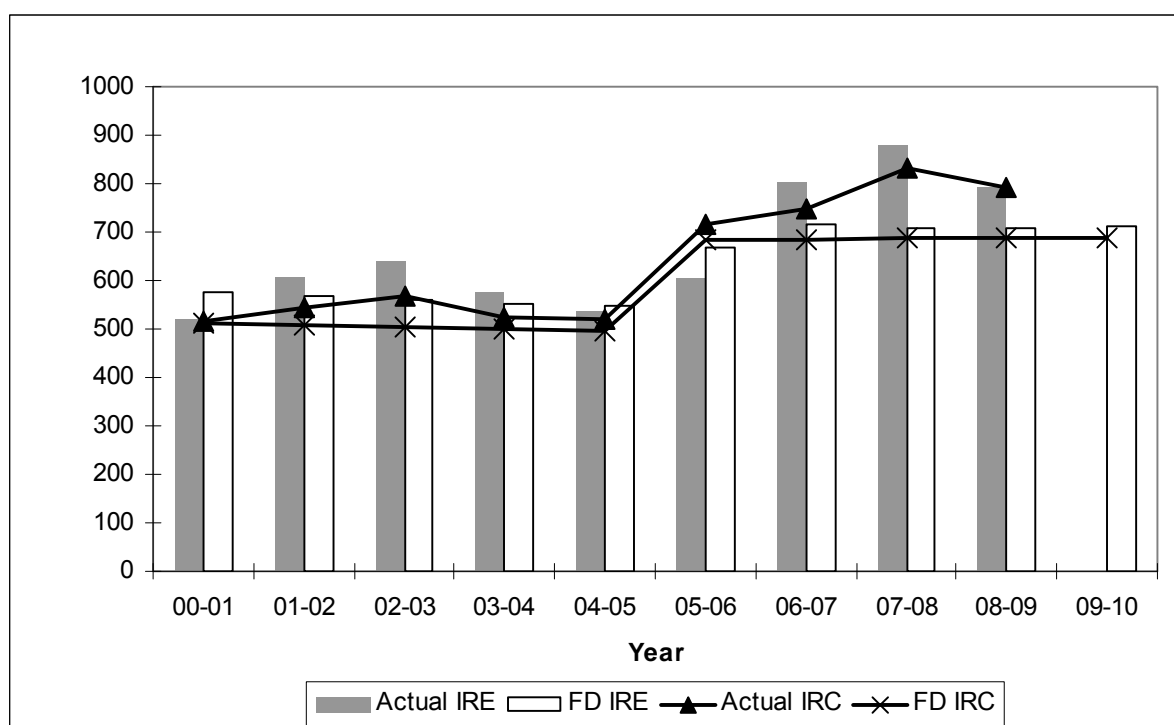
We use current cost depreciation (CCD) to derive the appropriate accounting charge in customers' bills to cover the capital maintenance needs of each company's above-ground assets. For underground assets, we use an infrastructure renewals charge (IRC).

CCD is the most significant component of capital maintenance charges. Over the long term, the CCD charged should be comparable to the capital expenditure required to maintain and replace the assets. In 2008-09, the CCD charge was 1.1% lower than in 2007-08. This is broadly in line with what we assumed when we set price limits in 2004, as is the cumulative charge over the past four years.

The water and sewerage sectors adopted infrastructure renewals accounting before privatisation. This is because it more accurately represents the manner in which infrastructure assets are managed, operated and maintained than conventional depreciation policies. Table 14 shows the infrastructure renewals expenditure (IRE) and infrastructure renewals charges (IRC) by service for each year for the period 2004-09. Figure 1 sets out the actual IRE and IRC that the sectors reported for each year over the period 2000-09, together with our assumptions when we set price limits in 1999 and 2004.

Table 14 Comparison of infrastructure renewals expenditure and charges

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09	2007-08 to 2008-09 change
	£m	£m	£m	£m	£m	%
Water service						
Infrastructure renewals expenditure	352	380	526	575	516	-10.3
Infrastructure renewals charge	388	470	471	520	522	0.4
Difference	(37)	(90)	55	55	(6)	
Sewerage service						
Infrastructure renewals expenditure	185	225	278	307	278	-9.4
Infrastructure renewals charge	132	246	276	310	271	-12.7
Difference	53	(21)	2	(4)	7	
Total						
Infrastructure renewals expenditure	536	605	803	881	793	-10.0
Infrastructure renewals charge	520	716	747	830	793	-4.5
Difference	16	(110)	56	51	1	

Figure 1 Comparison of infrastructure renewals expenditure and charges (£m)


We would expect a fairly constant IRC under infrastructure renewals accounting if networks are stable. But, if the network required higher levels of expenditure on a long-term basis, then we would expect this to be reflected in higher IRC levels. The companies' IRCs should equal their medium- to long-term views of their IRE.

When we set price limits for 2005-10, we recognised that higher levels of expenditure would be required in the future. The average IRE in the first four years of the price setting period is £771 million, which is 34% higher than the 2000-05 average level.

There was a small decrease in IRC in 2008-09 to £793 million. Some companies that reported decreases explained that their future projections of IRE had been revised downwards since 2008 for the final business plan, which they submitted in April 2009. These plans consider IRE from 2010-25. Coincidentally, in our draft determinations for 2010-15 we assumed IRC in 2010-11 to be £793 million.

2. Operating expenditure

Total operating expenditure for the water and sewerage sectors in 2008-09 was £3.6 billion (excluding exceptional items). At £84 million more than in 2007-08, it represents a 2% increase in real terms. It is £3.5 million (0.1%) more than we assumed in price limits for 2008-09 and £213 million (6%) less than the companies set out in their 2004 business plans. Total operating expenditure in 2008-09 was £197 million higher than in 2003-04 (6% in real terms). This was the year we used at the 2004 price review to establish the base level of costs.

Table 15 shows the trend at the sector level by service, while table 16 shows the performance of individual companies.

Table 15 Total operating expenditure by service

2008-09 prices	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2007-08 to 2008-09 change
	£m	£m	£m	£m	£m	£m	£m
Water service	1,874	1,820	1,944	2,004	1,927	1,979	52
Sewerage service	1,502	1,531	1,577	1,618	1,563	1,595	31
Total	3,377	3,351	3,520	3,621	3,490	3,574	84

Notes:

1. The numbers above do not reconcile to table 1 because exceptional items, excluded from the above, are as reported in June returns and do not correspond to those stated in table 1, which are reported under Ofwat regulatory accounting guidelines. Table 1 operating costs are net of operating income.
2. Numbers may not add because of rounding.

Table 16 Total operating expenditure by company

2008-09 prices	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	% change since 2003-04
	£m	£m	£m	£m	£m	£m	
Water and sewerage companies							
Anglian	339.8	328.7	345.5	347.5	338.2	358.7	5.6
Dŵr Cymru	249.5	239.5	228.3	235.9	234.0	260.6	4.4
Northumbrian	245.3	242.2	247.4	256.1	244.3	261.1	6.4
Severn Trent	455.1	481.5	491.9	506.7	487.2	495.7	8.9
South West	123.3	131.6	141.3	147.1	148.3	147.4	19.5
Southern	202.3	194.7	192.0	201.7	204.5	196.2	(3.0)
Thames	573.0	557.8	659.1	685.7	586.6	586.2	2.3
United Utilities	462.5	474.4	473.6	473.9	485.8	477.3	3.2
Wessex	104.2	109.8	116.0	119.5	116.2	123.4	18.5
Yorkshire	258.5	248.4	273.7	282.4	278.7	293.0	13.3
Total WaSCs	3,013.5	3,008.6	3,168.7	3,256.5	3,123.8	3,199.6	6.2
Water only companies							
Bournemouth & W Hampshire	16.1	15.5	15.0	15.0	14.9	16.7	4.3
Bristol	41.1	40.8	41.8	43.2	44.0	44.9	9.3
Cambridge	10.4	9.9	10.1	10.9	12.4	11.6	11.5
Dee Valley	9.9	9.4	9.8	10.7	10.5	10.9	9.7
Folkestone & Dover	8.4	7.7	7.8	8.4	8.4	8.7	3.9
Portsmouth	18.3	17.9	21.1	19.4	20.4	20.8	13.3
South East	77.9	72.0	74.3	74.5	71.5	72.0	(7.5)
South Staffs	38.9	36.6	40.7	40.5	40.0	40.1	3.2
Sutton & East Surrey	25.0	23.5	25.0	24.2	25.8	26.6	6.4
Tending Hundred	6.7	6.2	5.9	6.3	6.3	7.2	8.1
Three Valleys	110.5	103.1	100.0	111.8	112.3	114.9	4.0
Total WoCs	363.2	342.8	351.5	365.0	366.5	374.5	3.1
Industry	3,376.6	3,351.3	3,520.3	3,621.5	3,490.3	3,574.1	5.8

Notes:

1. Numbers may not add because of rounding.
2. Excludes exceptional items, but includes third party expenditure.

Table 17 shows operating expenditure by functional service and by type of expenditure within each function for 2003-04 and 2008-09.

There were significant increases in energy costs in 2008-09. Compared with 2003-04, energy costs have increased by 69% across the water and sewerage sectors. This is because the large energy price increases in 2007 and 2008 are now being reflected in the contracts that the companies negotiated in these years. As a result, many companies' energy contracts now reflect prices that are higher than the current rates.

Table 17 Industry total operating expenditure by service by function

2008-09 prices	2003-04								Industry total	2008-09								Industry total
	Water service			Sewerage service						Water service			Sewerage service					
	Water resources and treatment	Water distribution	Water service total	Sewerage	Sewage treatment	Sludge treatment and disposal	Sewerage service total	Water resources and treatment		Water distribution	Water service total	Sewerage	Sewage treatment	Sludge treatment and disposal	Sewerage service total			
	£m	£m	£m	£m	£m	£m	£m	£m		£m	£m	£m	£m	£m	£m	£m		
Employment costs	89	125	214	45	91	48	184	399	80	107	187	51	88	47	185	372		
Power	61	81	142	24	81	28	133	274	111	130	241	44	149	28	222	463		
Hired and contracted services	43	155	198	79	59	105	244	441	37	184	221	75	59	101	235	456		
Materials and consumables	54	19	73	6	30	34	70	143	70	14	84	7	29	37	73	157		
Service charges	106	0	106	15	37	0	52	158	106	0	106	14	36	0	50	156		
Other direct costs	32	23	55	6	6	19	31	87	35	23	58	7	8	13	27	85		
Total direct costs	385	403	787	176	304	235	714	1,502	439	458	897	198	368	226	793	1,690		
General and support expenditure	154	198	352	71	156	91	317	670	146	189	335	80	151	85	316	651		
Functional expenditure	539	601	1,140	246	460	325	1,031	2,171	585	648	1,233	278	519	311	1,109	2,341		
Customer services			199				163	362			200				168	368		
Scientific services			83				38	121			69				24	94		
Other business services			31				21	51			34				25	59		
Total business activities			313				221	534			303				218	521		
Local authority rates			236				122	358			242				131	373		
Doubtful debts			90				101	191			120				124	244		
Total operating expenditure less third party services			1,779				1,476	3,254			1,898				1,581	3,479		
Third party services operating expenditure			96				27	122			81				14	95		
Total operating expenditure			1,874				1,502	3,377			1,979				1,595	3,574		

Note:

Numbers may not add because of rounding.

3. Capital investment

Since privatisation, the sectors have invested about £85 billion in water and sewerage infrastructure in England and Wales. This equals average annual capital investment of more than £4.2 billion, compared with an equivalent investment figure of about £2 billion a year during the 1980s. In 2008-09, the companies made capital investment equivalent to 48% of their turnover. This is high when compared with other industries. Even so, overall capital expenditure is almost 4% behind our expectations for the first four years, mainly because of efficiency savings. However, there have been some delays in delivering schemes because of planning issues and rephasing schemes in the programme.

The aggregate gross capital investment in 2008-09 was £4.7 billion, compared with £5.0 billion in 2007-08. About 80% of this was for new fixed assets. We expected the companies to invest £4.1 billion (gross) in 2008-09, which is 14% more than our final determination assumptions in 2008-09.

Table 18 shows capital investment at sector level in the period 2004-05 to 2008-09.

Capital investment by service

Table 18 shows capital investment at sector level for each year for the period 2004-09.

Table 18 Gross capital investment by service – industry

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09	Five-year total
	£m	£m	£m	£m	£m	£m
Water service	1,874	1,833	2,353	2,536	2,339	10,934
Sewerage service	2,223	1,942	2,315	2,523	2,375	11,377
Industry total	4,097	3,775	4,667	5,059	4,714	22,312

Notes:

1. All investment is stated gross of capital contributions, including IRE that was previously reported as net of capital contributions.
Because of this, expenditure in this table does not match previously reported data.
2. This table has been adjusted into 2008-09 prices using year average RPI.
3. Assets adopted at nil cost are excluded from gross capital investment in tables 18-22.

- Investment in the water service in 2008-09 decreased by almost 8% compared with 2007-08.
- Investment in the distribution system has continued to make up most of the expenditure in the water service. This reflects the increase in the companies' mains renewal and relining activities.
- Investment in the sewerage service for the same period showed a decrease of about 6%. This apparent reduction was the result of disproportionately high expenditure in 2007-08 as the companies caught up on delays from the previous two years.
- During the first four years of this price review period, the water and sewerage sectors' capital maintenance expenditure was about 10% higher than projected in price limits. Because of the significant investment during 2007-08 and 2008-09, the companies are now investing about 4% more than our assumptions in the water service and 14% more than our assumptions in the sewerage service. The increase in investment reflects the companies' efforts to make sure they maintain their sewerage networks and serviceability of their sewage treatment works.
- At an industry level, supply/demand balance cumulative expenditure is about 5% lower than we projected when we set price limits in 2004. Some companies have been unable to catch up on delays from the first three years and there continues to be less developer-led activity than forecast. However, some companies have reported efficiency savings and reallocated investment to deliver other outputs.
- Similarly, to date, quality enhancement cumulative expenditure at an industry level is 24% lower than we assumed when we set price limits. The companies have made only minor progress in catching up with delays from the first three years of this price limit period. More than a third of the variance is the result of reported efficiency savings. The remainder of the variance is caused by outputs no longer being required (and therefore money will be returned to customers when we next set price limits) or reprofiling of expenditure and delays while the companies optimise the solutions. Despite these delays, the companies report that they are on target to meet their statutory obligations.
- Finally, enhanced service level cumulative expenditure at an industry level to date (that is, all investment associated with improving service to consumers) is 17% higher than the assumptions we made when we set price limits. This is mainly the result of increased investment to alleviate flooding from sewers.

Table 19 shows the expenditure breakdown by purpose for the water and sewerage sectors, while tables 20a and 20b show the breakdown at company level.

Table 19 Gross capital investment by purpose category – industry

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09	Five-year total
	£m	£m	£m	£m	£m	£m
Water service						
Base service:						
– IRE Maintenance of underground assets	380	406	549	596	536	2,468
– MNI Maintenance of above-ground assets	499	514	686	673	621	2,994
Improving and maintaining the supply/demand balance	521	483	575	700	751	3,029
Quality enhancement programmes	469	427	534	559	422	2,412
Enhanced service levels	4	2	8	7	9	31
Water service total	1,874	1,833	2,353	2,536	2,339	10,934
Sewerage service						
Base service:						
– IRE Maintenance of underground assets	213	248	304	333	303	1,402
– MNI Maintenance of above-ground assets	669	810	1,031	1,037	948	4,495
Improving and maintaining the supply/demand balance	113	102	150	181	182	727
Quality enhancement programmes	1,121	637	632	757	757	3,904
Enhanced service levels	108	144	198	215	185	850
Sewerage service total	2,223	1,942	2,315	2,523	2,375	11,377
Industry total	4,097	3,775	4,667	5,059	4,714	22,312

Notes:

1. All investment is stated gross of capital contributions, including IRE that was previously reported as net of capital contributions.
2. The above table has been adjusted into 2008-09 prices using year average RPI.
3. Assets adopted at nil cost are excluded from gross capital investment in tables 18-22.
4. In the water service, we have reported security of supply expenditure in the supply/demand balance category to align with the PR04 final determinations assumptions. Historic expenditure has been updated to allow a comparison to be made.

Table 20a Gross capital investment by purpose category 2008-09 – water and sewerage companies

2008-09 prices	Base service: maintenance of under- ground assets	Base service: maintenance of above- ground assets	Improving and maintaining the supply/ demand balance	Quality enhancement programmes	Enhanced service levels	Total investment
	£m	£m	£m	£m	£m	£m
Water service						
Anglian	39.0	54.7	96.1	31.0	0.2	220.9
Dŵr Cymru	51.5	48.7	14.9	67.4	0.0	182.5
Northumbrian	26.4	48.0	24.5	17.5	0.0	116.3
Severn Trent	78.4	85.6	74.5	27.1	4.7	270.3
South West	16.2	20.1	21.5	48.0	0.0	105.8
Southern	29.7	16.1	16.3	0.1	0.0	62.1
Thames	79.0	89.5	365.9	85.6	0.0	619.9
United Utilities	73.2	81.2	24.5	74.2	0.0	253.1
Wessex	16.2	26.0	12.6	9.2	0.0	64.0
Yorkshire	35.8	48.6	12.7	46.1	4.1	147.4
Total	445	519	663	406	9	2,042
Sewerage service						
Anglian	33.5	74.3	13.6	77.1	15.0	213.5
Dŵr Cymru	25.1	66.9	11.2	56.2	13.3	172.7
Northumbrian	15.1	76.6	14.8	23.5	3.6	133.5
Severn Trent	55.2	167.8	30.6	106.1	2.7	362.4
South West	11.3	27.0	5.8	6.0	1.9	52.0
Southern	16.4	96.2	24.0	50.6	22.2	209.3
Thames	45.5	152.3	30.1	65.2	82.9	376.0
United Utilities	63.9	148.3	26.2	227.8	27.9	494.1
Wessex	13.2	56.4	13.0	48.4	15.3	146.2
Yorkshire	23.8	81.9	12.4	96.3	0.6	214.9
Total	303	948	182	757	185	2,375

Notes:

1. All investment is stated gross of capital contributions, including IRE that was previously reported as net of capital contributions.
2. Assets adopted at nil cost are excluded from gross capital investment in tables 18-22.
3. In the water service, we have reported security of supply expenditure in the supply/demand balance category to align with the PR04 final determinations assumptions. Historic expenditure has been updated to allow a comparison to be made.
4. Numbers may not add because of rounding.

Table 20b Gross capital investment by purpose category 2008-09 – water only companies

2008-09 prices	Base service: maintenance of under- ground assets	Base service: maintenance of above- ground assets	Improving and maintaining the supply/ demand balance	Quality enhancement programmes	Enhanced service levels	Total investment
	£m	£m	£m	£m	£m	£m
Water service						
Bournemouth & W Hampshire	1.9	7.2	4.1	0.2	0.5	13.9
Bristol	10.9	9.2	6.2	4.9	0.0	31.3
Cambridge	1.2	2.4	3.8	0.3	0.0	7.7
Dee Valley	1.5	1.6	1.0	0.0	0.0	4.0
Folkestone & Dover	1.6	2.1	1.9	0.0	0.0	5.5
Portsmouth	5.1	1.9	2.1	2.7	0.0	11.8
South East ⁴	17.8	25.9	36.8	3.1	0.0	83.6
South Staffs	10.1	10.2	8.2	0.0	0.0	28.5
Sutton & East Surrey	5.4	8.9	5.1	0.0	0.0	19.4
Tendring Hundred	1.4	1.4	0.6	0.0	0.0	3.4
Three Valleys	34.4	31.1	17.5	4.8	0.0	87.8
Total	91	102	87	16	0	297

Notes:

1. All investment is stated gross of capital contributions, including IRE that was previously reported as net of capital contributions.
2. Assets adopted at nil cost are excluded from gross capital investment in tables 18-22.
3. In the water service, we have reported security of supply expenditure in the supply/demand balance category to align with the PR04 final determinations assumptions. Historic expenditure has been updated to allow a comparison to be made.
4. South East represents the total activity for merged companies Mid Kent and South East Water.

Table 21 sets out the capital investment trends by service area at sector level for each year for the period 2004-09, while table 22 shows each company's expenditure by service area in 2008-09.

Table 21 Gross capital investment by service area – industry

2008-09 prices	2004-05	2005-06	2006-07	2007-08	2008-09	Five-year total
	£m	£m	£m	£m	£m	£m
Water service						
Resources	141	88	127	141	125	622
Treatment	407	359	547	556	507	2,376
Distribution	1,106	1,185	1,455	1,615	1,461	6,822
General	220	201	223	224	246	1,115
Water service total	1,874	1,833	2,353	2,536	2,339	10,935
Sewerage service						
Sewerage	869	778	932	935	907	4,421
Sewage treatment	1,246	986	1,201	1,381	1,241	6,056
Sewerage general	107	178	182	207	226	900
Sewerage service total	2,222	1,942	2,315	2,523	2,375	11,376
Industry total	4,096	3,775	4,667	5,059	4,714	22,311

Notes:

1. All investment is stated gross of capital contributions, including IRE that was previously reported as net of capital contributions.
2. The above table has been adjusted into 2008-09 prices using year average RPI.
3. Assets adopted at nil cost are excluded from gross capital investment in tables 18-22.
4. In the water service, all IRE grants and contributions have been accounted for in the distribution category (although it is acknowledged that a small proportion of them may relate to water resources).
5. In the sewerage service, all IRE grants and contributions are included in the sewerage category.
6. Industry totals do not exactly match table 18-20 because of rounding.

Table 22 Gross capital investment by service area 2008-09 – by company

2008-09 prices	Water resources	Water treatment	Water distribution	Water general	Water total	Sewerage	Sewage treatment	Sewerage general	Sewerage total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Water and sewerage companies									
Anglian	24.4	54.8	129.5	12.1	220.9	88.0	107.3	18.2	213.5
Dŵr Cymru	6.5	44.3	104.9	26.8	182.5	91.9	56.1	24.6	172.7
Northumbrian	12.6	22.2	63.6	18.0	116.3	55.0	68.1	10.4	133.5
Severn Trent	0.9	82.2	151.2	35.9	270.3	119.0	203.1	40.4	362.4
South West	5.2	12.1	77.3	11.2	105.8	23.5	21.5	7.0	52.0
Southern	3.1	4.5	39.5	15.0	62.1	71.4	110.1	27.8	209.3
Thames	16.0	157.1	425.6	21.2	619.9	189.6	162.6	23.8	376.0
United Utilities	28.3	34.4	151.1	39.3	253.1	165.7	285.8	42.6	494.1
Wessex	1.7	15.8	39.6	6.9	64.0	49.6	85.3	11.3	146.2
Yorkshire	12.8	34.1	80.4	20.1	147.4	53.7	141.1	20.1	214.9
Total WaSCs	111	461	1,263	207	2,042	907	1,241	226	2,375
Water only companies									
Bournemouth & W Hants	0.9	2.5	9.0	1.6	13.9				
Bristol	1.8	4.0	20.7	4.7	31.3				
Cambridge	0.0	0.5	6.6	0.5	7.7				
Dee Valley	0.3	0.8	2.4	0.6	4.0				
Folkestone & Dover	0.3	0.5	2.7	2.0	5.5				
Portsmouth	0.7	0.6	8.2	2.3	11.8				
South East ⁵	7.4	10.6	54.9	10.7	83.6				
South Staffs	1.1	2.2	21.7	3.6	28.6				
Sutton & East Surrey	0.5	7.7	10.0	1.2	19.4				
Tendring Hundred	0.0	0.3	2.3	0.8	3.4				
Three Valleys	0.1	15.9	60.0	11.8	87.8				
Total WoCs	13	46	198	40	297				
Industry total	125	507	1,461	246	2,339	907	1,241	226	2,375

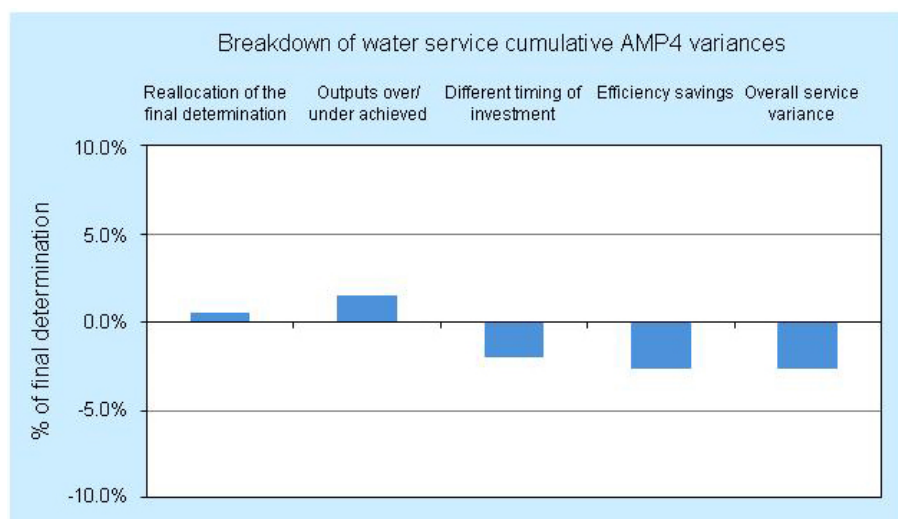
Notes:

1. All investment is stated gross of capital contributions, including IRE that was previously reported as net of capital contributions.
2. Assets adopted at nil cost are excluded from gross capital investment in tables 18-22.
3. In the water service, all IRE grants and contributions have been accounted for in the distribution category (although it is acknowledged that a small proportion of them may relate to water resources).
4. In the sewerage service, all IRE grants and contributions are included in the sewerage category.
5. South East represents the total activity for merged companies Mid Kent and South East Water.
6. Numbers may not add because of rounding.

Figures 2a and 2b illustrate the breakdown of the 4% cumulative shortfall for the current price limit period. The companies reported this year that most of this shortfall is because of efficiency savings. Activities such as supply chain management and re-engineering scheme solutions are the main source of these efficiency savings. There are still variances because of changes to the timing of some schemes, because of planning delays and the companies reprioritising their programmes. This is balanced by overspends in areas such as capital maintenance and additional outputs that were not foreseen when we set price limits in 2004.

Figure 2a Breakdown of the variances in gross capital investment 2005-10 – water service

Water	£m
Assumed total investment 2005-06 to 2008-09	9,204
Actual total investment 2005-06 to 2008-09	9,060
Variance	144

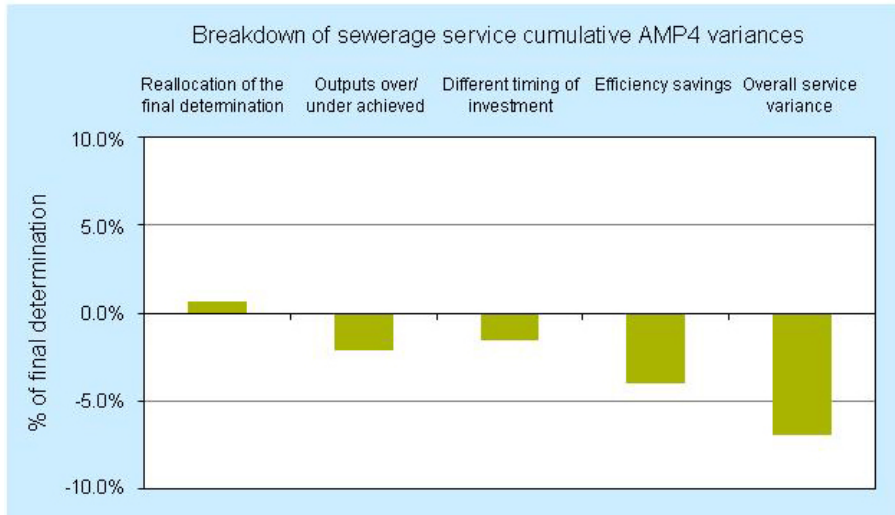


Note:

Actual investment and final determination assumptions are both reported gross of grants and contributions.

Figure 2b Breakdown of the variances in gross capital investment 2005-10 – sewerage service

Sewerage	£m
Assumed total investment 2005-06 to 2008-09	9,703
Actual total investment 2005-06 to 2008-09	9,154
Variance	549



Note:

Actual investment and final determination assumptions are both reported gross of grants and contributions.

4. Transfer pricing

The companies have a statutory duty to trade at arm's length with associate companies in their group and with their parent company. This is to ensure that price limits are set based on the actual costs of providing water and sewerage services to customers and not costs inflated by cross-subsidy. It also stops transactions taking place on preferential terms, which would potentially distort markets and could be anti-competitive.

Table 23 shows each company's expenditure with its associates in 2008-09. In 2008-09, the level of expenditure with associates in the water and sewerage sectors fell to £213.8 million, compared with £284.6 million (at 2008-09 prices) in 2007-08. The table also includes our assessment of compliance with our transfer pricing guideline, 'Regulatory Accounting Guideline 5.04' (RAG 5.04). Our assessment lags by one year to allow us to review and discuss issues with the companies. This ensures we make our assessment after a thorough analysis of issues.

The decrease in total expenditure with associates in the sectors between 2007-08 and 2008-09 was primarily driven by decreases at Anglian Water Services, South West Water and Thames Water Utilities, partly offset by an increase at United Utilities Water. The decreases in expenditure are because services previously provided by associates were brought in-house, the sale of associates or a decision to stop using the services of an associate.

We are pleased that for first time in several years United Utilities Water's compliance with RAG 5.04 has improved from 'significant improvement required' to 'some improvement required'. This reflects the company completing compliance with its December 2006 section 19 undertaking during the early part of 2007-08. This undertaking required it to take steps to bring it into compliance with its licence conditions relating to trade with associates.

United Utilities Water also continued to take steps to address the other areas of concern that we had with the company. We expect that its actions will help it to continue its improvement in compliance in future years.

We also make sure that new appointees comply with transfer pricing guidelines. We visited a new appointee during the year to discuss issues relating to compliance with our guidelines and continue to work with it to ensure future compliance.

We will continue to monitor the companies to make sure that trade with associate companies is at arm's length.

Table 23 Trade with other companies within the group

2008-09 prices	Total value of expenditure with other group companies 2008-09	Trade as a % of appointed business turnover		Compliance with RAG 5.04
		£m	2008-09	2007-08
Water and sewerage companies				
Anglian	19.7	1.9	5.2	●
Dŵr Cymru	–	–	–	●
Northumbrian	8.3	1.4	1.3	●
Severn Trent	25.2	1.9	2.2	▶
South West	5.2	1.2	3.8	●
Southern	-	-	-	●
Thames	7.5	0.5	3.6	▶
United Utilities	76.4	5.1	3.6	▶
Wessex	11.2	2.7	3.3	●
Yorkshire	26.3	3.2	3.2	●
Total	179.7	2.0	2.8	
Water only companies				
Bournemouth & W Hampshire	0.9	2.3	2.3	●
Bristol	3.2	3.4	4.2	●
Cambridge	0.3	1.8	1.6	▶
Dee Valley	–	–	–	●
Folkestone & Dover	1.5	8.5	7.7	●
Portsmouth	0.1	0.4	0.3	●
South East	2.0	1.2	1.2	●
South Staffs	18.3	23.3	25.2	●
Sutton & East Surrey	0.1	0.3	0.3	●
Tendring Hundred	1.9	13.4	10.2	●
Three Valleys	5.7	2.5	2.3	●
Total	34.1	4.4	4.6	
Industry total/average	213.8	2.2	3.0	

Key:

- Satisfactory compliance with RAG 5.04.
- ▶ Some areas to be improved.
- Significant improvement required.

Note:

Numbers may not add because of rounding.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We are responsible for making sure that the water and sewerage sectors in England and Wales provide customers with a good quality and efficient service at a fair price.



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