Monitoring financial resilience

Ofwat

January 2019

Introduction and context

Water companies are required to report performance information in their Annual Performance Reports. This includes information about their financial returns and resilience both now and in the longer term.

We report information on company performance annually and in this report we aim to enhance the visibility and transparency of company financial performance and financial structures in the sector.

This report draws on financial information published by individual companies in their Annual Performance Reports ("APR") for the year to 31 March 2018 and other publicly available information (e.g. reports from the credit rating agencies). We use this information[1] to highlight key issues for the financial resilience and performance of the sector.

For the first time, this report includes information on a new metric – 'financial flows'. We set out the requirement for companies to provide greater transparency and clarity about the financial returns to the company's equity holders each year in IN18/08 – Expectations for companies reporting of financial flows for 2017-18. The financial flows metric looks at the returns that a company's equity holders achieve, in comparison to the assumed level in price limits that were set in 2014. This year was a pilot year and companies were requested to include a narrative to assist in the explanation and understanding of the data. However, only a few companies have provided explanation and narrative. The expectation going forward is that all companies will include an appropriate explanation as it is a key part of the understanding and interpretation of the data.

Company financial results – an introduction

This section sets out information about the financial performance, cash flows and balance sheet of each company. Most of this information has been extracted from the APRs and statutory accounts published by each appointed company.

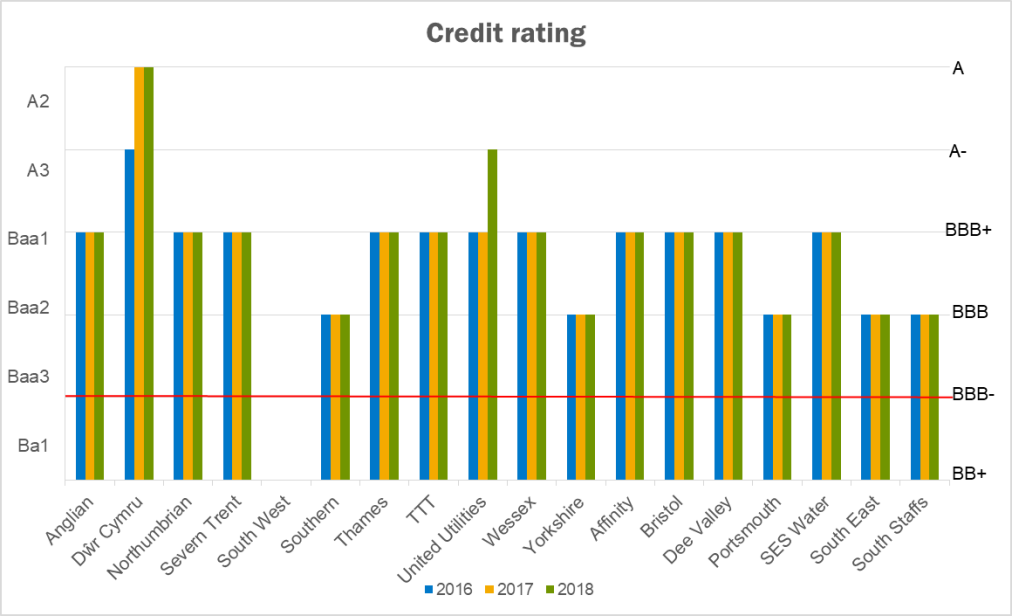
We have reviewed the information companies have published and queried companies if further clarification was needed. We present highlights from the APRs and from the other information that we have reviewed commenting on issues where they have arisen.

The metrics considered on the following pages are as follows:

- Credit ratings
- Long term viability statements
- Gearing
- Interest cover metrics
- FFO/Net Debt and RCF/Capex
- Return on regulated equity (RORE)
- Return on RCV and post tax return
- Dividends
- Company borrowings
- Interest rates
- Wholesale revenue
- Retail revenue
- Taxation
- Pensions
- Financial Flows

The delivery of the outcomes that were outlined in each company's final determination at PR14 are reviewed in more detail in our Service Delivery Report.

Credit ratings



Most companies' licences include a requirement with respect to maintaining an investment grade credit rating[2]. All the companies with this requirement currently have credit ratings which are at least one notch above the minimum investment grade level (BBB-/Baa3).

Typically, each company maintains a credit rating with one or some of Moody's, Standard and Poor's and Fitch. The credit ratings shown in the chart reflect those reported in the Annual Performance Report, which requires the lowest rating to be reported where a company is rated by more that one agency. South West Water is not required to maintain a credit rating, but its licence requires it to achieve financial ratios that are consistent with an investment grade credit rating.

In February 2017, Dee Valley Group was acquired by Severn Trent Water Limited, the Appointments of Dee Valley Water and Severn Trent Water were varied with effect from 1 July 2018, and the Welsh business was rebranded Hafren Dyfrdwy. As Dee Valley Water was the name of the Appointee throughout 2017-18, we refer to Dee Valley in this report.

Our 2017 report noted Southern Water and Northumbrian Water are on negative outlook with Moody's. Southern Water remains on negative outlook as a result of its highly leveraged capital structure and the cost and maturity of its debt profile in the context of its financing and refinancing requirements in 2020-25. Northumbrian Water also remains on negative outlook, although its ratings remain at Baa1 (one notch higher than Southern Water).

Following publication in December 2017 of our PR19 Final Methodology, Moody's placed Portsmouth Water, Severn Trent Water, and Yorkshire Water on negative outlook. Since the end of the 2017-18 financial year, Moody's has also placed Affinity Water, Thames Water, Wessex Water, Anglian Water and Dŵr Cymru on negative outlook, and Standard and Poor's has placed Thames Water, Anglian Water, Welsh Water and Bristol Water on negative outlook.

United Utilities Water's credit rating was upgraded to 'A-' from 'BBB+' on 25 July 2017, reflecting that the company's operating performance has improved in recent years and the view that the company can generate regulatory rewards over the regulatory period.

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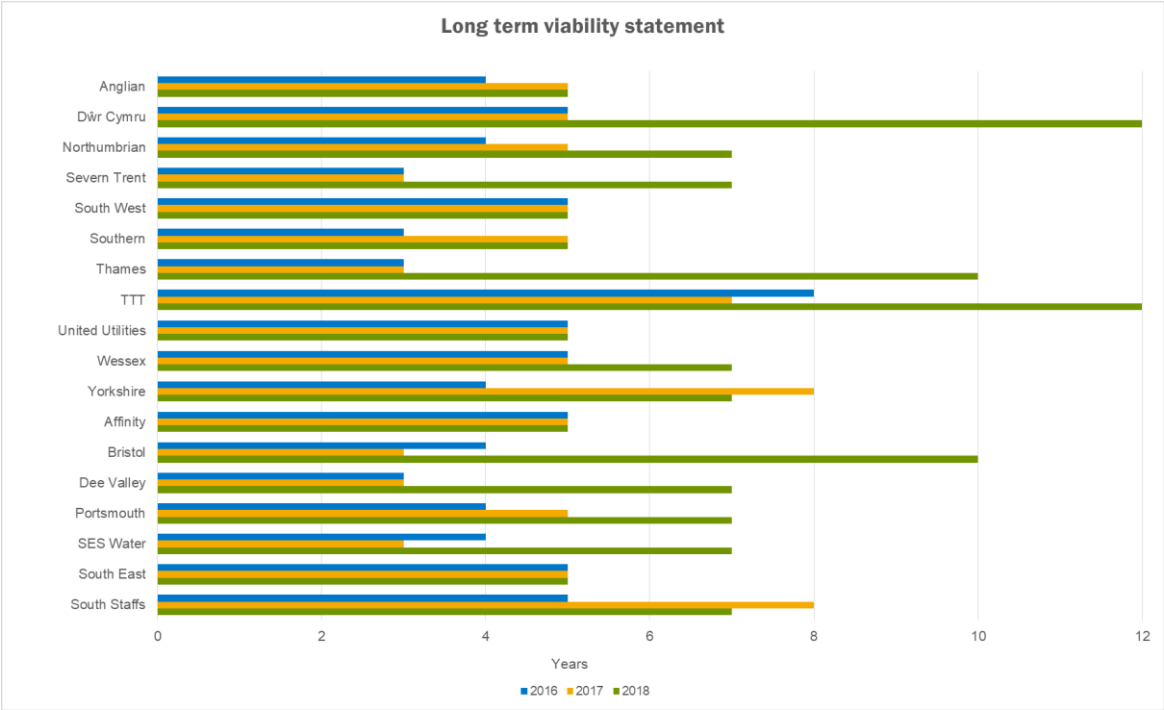
Long-term viability statement



We expect companies to test their long term financial resilience. Last year five companies (Thames Water, Severn Trent Water, Bristol Water, Dee Valley Water and SES Water) had only looked forward as far as the end of the current control period (2020).

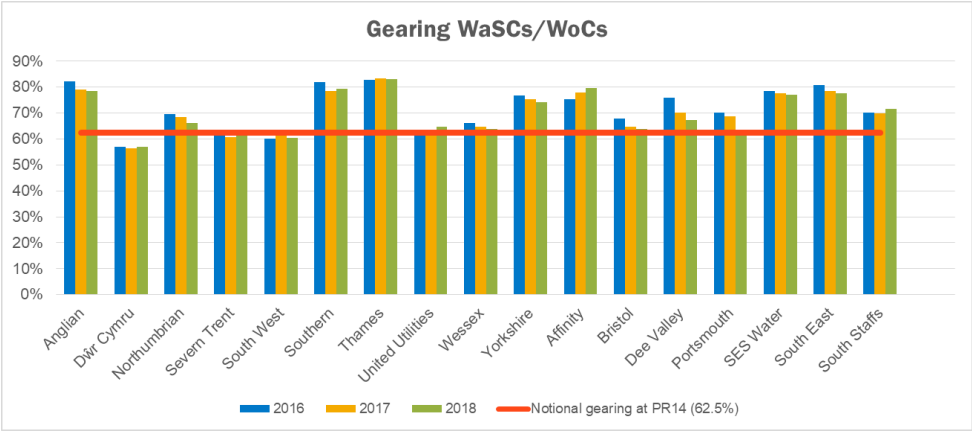
This year all companies have published Long Term Viability Statements that look at least five years ahead (until 2023) and twelve companies have published plans that extend at least until 2025.

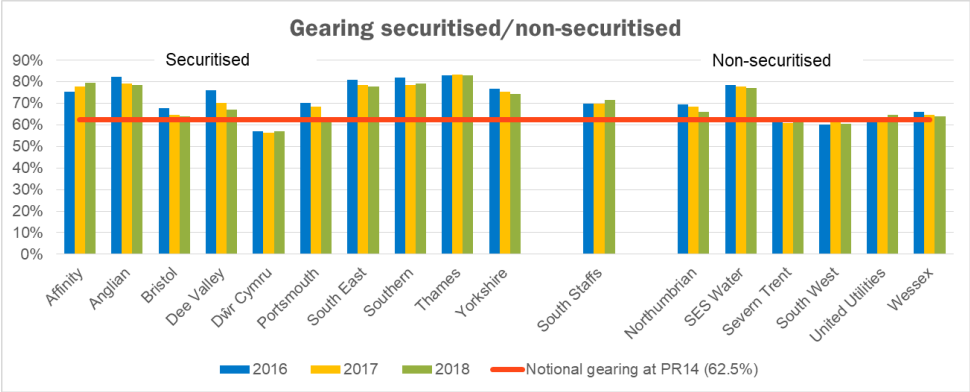
We consider that price control periods should not be a constraint given that stakeholders expect the companies to provide services to customers in the long term. Some companies have assessed financial resilience over the longer–term, with four companies extending their outlook to ten years or more.

In March 2018, we published an Information Notice, "Expectation for companies in issuing long term viability statements". The information notice set out our expectations for companies in preparing their long term viability statements, including that they should apply appropriate rigour in making their assessment.

Overall, most companies highlighted a suitable range of risks and monitoring procedures as well as the input assumptions and scenarios used in their stress testing. There were significant variances in the level of detail the companies provided for the mitigating actions within the risk assessment and the scenario testing, but overall there was an improvement in the quality of the statements compared with 2017. In Putting the sector in balance, we set out our expectations for companies to assess their financial resilience in their business plans for 2020-25. We are considering the evidence companies have put forward as part of our Initial Assessment of Business Plans, the outcome of which we will publish in early 2019.

Gearing





High levels of gearing potentially reduce resilience to cost shocks and so we encourage companies to consider whether high levels of gearing are sustainable.

Eight companies (Anglian Water, Southern Water, Thames Water, Yorkshire Water, Affinity Water, Sutton and East Surrey Water, South East Water and South Staffordshire Water) reported gearing at March 2018 in excess of 70% - the threshold beyond which outperformance sharing will apply from 2020; Thames Water's gearing exceeded 80%.

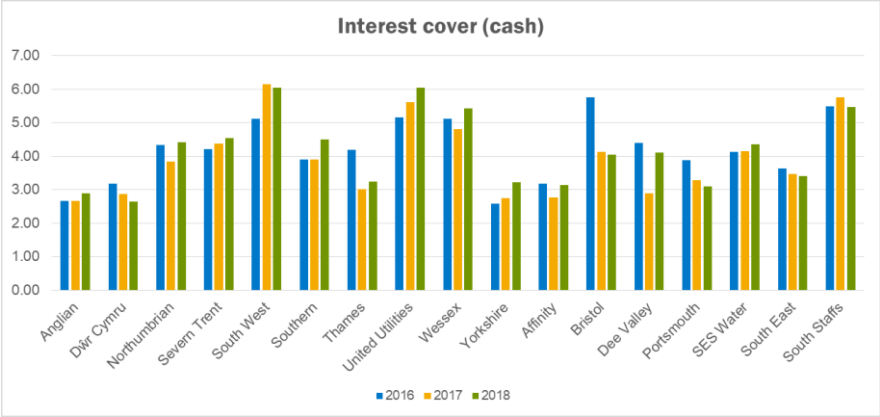
We have signalled that companies should consider carefully the resilience of their financing structures to a lower cost of capital in 2020-25, and some companies have signalled an intention to reduce gearing.

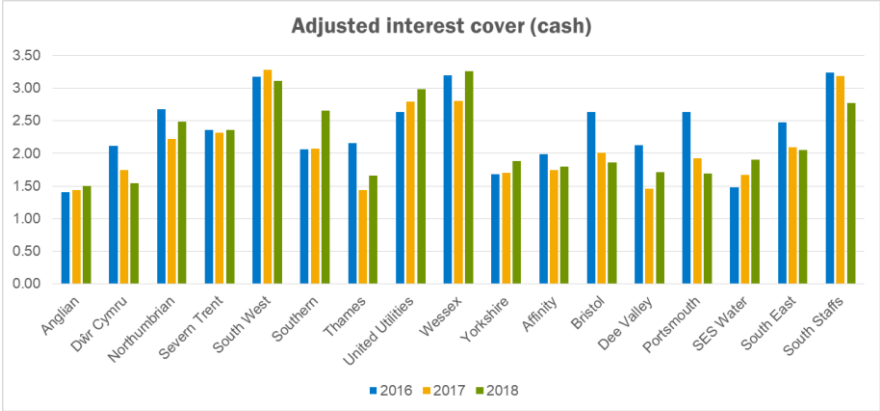
Portsmouth Water reduced its gearing from 69% in 2017 to 64% in 2018, Sutton and East Surrey Water has reduced its gearing to 58% since publication of its 2018 results.

We continue to monitor closely companies that exhibit lower levels of financial resilience.

Regulatory gearing is the ratio of net debt for the appointed business to its regulatory capital value (RCV). Net debt excludes any pension deficit liability and mark-to-market accounting adjustments. For AMP6 (2015-20) we have assumed a notional capital structure with a notional gearing level of 62.5%.

Interest cover





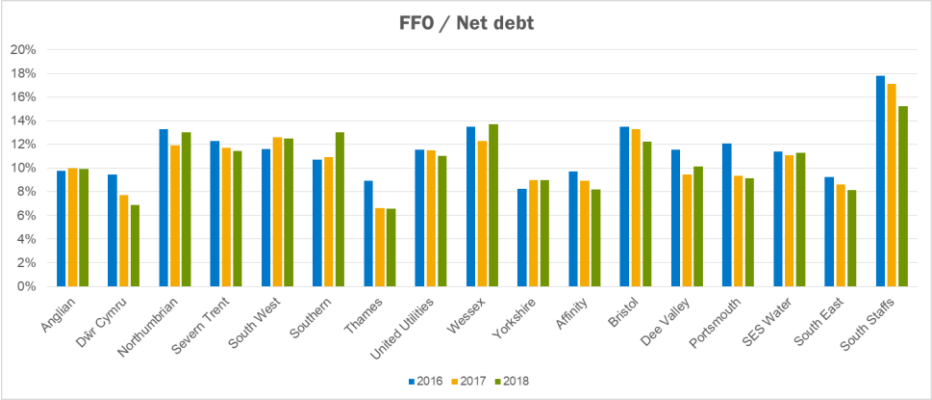
Interest cover ratios are used to assess the relative financial strength of a company. Interest cover is impacted directly by factors such as each company's actual debt costs, operational performance, operating costs and performance in respect of revenue collection.

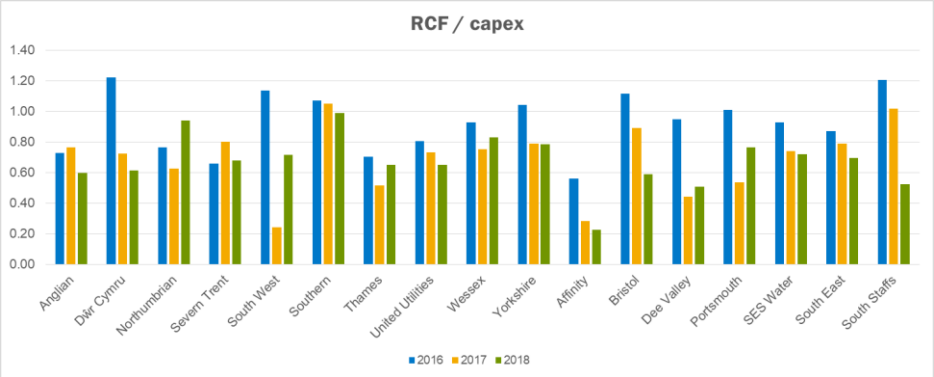
These charts present cash interest cover, so comparisons between companies is impacted by the mix and type of debt, which is presented in later slides.

Interest cover ratios for Anglian Water have been calculated after excluding interest receivable from the parent company as it is matched by internal dividends to give a net nil position overall. Anglian Water reports that this arrangement has now ceased (from 29 March 2018) as the inter company loan was settled as part of its simplification of the Group structure.

Interest cover ratios illustrate a company's ability to pay interest on its outstanding debt. Companies have provided two interest cover ratios in their APRs and these metrics are also used in Ofwat's assessment of financeability during price reviews. The interest cover ratio looks at the ratio of Funds from Operations (FFO) before the payment of interest to cash interest payable. In the adjusted interest cover metric, the numerator is adjusted to subtract regulatory depreciation which is an approximation of the capital cost that would be incurred if companies were to maintain the RCV at a constant level.

FFO/Debt and RCF/Capex





Companies report FFO/Net Debt and RCF/Capex in their Annual Performance Reports; these are also financial ratios that are monitored by credit rating agencies. There has been some variance in both of these metrics across the first three years of the current price control.

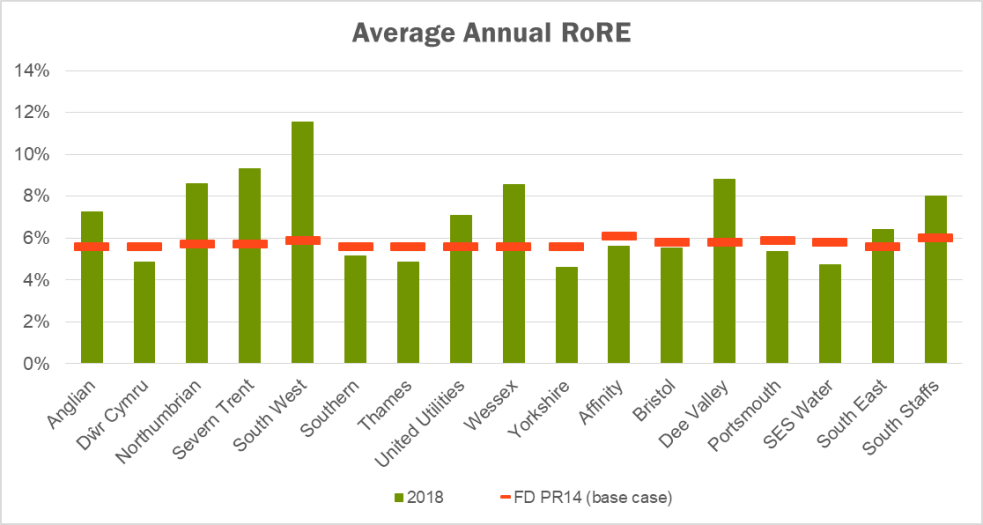
FFO/Net debt is impacted by matters such as amount and cost of debt, or company performance.

The RCF/Capex measure is impacted by financial performance or the payment of large dividends; the ratio will increase where companies incur relatively low levels of capex. Measures for ten of the companies have decreased. This may reflect some deferral of capital spend from the first years of the price control period, and in the case of South Staffordshire Water relates to an increase in dividends compared to 2017.

The ratios shown for Anglian Water have been calculated after excluding interest receivable from the parent company as it is matched by internal dividends to give a net nil position overall.

The Funds from Operations (FFO)/Debt and Retained Cash Flow (RCF)/Capex look at the ability of companies to repay their debt and to fund their capital expenditure requirements. FFO is also one of the metrics which Ofwat uses to assess financeability during price reviews.
FFO/Net Debt is calculated as FFO (after the payment of interest) as a proportion of net debt (excluding any pension liabilities). It relates to each company's ability to repay its long-term debt.
RCF/Capex is the ratio of retained cash flow after the payment of dividends but before capital expenditure and relates to a company's ability to meet its capital expenditure requirements.

Return on Regulatory Equity (RORE) (1)

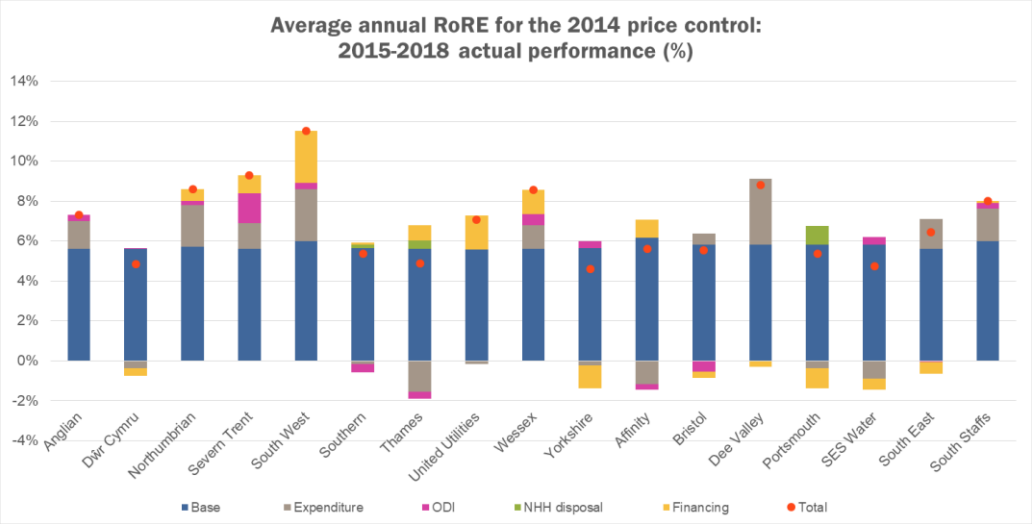


At PR14 we calculated an expected RORE for each company which is shown by the red line in the chart - this represents the return a company would generate if its performance were the same as assumed in our price determinations on the basis of the notional capital structure. In 2017-18, companies demonstrated a range of out and under performance. Nine companies report outperformance; eight companies report underperformance.

Variances are driven by both operational and financial performance. Further analysis of the individual components of this performance is shown on the next page.

Return on regulatory equity (RORE) measures the returns (after tax and interest) that companies have earned by reference to the notional regulated equity, where regulatory equity is calculated from the RCV and notional net debt (62.5% of RCV). The calculations presented are the responsibility of company management and have not been verified by Ofwat. The calculations require an element of judgement by company management particularly in relation to expenditure where companies have to determine whether any over or underspend in each year amounts to genuine additional costs or cost savings or is simply due to re-profiling of expenditure within the current price control period.

Return on Regulatory Equity (RORE) (2)



This chart shows the sources of companies' out/underperformance.

RORE variances for specific items were:

Expenditure – range -1.54% to 3.3% (average +0.63%);

Financing – range -1.16% to 2.6% (average -0.27%); and,

Service incentives – Outcome delivery incentives (ODIs) range -0.54% and 1.5% (average +0.13%).

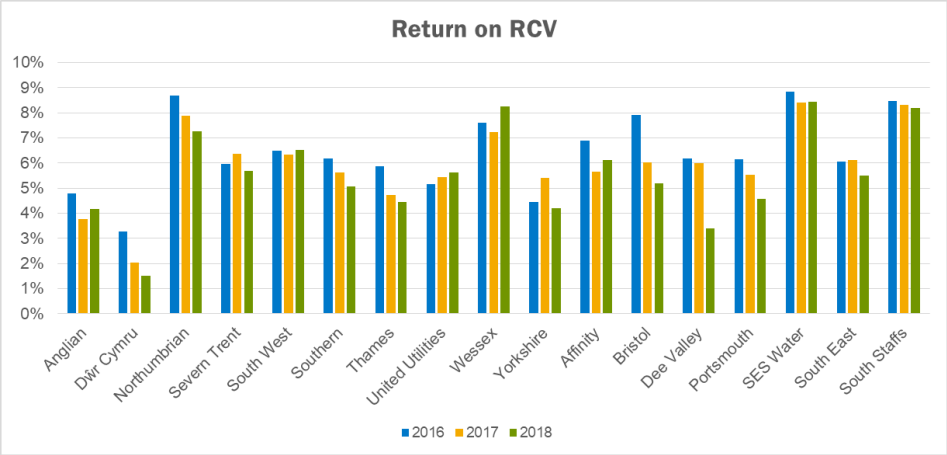
The majority of companies exited the non-household retail market during the year. Three companies identified the impact of the disposal on RORE (Thames, Southern & Portsmouth).

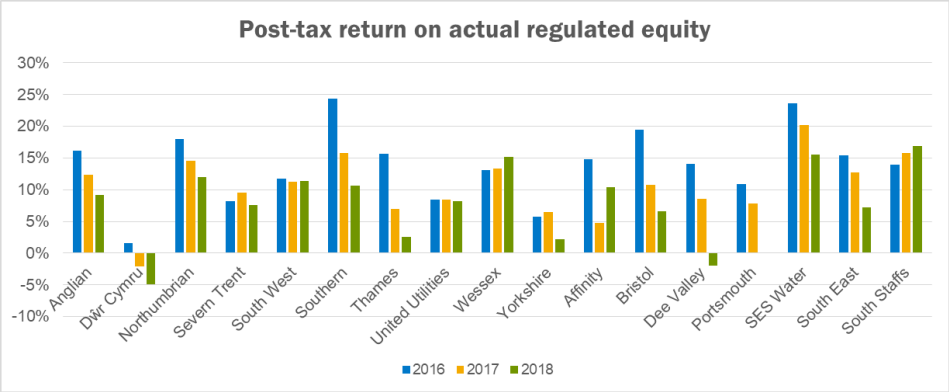
The base allowed return for United Utilities Water, Northumbrian Water, South West Water, Severn Trent Water, Southern Water, Thames Water, Portsmouth Water and Sutton and East Surrey Water reflects a small adjustment to remove the proportion of the return related to non-retail activities following retail exit.

Outturn RoRE performance is impacted primarily through:

- Financing – where companies out or under perform the cost of debt assumed in price determinations
- Operational performance which is reflected through Outcome Delivery Incentives (ODIs). ODIs incentivise companies to deliver high levels of service to customers by providing rewards or penalties against performance commitments.
- Cost out or under performance - companies are incentivised to deliver services at efficient cost by retaining some of the financial benefits of outperformance, but also sharing in the cost of underperformance

Return on RCV/Post tax return on regulated equity





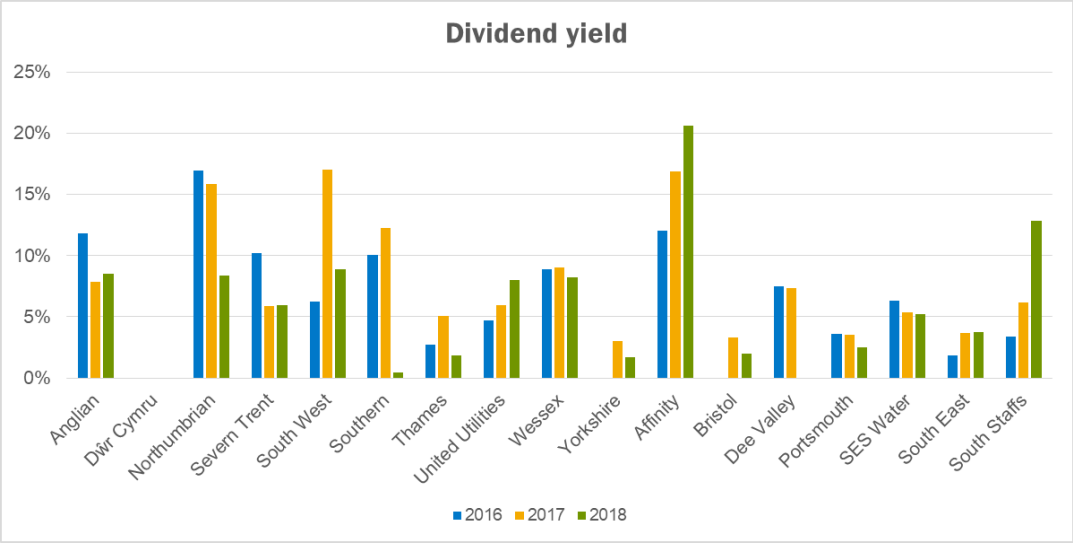
The return on RCV shows small year on year variances. Dee Valley's return reduced in 2018 due to an increase in current tax due to a prior year adjustment agreed with HMRC.

Like the return on RCV the post tax return on regulated equity reflects the performance of each company. Those companies which have returned revenue to customers (e.g. Dŵr Cymru) and those companies which have incurred additional costs (e.g. Dee Valley Water) have seen a negative impact on their returns.

Anglian Water used a slightly different basis for their published figures and removed the impact of intra-group interest received in their calculations. We have adjusted the company figures to report them on the same basis as other companies.

Return on RCV is measured as the profit for the year after tax but before the payment of interest.
This calculation differs from the base return on RCV set at PR14, calculated using the regulatory building blocks, which was 3.7% for Affinity Water and South West Water, 3.75% for Bournemouth Water and Portsmouth Water and 3.6% for all other companies.
The return used in the post tax return on regulated equity is calculated as profit after tax and interest paid. In this metric regulated equity is RCV less actual net debt.

Dividends



Variance in dividend yields reflects the circumstances and dividend policies of each company; companies with higher proportions of debt financing will have higher dividend yields for the same level of dividend relative to profit.

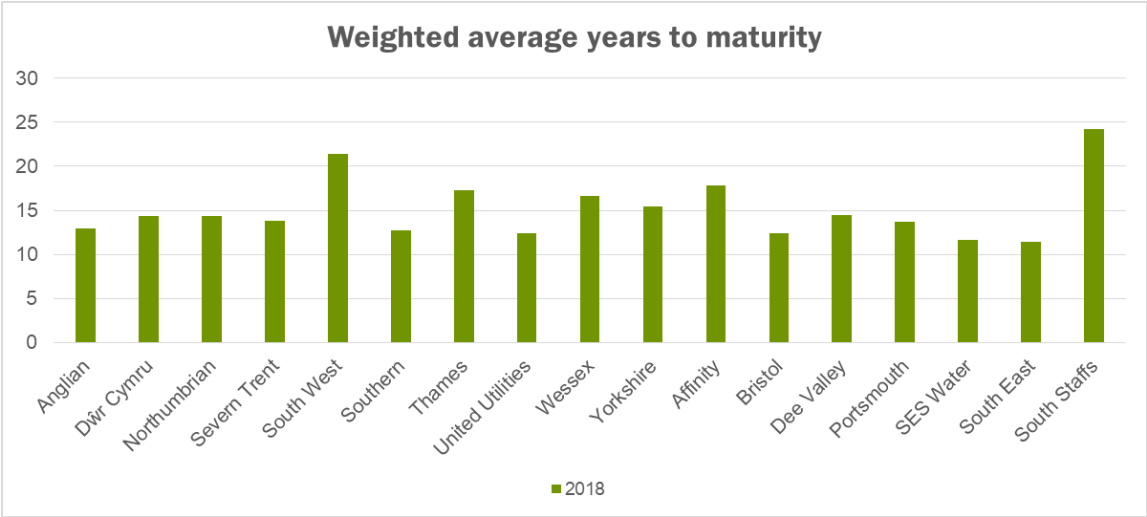
Higher dividends paid by South Staffordshire and Affinity compared with the prior year reflect the sale of non-household retail businesses.

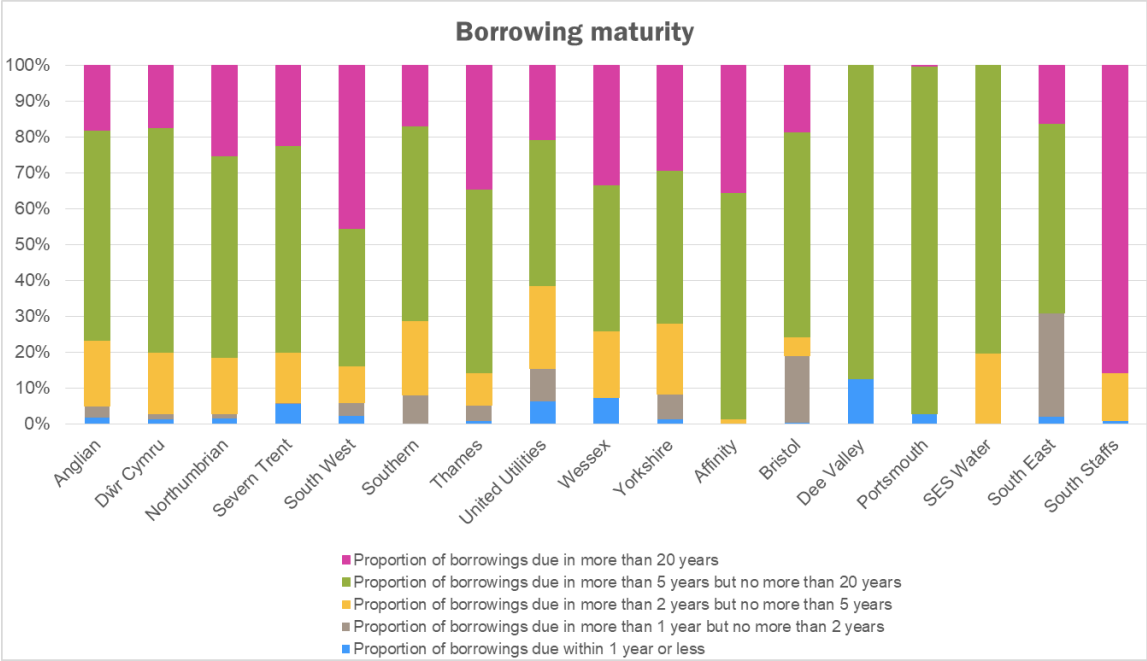
Dee Valley Water paid no dividends in the year; Dŵr Cymru is a company limited by guarantee and pays no dividend.

Our Putting the sector in balance position statement set out there is more companies can and should do to explain how their dividend policies and dividends declared or paid reflect delivery for customers. We continue to encourage companies to be transparent about how dividends paid relate to performance.

Dividend yield is calculated as dividend paid as a percentage of actual regulated equity. The dividend yield is based on the adjusted dividend paid by each company. This is the total dividend declared in the year less any dividends paid to holding companies to enable those companies to pay interest on intra-group loans from the regulated company and therefore captures only that part of the dividend that is paid out to external shareholders. For PR14 we assumed a real dividend yield of 4% - based on a notional capital structure with gearing of 62.5%.

Maturity of company debt





Companies use a portfolio of both long and short term debt to finance their business.

The term of average outstanding debt term (tenor) reported at 31 March 2018 has reduced to 15 years from 16 years in 2017.

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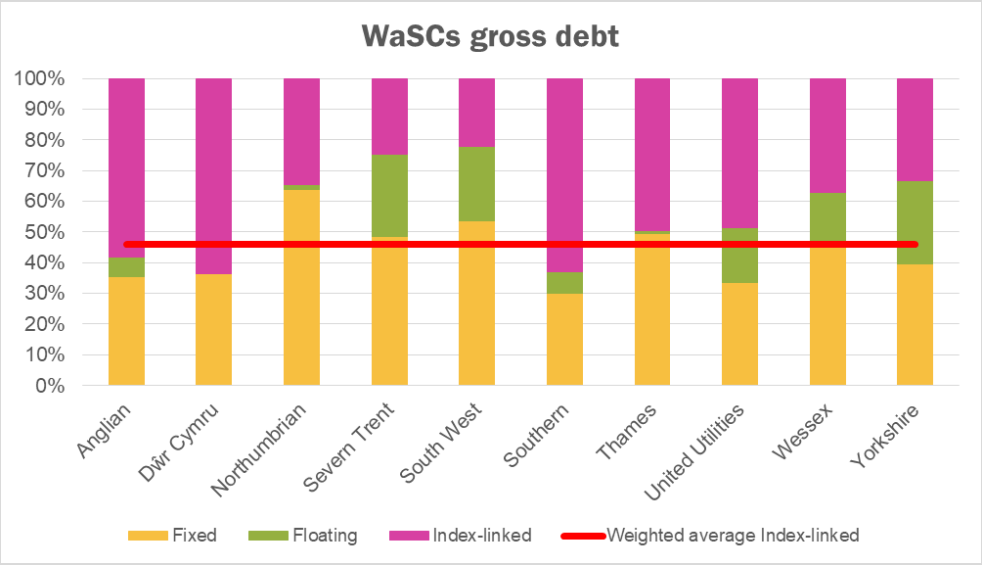
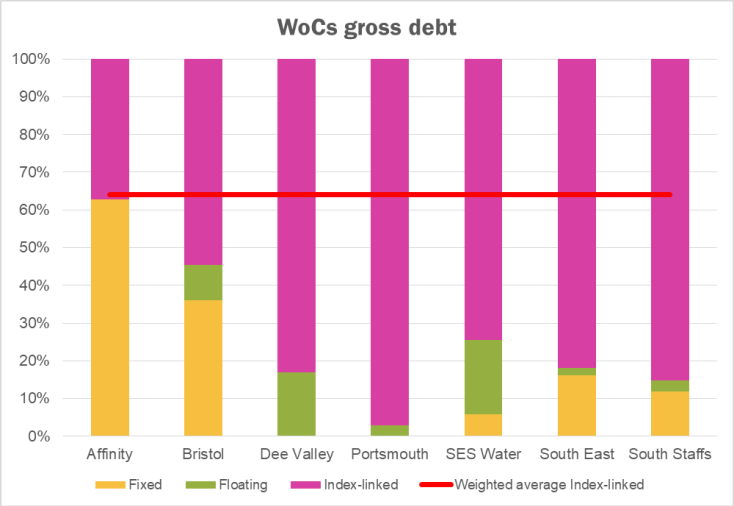
Composition of company borrowings





Companies typically use index linked debt to manage their exposure to inflation risk.

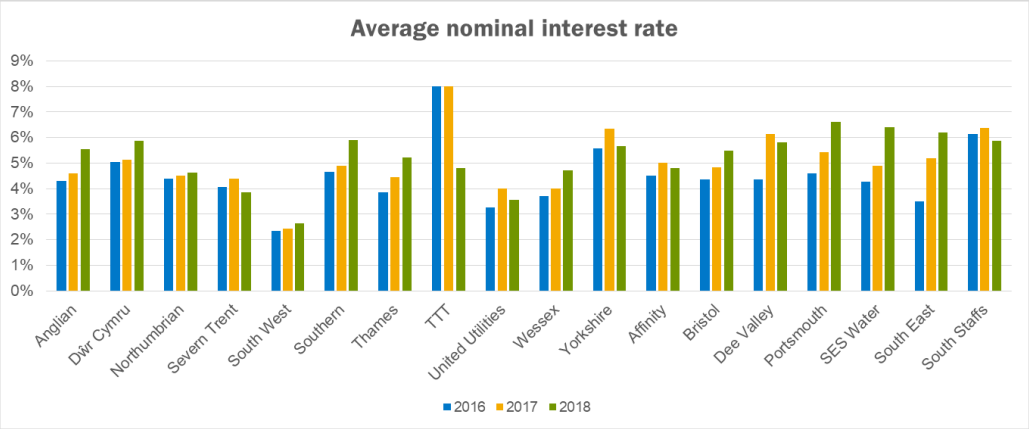
For WaSCs, approximately 46% of debt is index linked, for WoCs it is 64%.

Historically, index linked instruments have been linked to RPI. However, with price controls transitioning from RPI to CPIH from 2020, companies have issued some CPI linked debt.

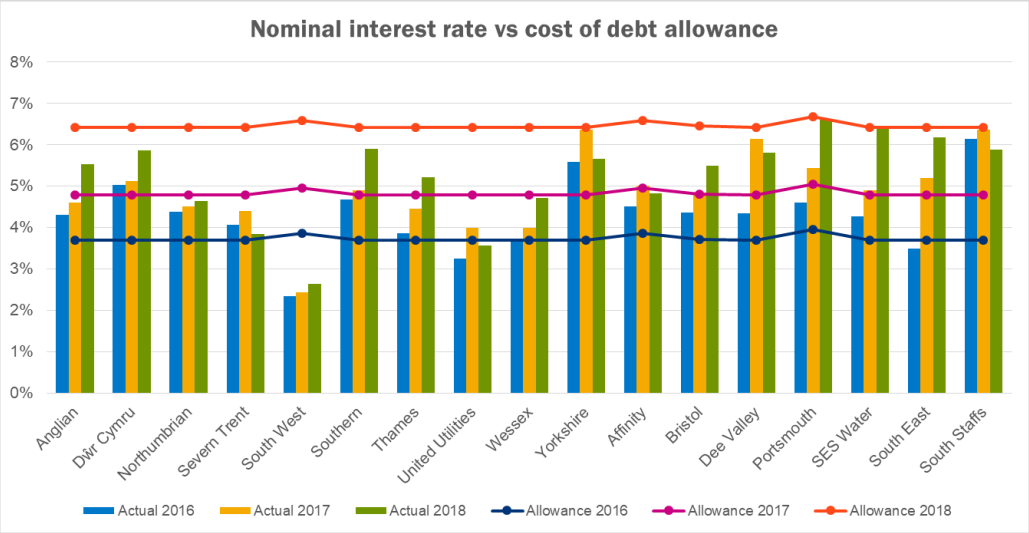
Companies that have issued CPI linked debt include United Utilities, Tideway and Affinity Water.

The charts show the gross debt of each company. Net debt (gross debt less cash) is used when calculating companies' regulatory gearing. At PR14 we assumed 33% of companies' net debt was index linked (linked to RPI). The use of index linked debt impacts the cash interest payments required each year. This can improve short term financeability but does not impact on companies' overall levels of debt.

Cost of debt



For companies with index linked debt, the calculation of average nominal interest rates is impacted by outturn inflation. Higher inflation in 2017-18 compared with the prior year results in higher nominal interest rates.

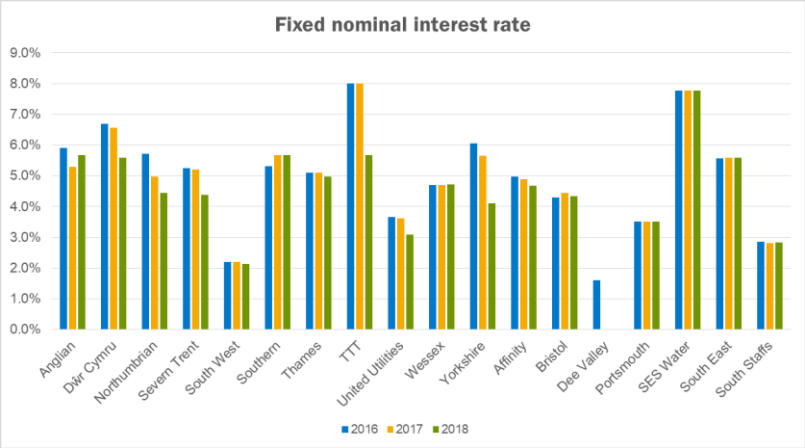


We have compared the average nominal interest rates reported by the companies to the PR14 cost of debt inflated by outturn RPI. The cost of debt allowances are set in real terms, therefore we have used year average inflation to present in nominal terms.

In 2017-18 compared to the previous year fewer companies are paying interest rates which are in excess of the allowances, this is because 2018 is impacted by relatively high RPI.

Where companies are able to outperform against our cost of debt, as a result of low real interest rates or due to inflation levels being higher than anticipated, we would expect companies to consider how best to use that outperformance. This could be reducing gearing, reducing pension deficits, improving services for customers or reducing bills. Our putting the sector in balance position statement confirmed that voluntary sharing mechanisms for 2020-25 will be taken into account in our ‘in the round’ assessment in our initial assessment of business plans.

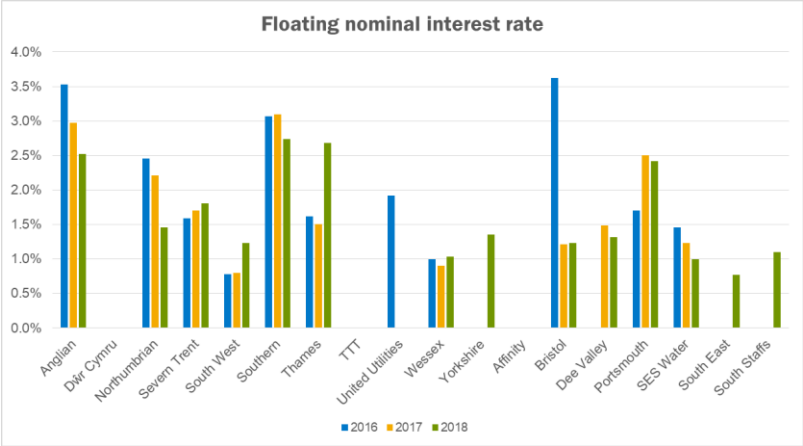
Reported interest rates

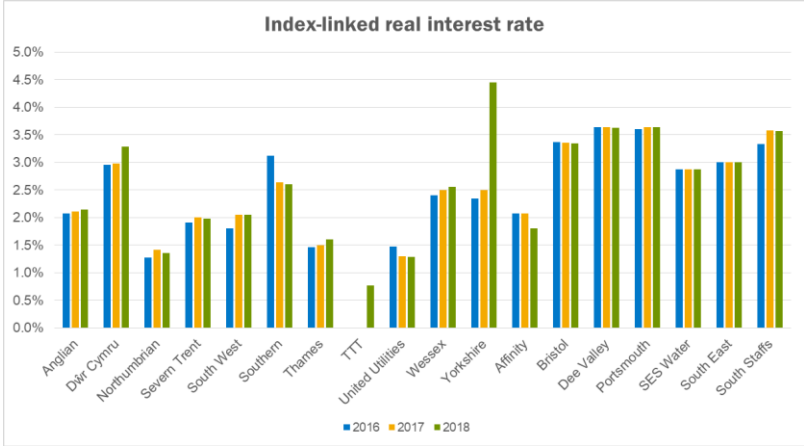


Companies have also published details of the interest rates paid in respect of their fixed, floating and index-linked debt.

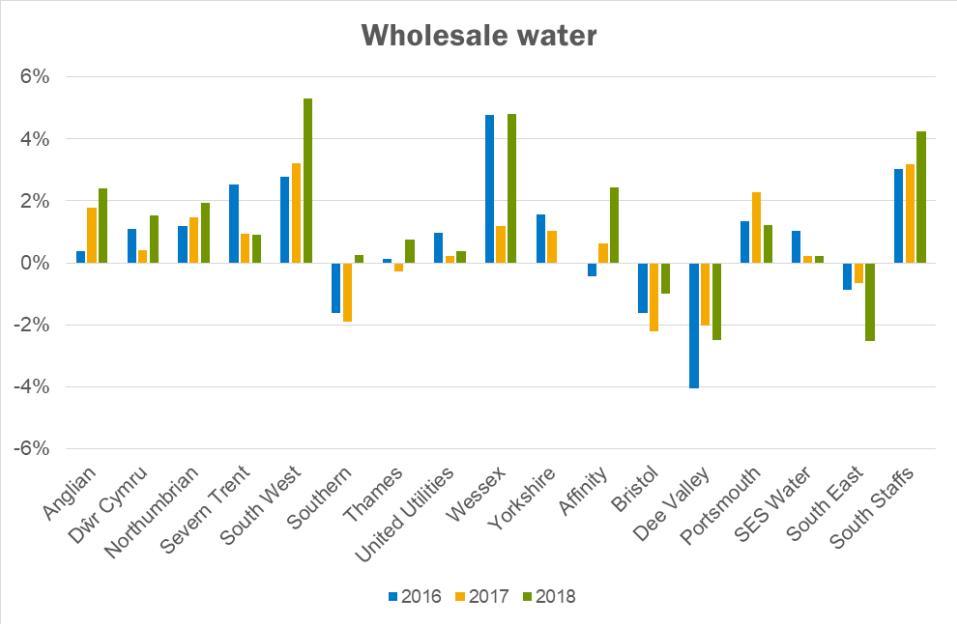
These three charts present the average nominal interest rates paid in respect of fixed rate debt, floating rate debt and the real interest coupon paid in respect of index linked debt.

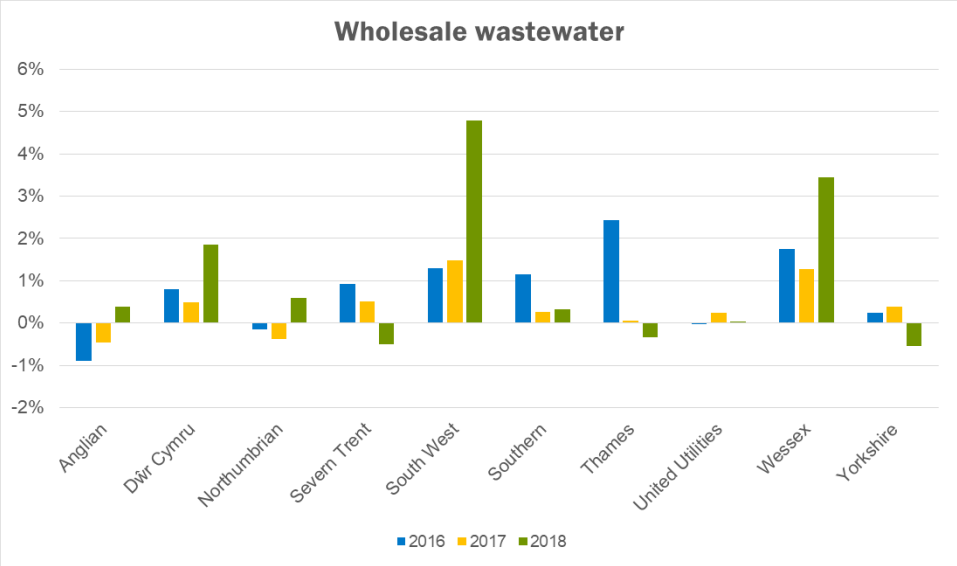
Floating rate debt makes up a relatively small proportion of the overall debt at a sector and company level, so floating debt variances have a more limited impact on the overall costs.





Wholesale revenue (under/over recovery)





We set binding separate revenue controls for both water and wastewater.

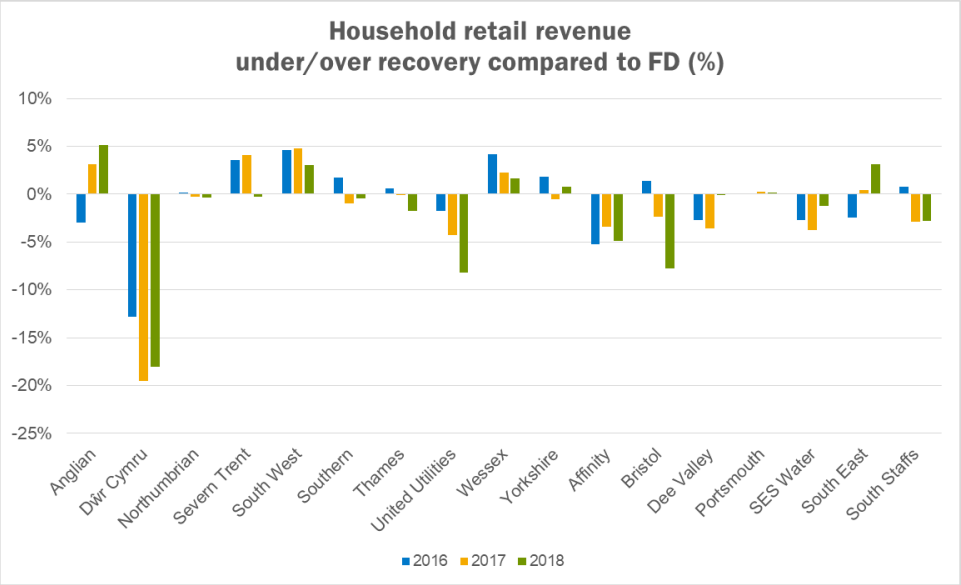
These charts compare revenue collected with revenue allowances. Companies are incentivised to accurately forecast revenue recovery under the wholesale revenue forecasting incentive mechanism (WRFIM), which allows reconciliation for over or under recovered revenue, subject to a penalty mechanism for material variances.

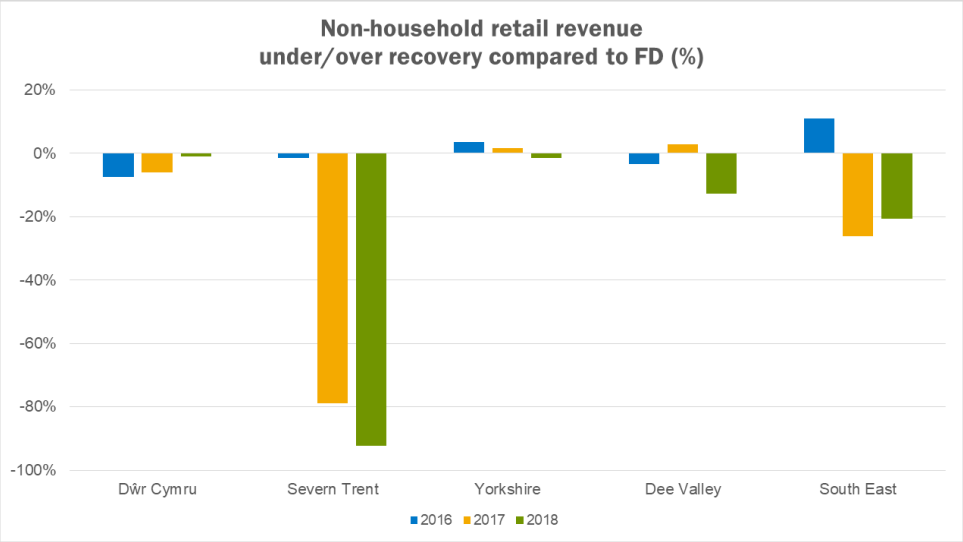
South West Water and Wessex Water show the highest over recovery (both services), due to higher customer demand and developer activity. Both companies have noted this results in a WRFIM penalty and the additional revenue will be returned to customers in the future. South Staffordshire Water's over recovery also related to higher developer charges than forecast.

South East Water shows the highest under recovery of wholesale water revenue, the company notes a loss of revenue due to customers switching to a metered supply.

Dee Valley Water reported a continuing trend in under recovery of wholesale water revenue in 2017-18, which is stated as mostly due to lower developer charges than forecast.

Retail revenue (under/over recovery)





These charts show the household retail component of revenue and non-household retail component of revenue compared to the amounts allowed at the PR14 final determination. The household and non-household controls are separate.

The household revenue chart continues to show a substantive under recovery of revenue by Dŵr Cymru, due to the provision of affordability tariffs and prior year adjustments.

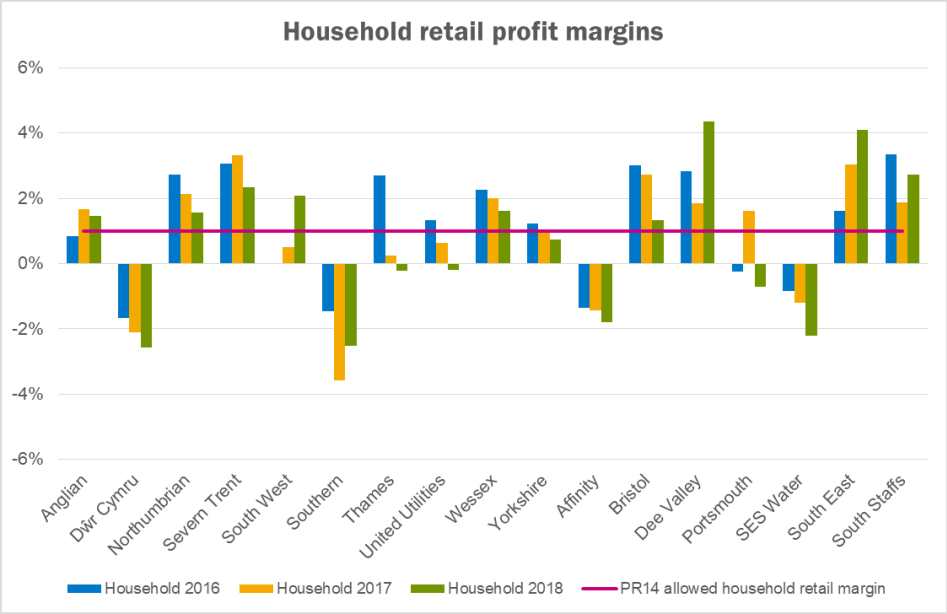
United Utilities Water's under recovery is driven by an increased take up of social and support tariffs.

Anglian Water's over recovery is due to prior year adjustments and a lower take-up of social tariffs than expected.

Since 1 April 2017 eligible non-household customers in England and Wales are able to choose their water and, in England, wastewater supplier. Only five undertakers remained in the non household retail market at 31 March 2018 (South East Water, Severn Trent Water, Dee Valley Water, Yorkshire Water and Dŵr Cymru).

Severn Trent Water formally exited the non-household retail market on 1 July 2018; in 2017-18, non-household activities were provided by an agent and the company chose not to report the majority of non-household revenue in the APR.

Household retail profit margins



At PR14 we introduced separate price controls for household and non-household retail services.

Our PR14 determinations assumed a household retail margin of 1%; Dee Valley Water and South East Water both significantly outperformed against their allowed household retail costs.

Dee Valley Water's outperformance was as a result of increased costs allocated to the non-appointed business. South East Water report better cash collection performance allowing for the release of amounts previously provided for.

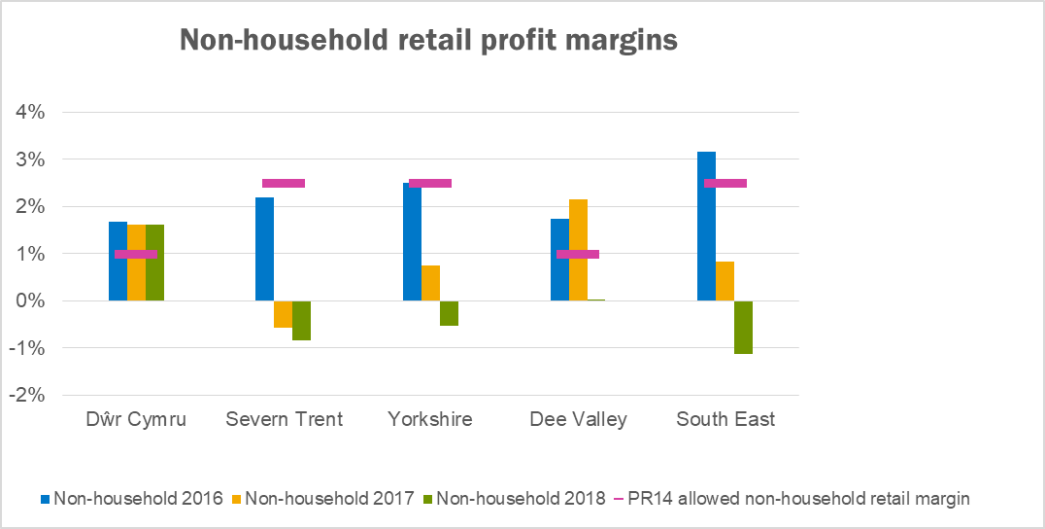
This performance provides an important insight for our determinations at PR19.

Margins were calculated by reference to the allowed costs at FD and companies' actual margins earned can vary from the amounts allowed in the final determination if their retail costs differ from the average cost to serve that we assumed in each companies' final determination. Companies can earn household margins above the levels allowed, by reducing costs below the levels allowed in the final determinations and by managing bad debts, but must bear the costs if their costs rise above the allowance.

The household and non household controls are separate binding controls and costs (and revenues) must be allocated to the control to which they relate.

Further information about each company's performance can be found in their APRs which each company publishes on its website.

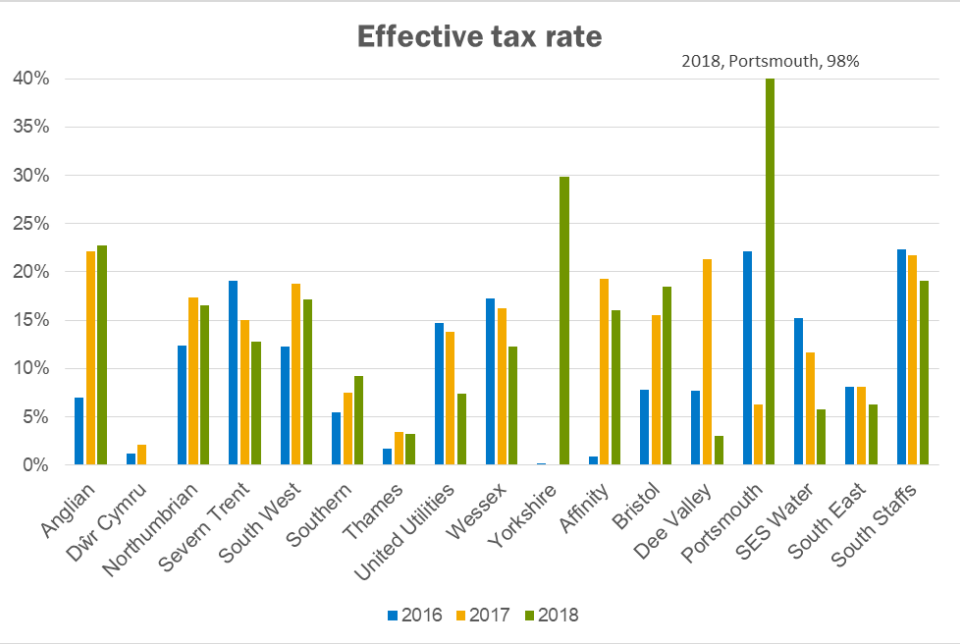
Non-household retail profit margins



As at 31 March 2018, only 5 companies were still operating in the non-household retail market, so only those companies are included in the chart. Severn Trent Water is included as its formal exit was after the end of the reporting year on 1 July 2018, although Non-Household Retail was provided by Water Plus in 2017-18 (a joint venture acting as an agent).

Severn Trent Water, Yorkshire Water and South East Water have under performed against their allowed non-household retail costs, reportedly as a result of higher costs associated with market opening than forecasted.

The lower retail margin allowed in the 2014 price determinations for Dŵr Cymru and Dee Valley Water represents the different approach taken for companies operating in Wales, recognising that the vast majority of non-household customers are not able to choose suppliers.



Excluding Portsmouth Water, effective tax rates exhibited a range of between 0.8% and 30% (2016-17 0% and 22.1%) compared to the current basic rate of corporation tax of 19% (2016-17 20%).

The effective rate of tax that companies pay is influenced by many factors including the level of capital expenditure over recent years, as a result of which they can claim capital allowances which defer taxation to future periods.

Portsmouth Water's effective tax rate has been impacted the removal of the Employee Benefit Trust (EBT), resulting in exceptional staff costs.

The disclosures made by companies show that Anglian Water, Southern Water and Thames Water were able to utilise group relief or consortium relief from connected companies which they did not pay for at the full tax value. This has enabled them to reduce the amount of tax paid and in most cases the effective tax rate reported is lower than the expected tax rate. Anglian Water disclaimed capital allowances to enable utilisation of group losses and in their accounts, Anglian Water state it will pay for the losses when it receives the benefit of the disclaimed capital allowances.

Our PR19 methodology assumes companies will pay full value for any group relief that they receive and, if they do not, we will claw back, at a future price review, a proportion of the tax allowance they have received equivalent to that unpaid for group relief.

The effective corporation tax rate that companies paid in the year is calculated as current tax as a percentage of profit before tax and fair value adjustments.

Introduction and context

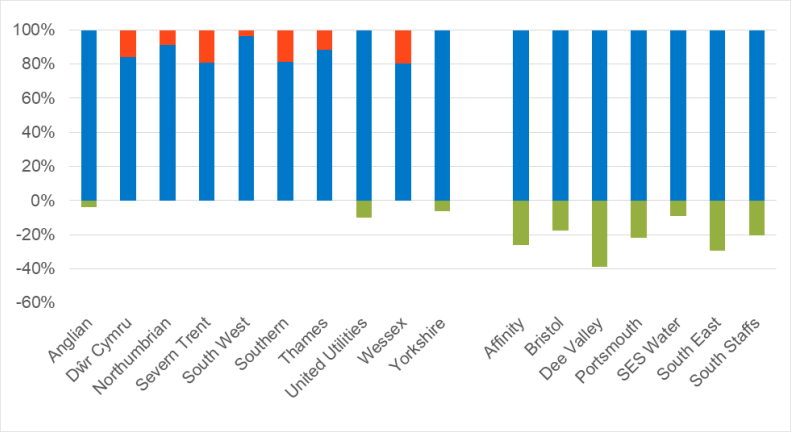
Key points

Company financial results

Appendices

Pension liabilities

Pension deficits (red) / surpluses (green) as a percentage of total pension liability as reported in 2017-18 statutory accounts.



Overall the industry wide deficit at March 2018 equalled an average 4% of total pension liabilities compared to 7% at March 2017. The £0.6 billion improvement appears to result from a mix of increases in discount rates, reductions in assumed inflation rates and higher asset values. Mortality assumptions remain generally steady.

Anglian Water, United Utilities Water, Yorkshire Water and all of the water only companies report a surplus; all other water and sewerage companies report a deficit. Severn Trent Water has, again, the largest deficit, as a percentage of RCV, at 6.3% although down from 7.3% in 2016-17. The chart shows deficits as a percentage of total pension liabilities by company.

Each company determines its own assumptions, including discount and inflation rates. All of the water and sewerage companies do however publish sensitivities which are useful in observing potential liability volatility. For example, a 50-basis point increase in discount rates could equate to a decrease in liabilities of circa £1.3bn.

Cash contributions agreed by companies to repair deficits reflect actuarial valuations undertaken by independent scheme trustees and are reviewed by the Pensions Regulator. The results of actuarial triennial valuations may differ from accounting valuations as trustees are required to be prudent in setting assumptions. We expect companies to take account of their pensions position in their Long Term Viability Statements.

In addition to our review of companies' IAS based reported exposures we commissioned a targeted review of company pensions arrangements by Barnett Waddingham LLP , an independent UK consultancy, which we have published alongside this report.

At the PR14 price review we set out our treatment of pension deficit repair costs for the 2015-20 price control period and beyond. We stated for each company the date at which customer contributions to deficit repairs will end; that no further allowances for deficit repair costs beyond the stated date will be allowed; and that we do not intend to allow within the PR19 price review companies to recover from customers any incremental deficit repair costs beyond those assumed at PR14 (which were based on PR09 valuations).

We continue to expect deficit repair costs, whether incremental or due after the dates specified, to be dealt with by management action or contributed to companies and their shareholders.

Overview of Financial Flows

In the 2018 Annual Performance Reports, companies reported on their financial flows for the first time. The purpose of reporting on financial flows is to provide greater transparency and clarity about the financial returns to the company's equity holders each year. Financial flows information allows clear comparison between the financial flows under actual capital structures that companies have adopted and the structure we have used in setting the prices that customers pay. This is particularly where companies have adopted a complex highly-leveraged structure compared with the more traditional capital structure assumed in our price determinations.

The Financial Flows metric looks at the returns that equity holders achieve, the Return on Regulatory Equity (RoRE). It compares the RoRE on two bases against the capital structure and returns assumed by Ofwat at the last price review in 2014.

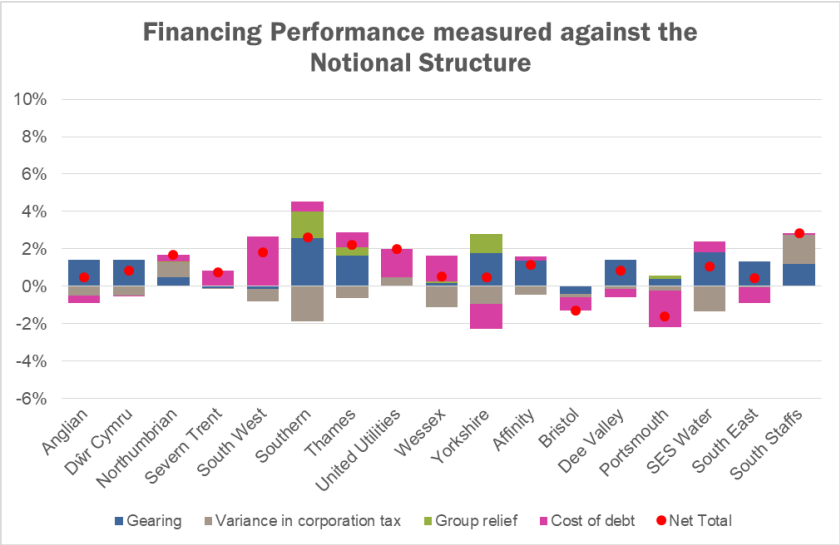
1. The actual returns that companies earned based on Ofwat's assumed capital structure
2. The actual returns that companies earned on their actual capital structure.

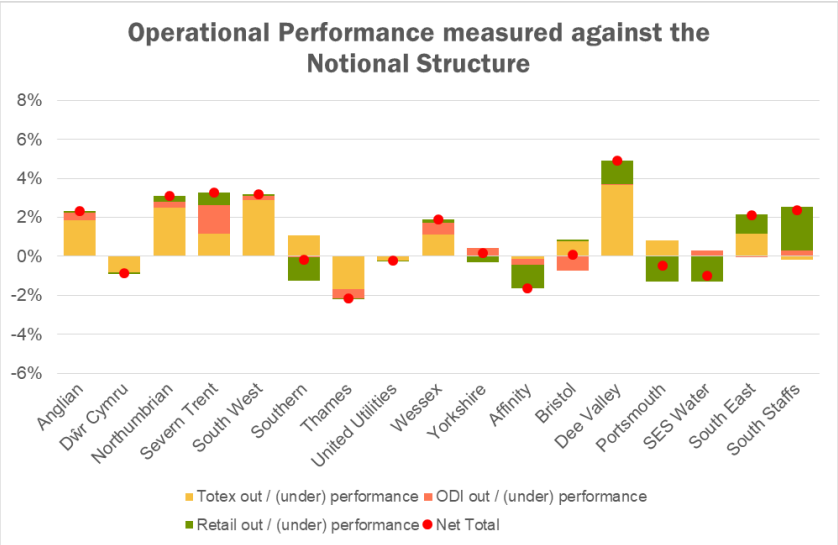
The metric starts with the base RoRE (slide 9) assumed in price limits set in 2014 adjusted for true ups for incentives in previous price reviews. Changes in RoRE are then analysed into changes due to (i) financing over/underperformance and (ii) operational over/underperformance (presented on slide 24). Annual growth in the Regulatory Capital Value is added to actual returns to calculate Total Shareholder returns

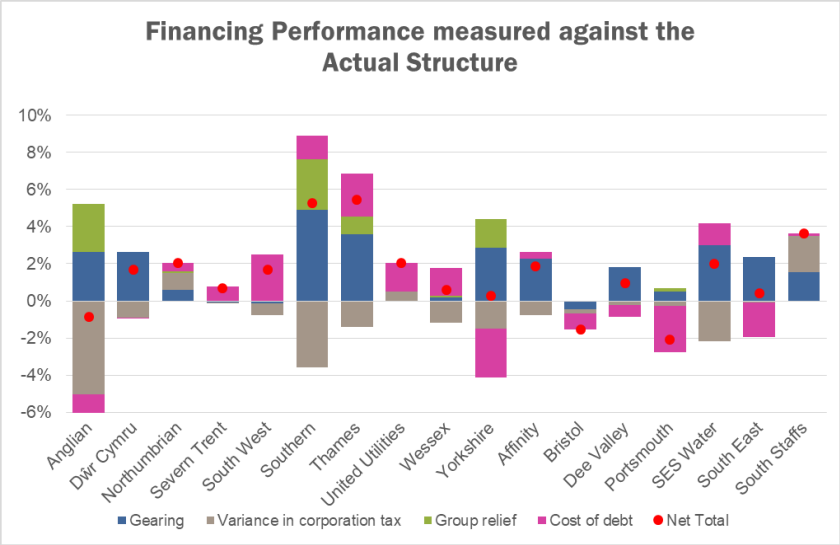
Slide 25 shows the Total Shareholder returns on the basis of the actual structure, compared with the notional structure assumed in the price control. The slide also shows the dividends and shareholder retained value on the same basis, in separate charts.

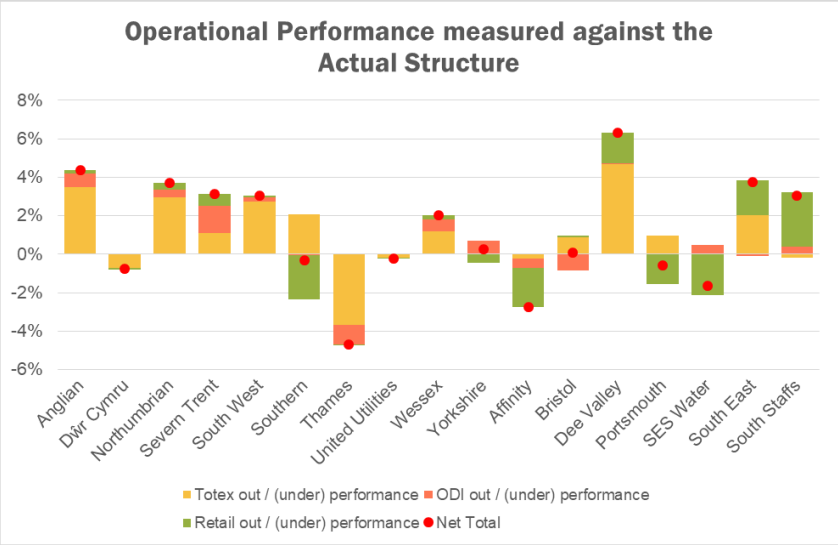
Only a few companies included accompanying narrative with the Financial Flows metric. The narrative is a key part to the understanding and interpretation of the data. We expect companies to do this going forward.

Financial and Operational - Out/Under Performance

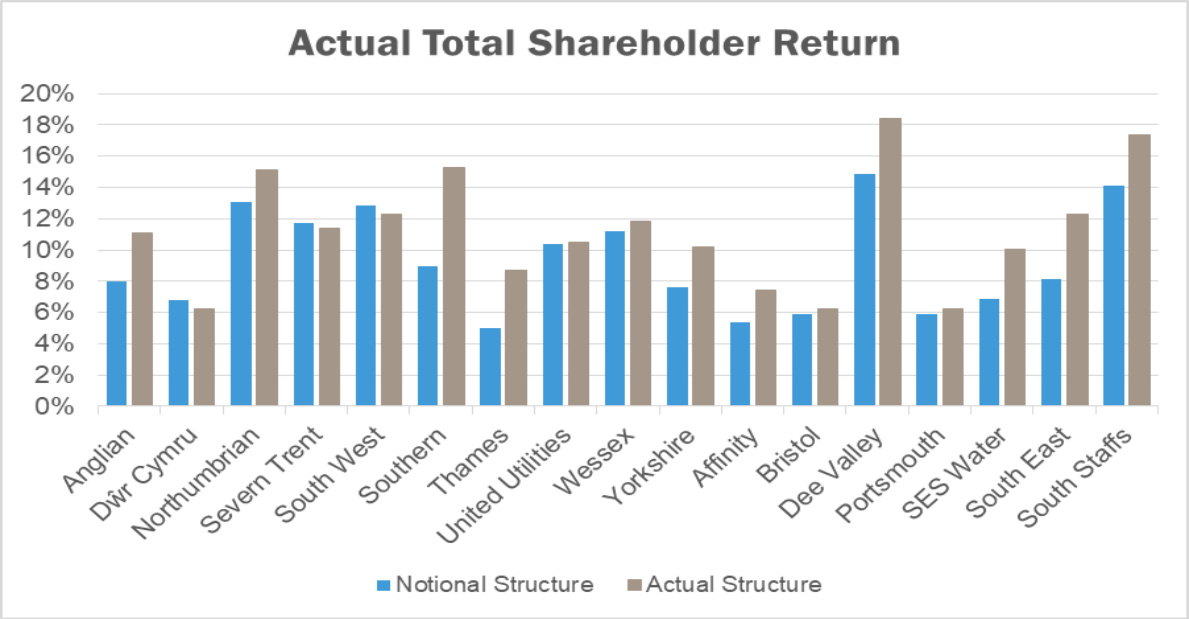


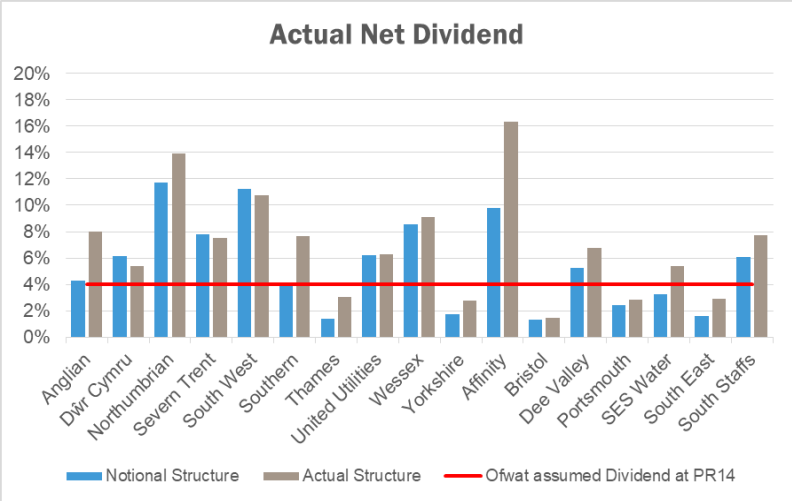


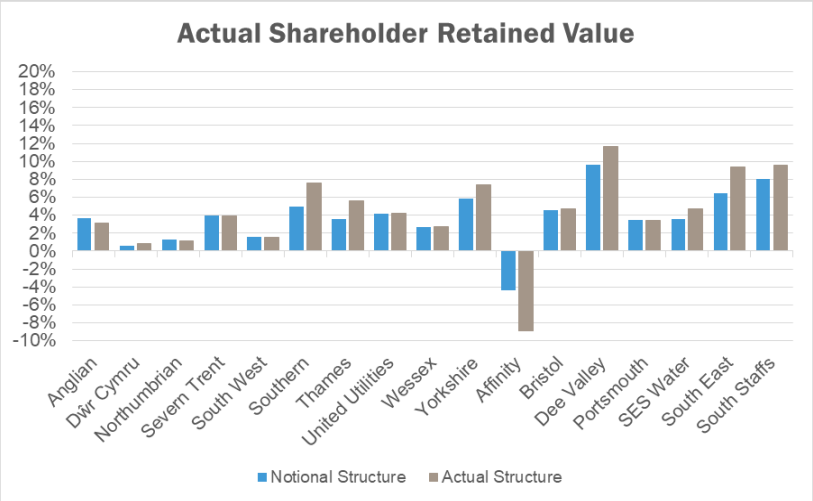




Total Shareholder Return, Net Dividend and Retained Value







Appendix 1: Glossary

APR	Annual Performance Report – Annual report of performance published by the appointed companies
Dividend yield	Dividend paid as a % of regulated equity
FFO	Funds from operations – calculated as net cash generated from operating activities before changes in working capital
FD – Final determination	The final determination of allowed costs, revenues and prices by Ofwat
Gearing	Net debt / RCV
Net Debt	Net debt is calculated as all borrowings of the company less cash. It excludes any pension deficit liability and mark-to-market accounting adjustments.
Nominal	Interest rates, prices and costs are said to be in nominal terms if they include the impact of inflation
Notional	Ofwat "notional" capital structure for setting prices. For the current period the notional gearing is 62.5%
PR14 (PR19)	The Price Review which covers the period 2015-2020 (2020-2025)
RAGs	Regulatory Accounting Guidelines
Real	Interest rates, prices and costs are said to be in real terms if they exclude the impact of inflation
Regulatory deprecation	The amount by which the RCV is depreciated
RCF	Retained Cash Flow – the cash generated by the business after payment of dividends, but before capital expenditure
RCV	Regulatory capital value – This is the regulatory value of the investment that has been made in the company
Regulated Equity	RCV less net debt. This can be in actual or notional terms
RORE	Return on Regulated Equity – A return metric calculated using the notional level of net debt
Securitisation	Securitisation enables a company to raise debt by granting a mortgage (charge) over an identifiable stream of future cashflows
Totex	Total expenditure which includes both operational expenditure (opex) and capital expenditure (capex)
WaSC	Water and wastewater companies
WoC	Water only companies

Appendix 2: Comparability of data

To enable us to make meaningful comparisons between companies it is essential that the information about each company is compiled on a consistent basis.

We have been working with companies to ensure that all companies are reporting data that is clear and transparent and that they are reporting in line with guidance that we have issued.

We are continuing to keep our reporting guidance under review and continue to highlight examples of good practice in reporting. We will also issue further guidance and clarification where we consider it necessary and will look to incorporate this into the Regulatory Accounting Guidelines (RAGs).

We also recognise that there may be good reasons why companies may wish to present alternative versions of specific metrics which we have asked them to publish. In this case we have asked companies to make it clear that they are using an alternative approach and to clearly state how their alternative calculations differ from the approach specified for the APR.

We do not expect any one company to be identical to all other companies. However we believe that, where appropriate, a company should be able to explain its relative position compared to its peers.

Where appropriate we have included the financial results of Bazalgette Tunnel Limited (Tideway or TTT) which is currently constructing the Thames Tideway Tunnel. While Tideway is a regulated business, its activities are significantly different to those of the other regulated water and wastewater companies and as a result we do not expect its financial performance to be directly comparable with that of the other regulated companies.

Appendix 3: Links to company submissions on Financial Flows

Anglian Water
Affinity Water
Bristol Water
Dee Valley Water
Northumbrian Water
Portsmouth Water
Severn Trent Water
South Staffordshire Water
South West Water
Southern Water
Sutton and East Surrey Water
Thames Water
United Utilities
Welsh Water
Wessex Water
Yorkshire Water

End notes

1. While we have undertaken a high level review of the information published by companies and included in this report to ensure consistency, the responsibility for the accuracy of the information that each company publishes and which we have used when compiling the report remains with each of the appointed companies. Some companies have since restated figures and/ or revised their APR's and these changes may not be reflected in this report.

Severn Trent Water acquired Dee Valley Water in 2017. Variations and modifications to the Conditions of Appointment (licences) for both companies were made which came into effect on the 1 July 2018. The changes allowed Dee Valley Water to become a water and wastewater services company based wholly in Wales and for Severn Trent Water to become a water and wastewater services company based wholly in England. The new Welsh company is called Hafren Dyfrdwy. This report contains information on the companies existing at 31 March 2018 and continues to refer to Severn Trent Water & Dee Valley Water.

From 1 April 2017 the non-household retail market in England has been opened further to competition for eligible customers. A number of the appointed companies have already exited this market, and the retail only businesses are being regulated in a different way. For these reasons, this activity will not be covered by this report.

2. Most companies' licences include a requirement with respect to maintaining an investment grade credit rating. The licence for South West Water (incorporating Bournemouth Water from 1 April 2016) also has a requirement with respect to maintaining an investment grade credit rating but in its current specific circumstances an exemption applies. This is because neither South West Water nor its parent company Pennon raise finance on the bond market, and as a result does not maintain a credit rating. This is why no rating is shown in the table on slide 7. However, South West Water's licence does require it to maintain financial metrics appropriate to an investment grade credit rating regardless of this. We note that this exemption is also expected to apply to Hafren Dyfrdwy, a new company which came into existence on the 1 July 2018.

Credit ratings are usually provided by one of the three main credit rating agencies. The minimum investment grade credit ratings are Baa3 for Moody's Investors Service and BBB- for both S&P Global and Fitch Ratings as shown by the red line. Where a company has received an issuer or corporate family credit rating from more than one agency, the lowest credit rating received has been recorded.

3. In line with changes to the UK Corporate Code in 2016, we introduced a requirement for companies to include a long term viability statement in their accounts. We set out our expectations on what companies should include in their statements in our Information Notice IN 16/03 March 2016. Following a review of the long term viability statements that companies published in 2017, we identified significant inconsistencies in the level of detail provided by companies and in most cases the information provided did not fully explain the procedures that had been followed. We set out further guidance for companies in our Information notice IN 18/04 Expectations for companies in issuing long term viability statements.