Monitoring Financial Resilience Report 2022–23

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About this report

We expect the regulated water companies to maintain a level of financial headroom so that they are able to manage short term volatility and shocks to their financial structures and meet their obligations and commitments.

We assess the financial resilience of the water companies* on an ongoing basis, which informs our approach to company monitoring and engagement. And where necessary, we will step in to use our regulatory tools to intervene and ensure customer interests are protected.

The Monitoring Financial Resilience Report (the MFR) is our annual publication to highlight for stakeholders our categorisation of the regulated companies based on our wider assessment of their financial resilience, alongside relevant information.

Through the MFR, we aim to promote a focus on efficient investment that secures long-term resilience and delivers long-term value for money for customers and the environment.

* The 16 largest companies in England and Wales plus Bazalgette Tunnel Limited (Tideway) which is referenced separately in this report as its activities and the way in which it is regulated differs to the rest of the industry.

Key messages

Thames Water needs to strengthen its financial resilience and deliver a turnaround in performance. In addition, we have categorised Southern Water, SES Water and South East Water as a higher priority for engagement and monitoring.

Since September 2021 Southern Water has received £905m of equity investment and Thames Water has received £500m with shareholder agreement for further equity support (subject to conditions).

Although positive steps have been taken, both companies remain in our **Action Required** category as they deliver against respective Turnaround Plans.

We have been clear that Thames Water has significant issues to address. Alongside improving operational performance, the company needs to strengthen its financial resilience.

We have moved South East Water into this category reflecting increased financial pressures which sit alongside a weakening in operational performance.

SES Water remains in this category as its financial metrics remain under pressure. The company's shareholders have provided an equity commitment, while they undertake a strategic review of the business, which is expected to support an improvement in financial resilience.

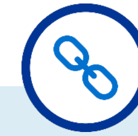
We have taken Portsmouth Water and Yorkshire Water out of our higher priority category but continue to monitor their progress on a targeted basis.

Both companies have taken action in support of their financial resilience during 2022-23.

Portsmouth Water has secured £150 million of additional equity from its investors to support its substantial investment plan with the construction of the Havant Thicket Storage Reservoir and its financial resilience.

Following our challenge to the company and its investors Yorkshire Water has provided a range of undertakings, including the recovery of loans totalling around £940 million by the end of March 2027, which will strengthen its financial resilience and are now underway.

The companies are placed in our **Elevated Concern** category, alongside Affinity Water and Northumbrian Water, as we continue to take a targeted approach in monitoring their financial position and overall performance.



We have seen an improvement in companies' articulation and transparency of dividend decisions this year, but for some the link to overall performance must be clearer.

Dividends are an important part of the investor return however they must take account of performance delivered to customers and the environment.

In 2022-23 companies declared a total dividend of £1.4 billion. Some companies must do more to explain how dividend decisions reflect overall performance, alongside investment and financial resilience needs, to meet our guidance. We will provide each company with feedback on our assessment which we will publish.

With effect from 17 May 2023, companies will need to meet the modified dividend licence conditions. We will consider appropriate action where dividend decisions made by individual companies fail to meet those licence conditions.

For further performance information, our Water Company Performance Report sets out company operational performance against a set of key metrics.

Key messages

There has been significant injections of equity across the sector in AMP7 to date.

There has been significant shareholder support over AMP7 to date, with around £4.6 billion of fresh equity either injected into the sector or agreed to be provided*. This money will help fund investment plans, support financial resilience, and for some companies facilitate improvements in their operational performance.

Water companies have raised new debt to fund investment programmes and subscription levels continue to signal investor interest in the sector.

Our regulatory approach aims to support the ability of companies to fund investment throughout the economic cycle.

Financial performance of individual companies varies due to variations in financing arrangements and company performance in delivering services to customers and the environment under the incentive-based regime.

*Including shareholder agreement to provide £750million of funding to Thames Water by 2025 which is subject to conditions.

Current macro economic conditions highlight the importance of companies maintaining headroom and financial flexibility to manage periods of volatility.

Revenue allowances and the regulatory capital value (RCV) rise in line with inflation, and inflation has contributed to the growth of the sector's RCV. The compound average annual growth rate of the RCV was 7% in the period 2020-23.

At times of high inflation equity investors benefit where fixed rate debt is in place as the equity portion of the RCV rises faster than the amount of RCV that is financed by debt.

However, higher than expected inflation and rising interest rates have also placed upward pressure on operating, capital investment and financing costs. This has caused short-term cash pressures for some companies that has impacted on financial ratios and credit metrics.

Delays to the delivery of AMP7 enhancement programmes (as referenced in our separate Water Company Performance Report), will increase pressure on companies to deliver the step up in enhancement programmes for AMP8.

Looking ahead financial resilience will continue to be of critical importance.

Companies have significant investment programmes to deliver in 2025-30 and beyond – with PR24 business plans proposing levels of enhancement spend that are around three times as great as PR19.

Companies will need access to both debt and equity finance to deliver these schemes to minimise risks to financial resilience.

We continue to take steps to encourage companies to maintain adequate levels of financial resilience.

In March 2023 we published our decision document setting out the modifications we have made to certain conditions in each water company's licence. These changes took effect from May 2023, with the amendment to the cash lock-up licence condition trigger taking effect from April 2025.

The modifications aim to strengthen the regulatory ring-fencing provisions, to protect customers' interests, and enable earlier action where financial resilience may be at risk.

Contents

The MFR report is divided into the following sections together with appendices:

Key messages

Our key messages and observations from our assessment of financial resilience.

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Our approach to monitoring and engagement, company categorisation and activity to strengthen financial resilience

We set out our categorisation and approach for our monitoring and engagement of the regulated companies. We highlight some of the steps and actions companies have taken to strengthen and support their financial resilience.

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Financial metrics analysis and credit ratings

The section captures and presents some of the key financial data reported by the companies in their Annual Performance Report (APR) for the year ending 31 March 2023. The supporting data underpinning the charts has been published on our website.

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Summary of our assessment of dividend policies, application and reporting

We have considered whether companies have met our expectations around dividend policies and their application, and regarding transparency of dividends declared and paid, including how dividend decisions have taken account of performance delivered for customers and the environment.

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Summary of our assessment of long term viability statements

We provide an overview of our assessment against our expectations for content and transparency of reporting.

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Our approach to monitoring and engagement, company categorisation and activity to strengthen financial resilience

Our approach to monitoring and engagement

We collect and consider relevant financial data and non-financial information from a range of sources, over time and in the round, and apply judgement in forming our view on companies' financial resilience.

Our assessment takes into account a range of matters, including known events and company actions that could impact financial resilience over the coming year and/or the longer term, and is intended to enable us and companies to plan for monitoring and engagement that is proportionate to the company's potential vulnerability to volatility and shocks.

This holistic assessment informs our prioritisation and approach to company monitoring and engagement. This is a sliding scale ranging from Standard/Routine as relevant to Action Required/Active, with a view in some cases to action being taken to address concerns. **Where necessary we will use our regulatory tools to intervene to strengthen and protect financial resilience.**

The type of matters that we take into account and that can impact on a company's financial resilience long term, and that might lead to an increase in our prioritisation for monitoring and engagement include:

- A weakening trend across key credit metrics, alongside lower credit ratings and the risk of downgrade.
- The scale of investment needed to address current performance relative to financial headroom.
- The complexity and risk presented by a financial structure or arrangement in place.
- Risks associated with undertaking a large capital project or implementation of new systems and processes.
- The impact of potential financial penalties or remedial measures including as a result of potential regulatory enforcement action.
- A lack of transparency around key policies and reporting and falling below expectations, including in regard to dividend policies and LTVS.

Our financial resilience categorisation – 1 of 2

Below is our categorisation of the regulated companies as based on our wider assessment and involvement on matters of financial resilience.

Financial Resilience Status	Monitoring and Engagement Approach	Company (alphabetical)
Standard No specific concerns with the financial resilience of the company that we are aware of at this time. No specific company action expected to be required at this time.	**Routine** Company is subject to ongoing monitoring, including through standard regulatory reporting and engagement.	Anglian Water, Dŵr Cymru, Hafren Dyfrdwy, Severn Trent, South Staffs, South West Water, United Utilities and Wessex Water.
Elevated Concern We have identified some concerns or potential concerns with the company's long term financial resilience that may require action to address.	**Targeted** More frequent or targeted monitoring including engagement, with a requirement for the company to provide additional information where appropriate.	Affinity Water, Northumbrian Water, Portsmouth Water and Yorkshire Water.
Action Required Company action is being taken or is required, and/or commitments have been made to strengthen long term financial resilience.	**Active** Higher priority for our monitoring and engagement. Additional information and reporting on improvements, and at a senior level in Ofwat, as required.	SES Water, South East Water, Southern Water, Thames Water.

Category Movements

Our examination and prioritisation of companies', both between and within category, changes over time based on the financial resilience matters or concerns that might arise. The type of matters that can impact on a company's long term financial resilience, and that can trigger an increase in our prioritisation, include those set out on the previous page.

Compared to prior year, **Portsmouth Water** and **Yorkshire Water** are placed in our **Elevated Concern / Targeted** category (from Action Required).

- **Portsmouth Water** has secured significant additional equity from its investors to support its substantial investment plan with the construction of the Havant Thicket Storage Reservoir.
- In 2022 **Yorkshire Water** provided a range of undertakings which will strengthen financial resilience and are now underway.

As the companies deliver on their commitments, and whilst some risk to financial resilience remains, we continue to closely monitor.

South East Water has been moved into our **Action Required / Active** category (from Elevated Concern) reflecting a deterioration across key financial metrics, leverage and with a change in credit rating outlook in the year noting inflationary pressures, alongside the company's weakening operational performance.

Our financial resilience categorisation – 2 of 2

Action Required / Active Engagement

In respect to the other companies in this category we comment as follows:

We continue to engage with and closely monitor **Thames Water** as the company works to deliver its Turnaround Plan. The company needs to deliver a significant improvement in performance, alongside a need to strengthen its financial resilience. In support of its turnaround, the regulated company received an equity injection in 2022-2023 and shareholder agreement for further funding by 2025 subject to conditions. Both company and shareholders acknowledge that further equity investment will likely be required as the turnaround continues into AMP8.

On 30 June 2023 S&P placed its BBB (class A debt) rating of Thames Water on CreditWatch negative indicating the potential for a credit rating change.

Southern Water remains in this category as it delivers against its two-year Turnaround Plan to improve performance by the end of AMP7, with additional equity invested by its shareholders to support delivery.

On 7 July 2023 Fitch downgraded its (senior secured class A debt) of Southern Water to BBB from BBB+ (Negative outlook) resulting in a trigger event under the company's funding documents which prevents the company paying dividends. We note the trigger is not expected to impact on Southern Water's access to funding or on its operating activities.

SES Water's categorisation is unchanged. High inflation and operational issues have continued to put pressure on its reported financial metrics, with the company recognising further funding will be required to support its capital programme for the rest of AMP 7 and AMP 8, and to strengthen financial resilience. The current shareholders have invested additional equity and a commitment for further equity, whilst also engaging external advisors on a strategic review of SES Water and the wider East Surrey Holdings group, which is ongoing.

Without an improvement to their lowest monitored credit rating, **Thames Water, Southern Water** and **South East Water** could trigger a cash lock-up from April 2025 when our recent licence modifications take effect.

Elevated Concern / Targeted

Affinity Water and **Northumbrian Water** remain in this category.

The categorisation of both companies is unchanged from prior year, reflecting pressures on financial metrics and in the context of challenging investment programmes.

Activity to support investment and to strengthen financial resilience

In March 2023 we announced our decision on licence modifications which strengthen the ring-fence provisions in each company's licence. The modifications seek to incentivise companies to engage with us at an early stage where financial resilience is at risk and provide us with greater powers to take enforcement action where dividend payments do not take account of company performance or financial resilience over the longer term.

A number of companies have taken steps to support investment and strengthen financial resilience, these include dividend restrictions and the injection of equity. Since April 2022, actions taken to inject, or commit to the injection of equity include:

Thames Water – In accordance with the commitment made by shareholders in June 2022, Thames Water received £500 million of equity on 30 March 2023 to support investment in AMP7. Shareholders have agreed to provide a further £750 million of funding by 2025, subject to conditions.

Southern Water – On 19 October 2023, £550 million of further equity was injected into the Southern Water Group, of which £375 million has been received by the regulated entity. The commitment follows the £1.1 billion of equity injected in the Southern Water Group in September 2021 by funds managed by Macquarie Asset Management to facilitate investment and reduce leverage across the Group (with £530 million received by the regulated entity).

Yorkshire Water – In October 2022 Yorkshire Water resolved to take steps which will strengthen its financial resilience, including the recovery of two loans made to group companies totalling around £940 million by the end of March 2027 of which £400 million was received in June 2023 (greater than the minimum £300 million scheduled). In addition, the company has made further undertakings to strengthen its financial resilience such as to carry out a review of its financial structure by April 2025.

Portsmouth Water – Alongside raising new debt in 2022-23, shareholders provided an equity injection of £20 million and a commitment for a further £150 million to support the business and the construction of the Havant Thicket Winter Storage Reservoir. On 3 July 2023 £120 million had been received (£60m via an intercompany loan repayment), with the remaining £30 million of committed capital anticipated to be drawn in 2024.

SES Water – Shareholders have agreed to inject £22 million into the company in tranches by March 2024 to strengthen financial resilience, of which £7 million has been received. Shareholders have also indicated that they may advance further amounts, if required.

Severn Trent Water – On 29 September 2023, Severn Trent Plc announced it had raised £1.0 billion of new equity, with net proceeds to support the funding of Severn Trent Water's business plan for the regulatory period 2025-2030 (AMP8). This follows a £250 million equity raise in 2021-22 to help fund the company's Green Recovery programme.

Other actions taken and committed by companies in the year to strengthen financial resilience include reviews of financial structures, to lower gearing and non-payment of dividends to shareholders.

In addition, we have updated our reporting requirements on swap and pension liabilities for 2022-23 to improve transparency and information in these financial areas.

Financial metrics analysis
and credit ratings

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Key Financial Metrics as at 31 March 2023

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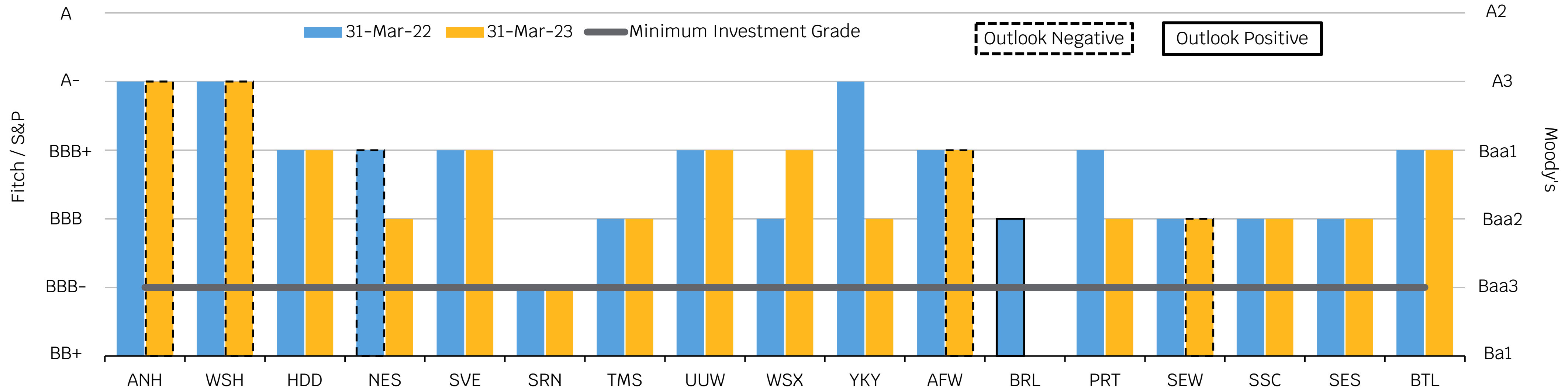
Below is a table of certain key financial metrics for the year ended or as at 31 March 2023. We highlight the metrics provide only static reference points on certain matters within our wider, active assessment of resilience and do not represent a grading or ranking of companies by resilience.

Company* (alphabetical)7	Acronym	Closing RCV	Financial Metrics						
			Regulatory Gearing	Funds From Operations / Net Debt	Adjusted Interest Cover Ratio	Return on Regulated Equity 2022-23 (notional structure)	Dividend Yield	Financial Derivatives mark-to-market (total) as a % of RCV	Lowest monitored credit rating and outlook
Affinity	AFW	1,713.7	74.1%	5.1%	0.47	-1.11%	0.0%	1.0%	BBB+ (Negative)
Anglian	ANH	9,958.5	66.3%	8.1%	1.33	1.48%	4.8%	7.0%	A- (Negative)
Dŵr Cymru	WSH	7,160.6	58.3%	6.0%	0.66	-1.23%	0.0%	6.1%	A- (Negative)
Hafren	HDD	106.6	60.2%	-5.7%	-5.59	8.45%	0.0%	0.0%	BBB+ (Stable)
Northumbrian	NES	5,097.4	68.3%	6.0%	0.56	10.21%	6.9%	1.7%	BBB (Stable)
Portsmouth	PRT	220.4	78.4%	5.0%	0.94	3.87%	7.1%	0.0%	Baa2 (Stable)
SES Water	SES	334.0	77.0%	4.8%	-0.40	-3.95%	4.0%	0.0%	Baa2 (Stable)
Severn Trent	SVE	11,298.5	62.1%	7.8%	0.92	12.14%	9.9%	-0.6%	BBB+ (Stable) l Baa1 (Stable)
South East	SEW	1,663.9	74.0%	4.4%	0.80	-0.24%	1.5%	0.0%	BBB (Negative)
South Staffs	SSC	515.9	59.6%	10.8%	0.88	1.19%	3.7%	0.3%	Baa2 (Stable)
South West Bristol**	SBB	4,646.6	61.9%	-	-	-	-	-1.0%	-
Bristol**	BRL	644.7	-	7.2%	1.02	5.11%	32.1%	-	-
South West**	SWB	4,001.9	-	4.0%	0.22	9.34%	0.6%	-	-
Southern	SRN	6,434.2	69.8%	4.5%	-0.46	-10.07%	0.0%	24.4%	Baa3 (Stable)
Thames	TMS	18,945.1	77.5%	5.7%	1.07	2.50%	1.1%	3.9%	BBB (Stable) l Baa2 (Stable)
United Utilities	UUW	13,414.1	66.2%	8.5%	1.44	10.95%	10.0%	-1.7%	BBB+ (Stable)
Wessex	WSX	4,075.9	67.5%	6.5%	1.02	8.65%	5.3%	0.0%	BBB+ (Stable) l Baa1 (Stable)
Yorkshire	YKY	8,714.6	70.2%	6.9%	1.56	3.86%	2.4%	23.0%	Baa2 (Stable)

*Bazalgette Tunnel Limited (Tideway), the infrastructure provider responsible for the delivery of the Thames Tideway Tunnel project, is not included in the table as its activities and the way in which it is regulated differs to the rest of the industry.
**Following its acquisition by Pennon Group Plc in June 2021, on 1 February 2023 the activities of Bristol transferred to South West, resulting in a termination of Bristol Water Plc's licence. Separate reporting information continues to be provided for South West and Bristol and Ofwat maintains separate price controls. However certain financial metrics are also provided at a regulated entity level as appropriate for 2022-23.

Lowest Monitored Credit Rating as at 31 March 2023



The chart presents the lowest credit rating we monitor for licence purposes as at 31 March 2023, alongside the rating outlook*.

Credit ratings and outlooks reflect a credit rating agency's assessment of a company's or corporate family's relative credit quality or the credit risk of a financial obligation. An important part of the regulatory ring-fencing licence conditions is the requirement for companies to maintain an Issuer Credit Rating that is in the investment grade.

We expect companies to have headroom against the bottom of investment grade. If one or more of a company's monitored ratings is at the minimum for investment grade (currently BBB-/Baa3) and is put on negative outlook or review for possible downgrade, a cash lock-up clause in the licence will automatically be triggered. While in cash lock-up, the regulated company is unable to make certain payments, including dividends, without our approval.

Following consultation, in May 2023 we modified relevant licence conditions to strengthen the regulatory ring-fence protections. As a result, companies are now required to hold Issuer Credit Ratings from two credit rating agencies unless they have sought a dispensation from that requirement**, and with effect from 1 April 2025 the trigger for cash lock-up will be raised one notch to BBB/Baa2 with negative outlook.

On 23 November 2022 Moody's withdrew its senior secured debt rating of Bristol (Baa2 Positive) following the company's acquisition by the Pennon Group in 2021.

On 30 June 2023 S&P placed its BBB (class A debt) rating of Thames Water on CreditWatch negative.

*South West currently has a dispensation to this requirement. Its licence requires the company to instead annually certify that it would be able to maintain an investment grade credit rating, which was certified as at 31 March 2023. Under the licence the dispensation will expire on 31 March 2025 or, if earlier, the date on which the company procures an issuer credit rating.
**We have given consent to Hafren, Portsmouth Water and SES Water to hold only one credit rating, subject to conditions that reflect the individual circumstances of each company.

Borrowings as at 31 March 2023

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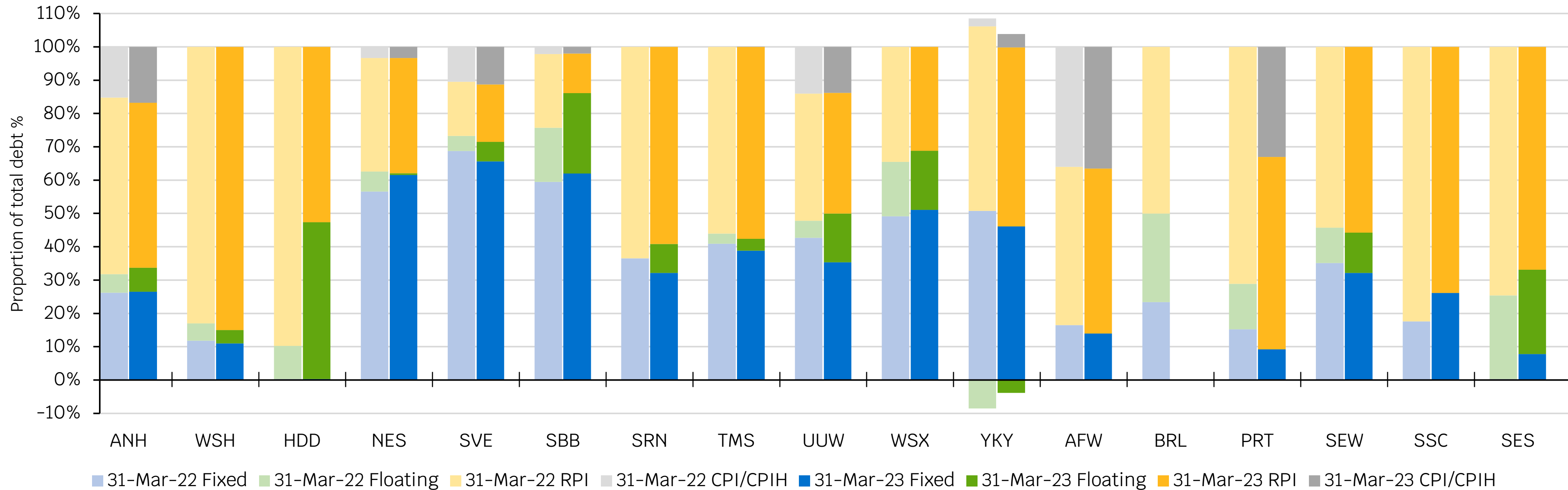

Total borrowing in the sector has increased from £60.6 billion as at 31 March 2022 to £68.3 billion at 31 March 2023*. The chart shows the composition of debt across the sector, split by fixed, floating and index-linked debt. As at 31 March 2023 53.2% of total borrowing across the sector was indexed to inflation (53.9% as at 31 March 2022).

Whilst most companies have raised new debt in the year, both to support investment programmes and refinance maturing debt, a key driver for the year-on-year increase in borrowings is the impact of high inflation.

All companies have debt instruments that are linked to inflation including index linked bonds and loans (and through interest swap arrangements). Therefore, the nominal value of total debt, and financing costs, will increase with rising inflation. The increase will vary across the sector depending on the proportion of debt that is floating or index linked.

Whilst indexation has increased the nominal value of debt, inflation has also contributed to the growth of RCV, which is also part of investors' return. The compound average annual growth rate of the RCV was 7% in the period 2020-23.

As at 31 March 2022 and 31 March 2023, Yorkshire reported negative floating rate debt. This is due to the nominal value of a swap from floating rate to index-linked (RPI) debt, which at the yearend exceeded the balance of other floating rate debt.

* Net debt has increased from £57.6 billion as at 31 March 2022 to £64.4 billion as at 31 March 2023. All figures exclude Tideway.

Regulatory Gearing as at 31 March 2023

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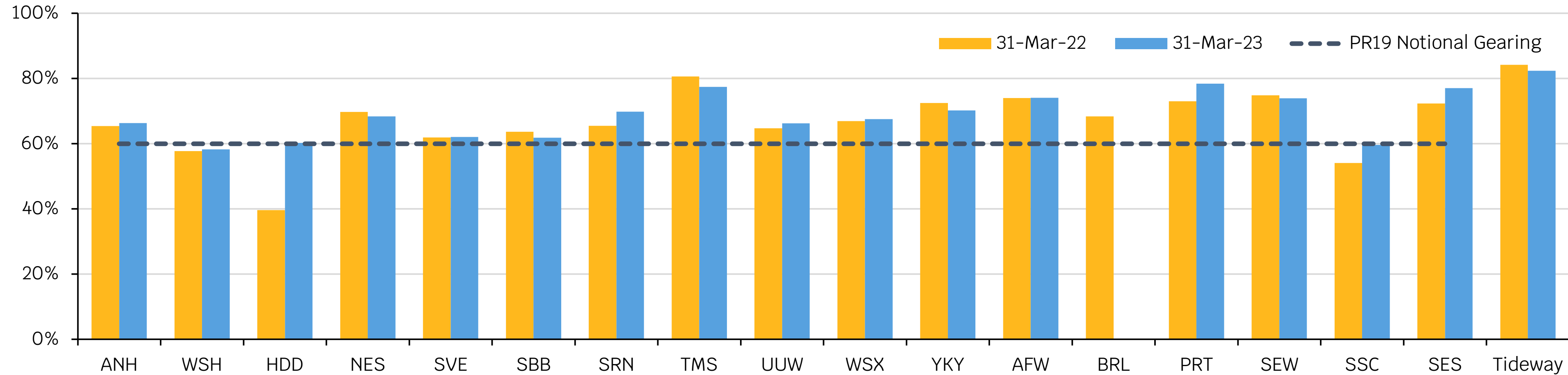

Regulatory gearing measures each company's reported net debt as a proportion of its Regulatory Capital Value (RCV) at year end. At PR19, for the notional company we assumed a capital structure in which 60% of RCV is funded by debt. In the final methodology for PR24 we have signalled our intention to adopt a gearing level of 55% for the notional capital structure.

Average gearing* across the sector as at 31 March 2023 was 68.2% compared to 66.2% as at 31 March 2022.

High levels of inflation provide benefits to equity investors, particularly where companies have a greater proportion of fixed-rate debt as the inflationary increase of the RCV can be greater than the increase to net debt. However gearing levels are also impacted by other factors such as the financial consequences of company performance and dividend payments. The equity injection at Thames Water supported a reduction in its regulatory gearing compared with the prior year, but this reduction in gearing may only be temporary as the new funds introduced are used to support the company's turnaround plan.

As at 31 March 2022 and 2023, six companies reported a gearing of 70% or more: Thames, Yorkshire, Affinity, Portsmouth, South East and SES.

Portsmouth reported the highest regulatory gearing at 31 March 2023 (78.4%) with the company raising additional debt in the period to finance the development of the Havant Thicket Reservoir. We note however that company gearing is expected to reduce with additional equity received and committed to be provided in 2023-24, alongside an uplift in its RCV relating to the Havant Thicket project.

Hafren reported the greatest increase in gearing (39.7% to 60.2%). Of the increase, the company has attributed 12.4 percentage points to post year end transactions relating to the movement of the company within the Seven Trent group in the year to 31 March 2022, with an expectation that gearing will remain below 65% throughout AMP7.

*Simple average
All sector references exclude the figures for Tideway.

Indicative Weighted Average Interest Rates as at 31 March 2023

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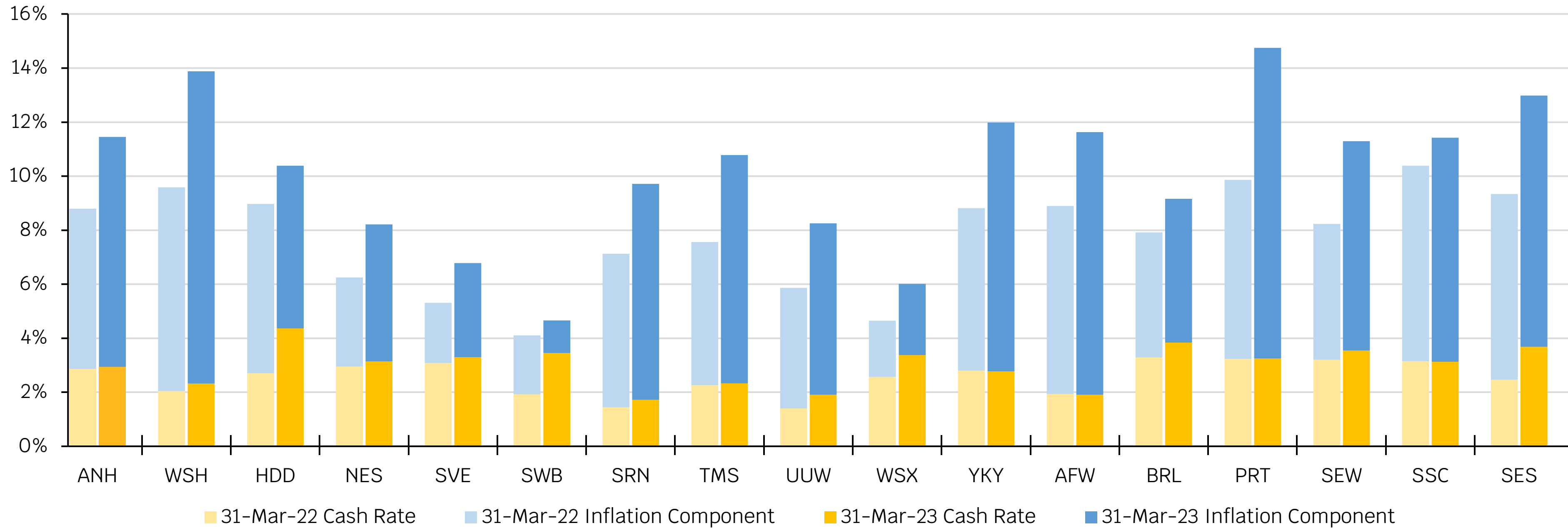

The chart presents the weighted average cash and nominal interest rates (cash rate plus inflation component) reported by the companies (calculated post hedging arrangements).

On a cash basis, companies have seen their rate increase in 2022-23 by between 0 and 1.7 percentage points, reflecting an increase in debt interest costs. The regulatory regime provides protection to companies and customers from changes in the market cost of debt through the cost of new debt indexation mechanism.

Outturn inflation was high in both 2021-22 and 2022-23 and well above the long term inflation assumption used in our PR19 determinations and to set the allowed return on debt. This impacts on the nominal rates illustrated in the chart.

The nominal and cash cost of debt varies between companies as a consequence of their financing choices. However, the impact of inflation on the accretion of index linked debt is broadly matched by the inflation of the RCV, subject to timing differences and differences in the specific inflation indices used for debt instruments and the inflation of the RCV.

Debt Maturity as at 31 March 2023

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Proportion of debt due within x years

Weighted average years to maturity

100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%

25
20
15
10
5
0

ANH WSH HDD NES SVE SBB SRN TMS UUW WSX YKY AFW BRL PRT SEW SSC SES

31-Mar-22 <1 yr
31-Mar-22 1<x<=2
31-Mar-22 2<x<=5
31-Mar-22 5<x<=20
31-Mar-22 >20 yrs
31-Mar-23 <1 yr
31-Mar-23 1<x<=2
31-Mar-23 2<x<=5
31-Mar-23 5<x<=20

Water companies typically raise debt with maturities that extend beyond the length of each price control, and this is supported by the regulatory regime.

Average years to maturity has fallen to around 11.9 years at 31 March 2023 from 12.5 years at 31 March 2022. Drivers for this reduction as reported by companies include the uncertainty and volatility created by the economic environment and to match investment programmes.

Refinancing requirements vary between companies depending on their debt maturity profile. Those companies with greater upcoming refinancing requirements and/or that have a higher proportion of floating rate debt are more exposed to interest rate rises and higher financing costs.

FFO to Net Debt as at 31 March 2023

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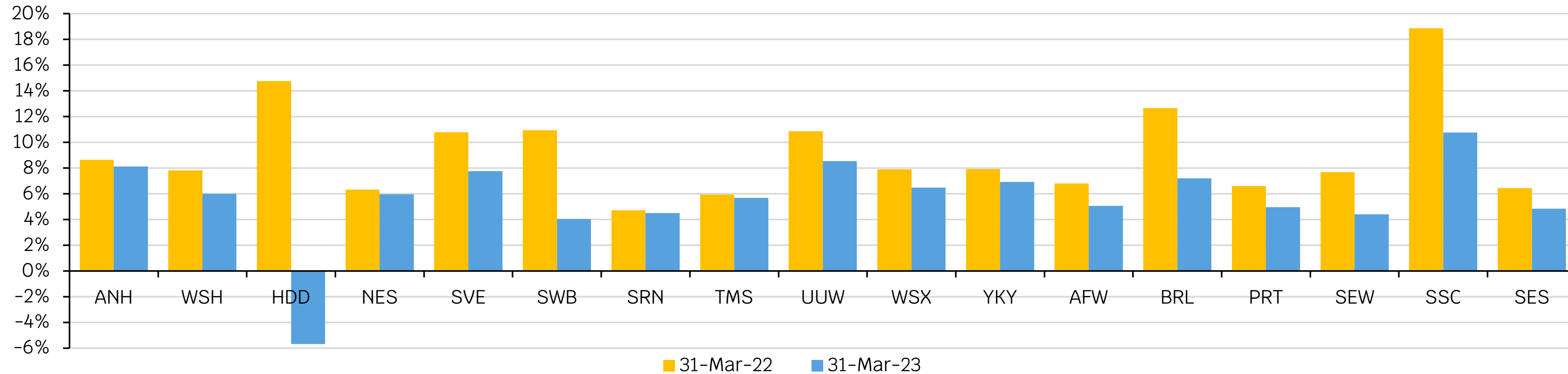

This metric shows the Funds from Operations (FFO), being the net cash generated from operating activities each year (excluding movement in working capital), that is available to meet net debt liabilities. All companies reported a deterioration in this metric compared to the prior year.

FFO has generally decreased this year as high outturn inflation, interest rate rises and underlying price increases (including for key inputs like power and chemicals) have increased companies' operating and finance costs. The lag in revenue uplift, which is indexed to November CPIH for the preceding year, also adding to the pressure on cash and some financial ratios to varying degrees in the short term. These issues should unwind over time as inflation levels return to more normal levels.

At the same time net debt has increased across the sector driven by both cash and non-cash impacts (namely debt indexation and swap accretion).

FFO can also be impacted by a range of factors including for example changes in consumer demand, investment profiles, cash collection and taxation, and as such companies will not have the same FFO or FFO/Net Debt metric.

Hafren reported a negative metric as at 31 March 2023, reflective of the operating loss generated in the year alongside the one-off repayment of a tax creditor balance in full during the year*.

South Staffs also reported a material decrease in this metric (8.1 percentage points), reflecting the company's higher operating and maintenance costs incurred in the year, one-off costs relating to a cyber-attack on its parent company, alongside increased finance costs on its largely long-term RPI linked debt.

*Without the one-off repayment, Hafren's FFO/Net Debt metric would have been -0.1% at 31 March 2023.

Adjusted Cash Interest Cover Ratio as at 31 March 2023

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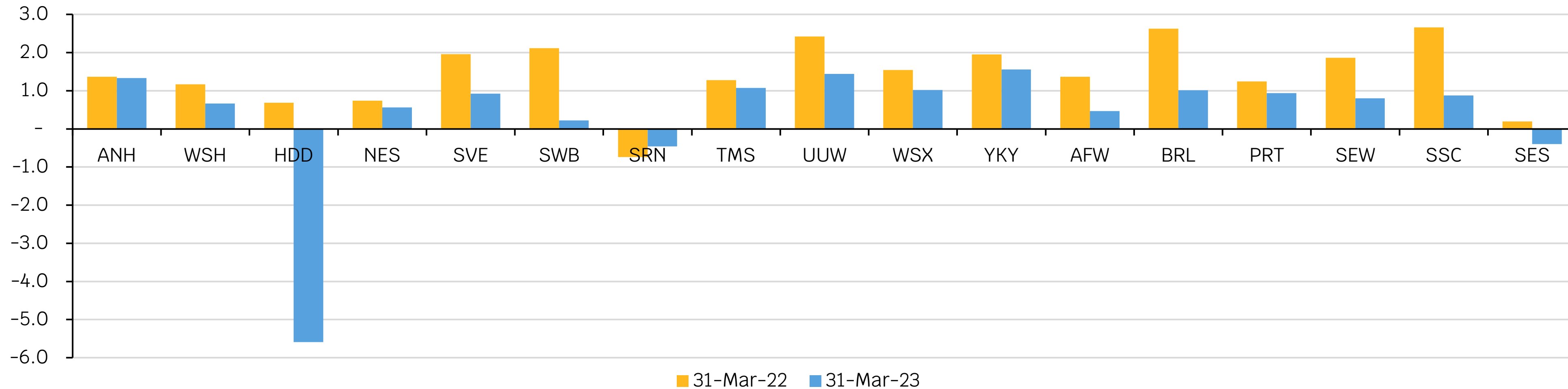

The Adjusted Cash Interest Cover Ratio (AICR) measures the scope to make interest payments after meeting costs that have been expensed (FFO) and the annual depreciation of the RCV (RCV run-off)*. The ratio is calculated by reference to cash interest paid in the period on borrowings (post the impact of hedging arrangements).

Nearly all companies have reported a deterioration in their AICR metric compared to prior year, reflecting generally a reduction in available FFO and for some companies' higher interest paid on a cash basis with recent inflation volatility and rate rises, together with a rise in regulatory depreciation with an uptick in investment as profiled over the AMP.

Hafren, Southern and SES Water all reported a negative ratio as at 31 March 2023, with each reporting negative funds available to service interest costs after accounting for RCV run-off. Hafren's metric being impacted by a tax creditor repayment as reported on the previous page**.

There are a range of factors that can impact on AICR, some specific to the circumstances of each company. It is important that companies maintain adequate levels of financial resilience to manage short-term cashflow impacts, such as from high inflation, which may smooth out over time.

*The RCV run-off figures are published by Ofwat each year. AICR is a more conservative measure than the unadjusted interest cover and provides an indication of coverage assuming companies could not reduce RCV run-off. The AICR has been reported above applying the RCV run-off figures as provided by Ofwat to each company.

**Excluding the tax creditor repayment AICR is -3.3 as at 31 March 2023.

Retail profit margin for the year ended 31 March 2023

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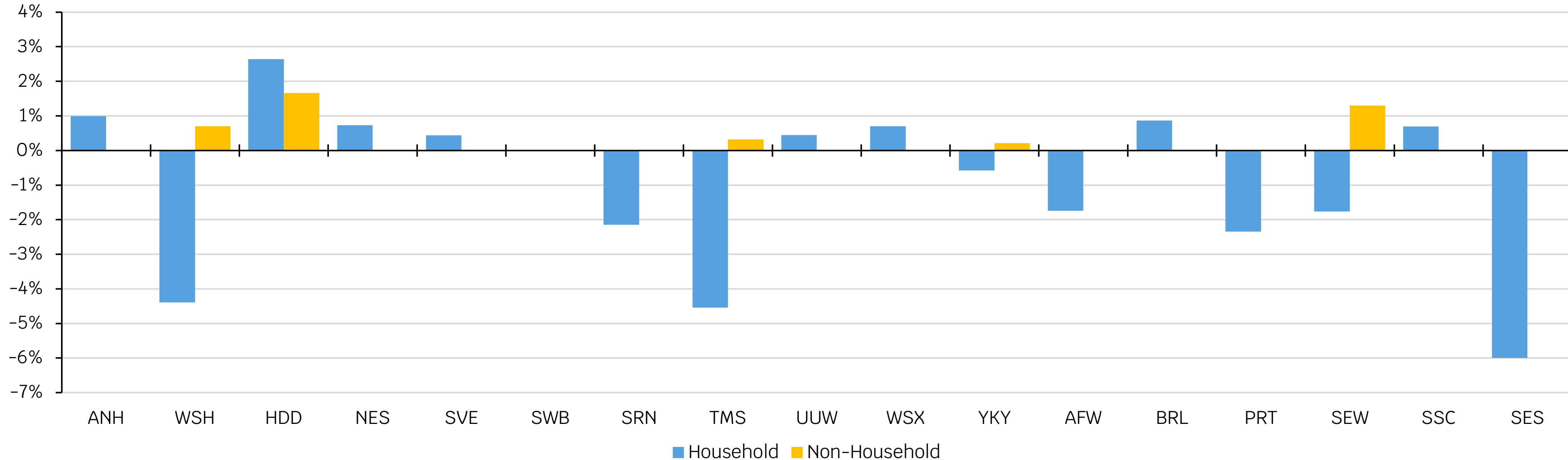

The average (household) retail margin for 2022-23 was -0.94% (simple average, 2021-22 -0.44%) compared with a net retail margin of 1% set at PR19*. Several companies reported a loss across their retail business, citing reasons including:

- Higher than expected bad debt charges related to COVID and the impact of the cost-of-living crisis, notwithstanding additional support companies are providing for customers.
- Inflationary pressures across the supply chain rose as employment costs impacted margins.

Thames Water saw its retail margin decline from -3% to -4.5% as the business continued to invest to seek to improve customer service metrics. SES Water had the lowest retail profit margin at -6.0% as they also made investments in enhancing customer service and debt collection capabilities (including higher costs associated with the implementation of a new billing system) whilst also been negatively impacted by an increase in bad debts been written off.

*The non-household retail market opened to competition in April 2017, following which all companies except for Hafren, Dŵr Cymru and South West Water have exited the non-household retail market.

Return on Notional Regulatory Equity (RoRE) 2022-23

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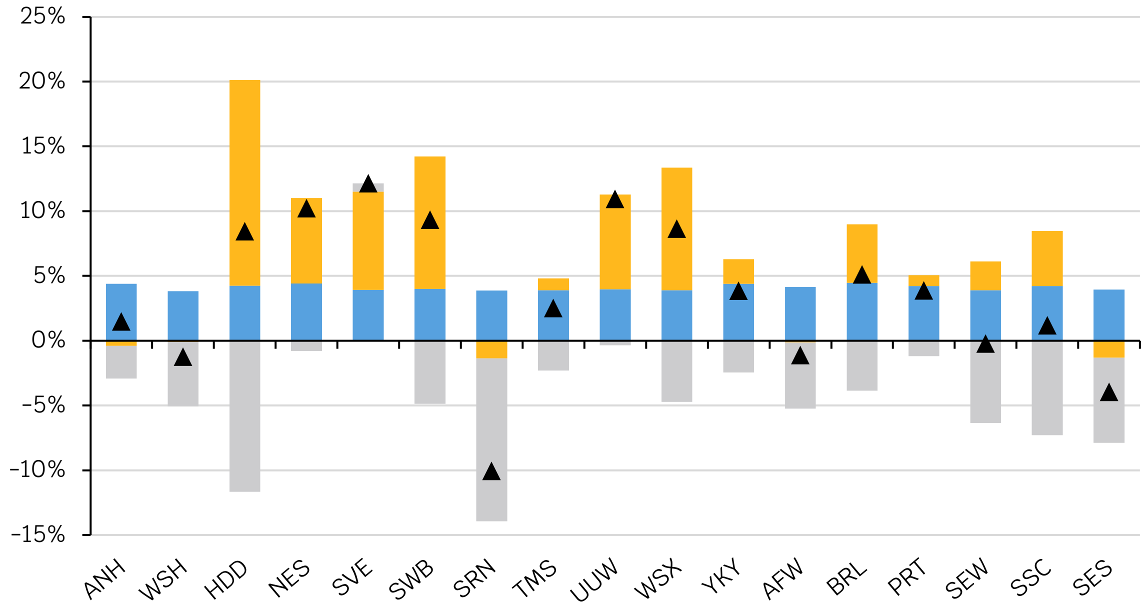

Financing and Operational Performance	High	Low	Simple average 2022-23	Simple average AMP to date
Base return*	4.47%	3.83%	4.10%	4.08%
Financing performance	15.86%	-1.37%	4.02%	1.51%
Operational performance	0.64%	-12.57%	-4.53%	-2.78%
RoRE	12.14%	-10.07%	3.60%	2.81%

We set an allowed return on regulatory equity (RoRE) for a notional capital structure that remunerates investors for the risks of their investment.

We expect efficient companies, performing in line with their determination, should be able to earn their allowed return on regulatory equity (Base return*). There is scope for companies to achieve a higher return where they outperform their performance commitments and cost allowances including totex, cost of debt and retail.

This chart compares the Base return determined at PR19 for each company to the RoRE reported for 2022-23, calculated by reference to the notional capital structure. It shows the overall contributions to the net outturn RoRE driven by financial and operational performance.

The table presents the range and average impact that financing and operational factors have had on the Base return this year, alongside the average for the year and the average for AMP7 to date.

For 2022-23, seven companies reported a RoRE above their Base return with Severn Trent reporting the highest at 12.14%.

Dŵr Cymru, Southern, Affinity, South East and SES Water all reported a negative RoRE.

We comment further on the financial and operational performance of the companies on the following pages.

*The base return on regulatory equity varies between companies for the following key reasons; different speeds of transition to CPIH indexation at PR19, variations in the impact of the retail price control margin, specific company adjustments and reflecting the allowed return on equity set by the CMA for companies that appealed the PR19 final determination.

RoRE – Financing Out / (Under) Performance 2022-23

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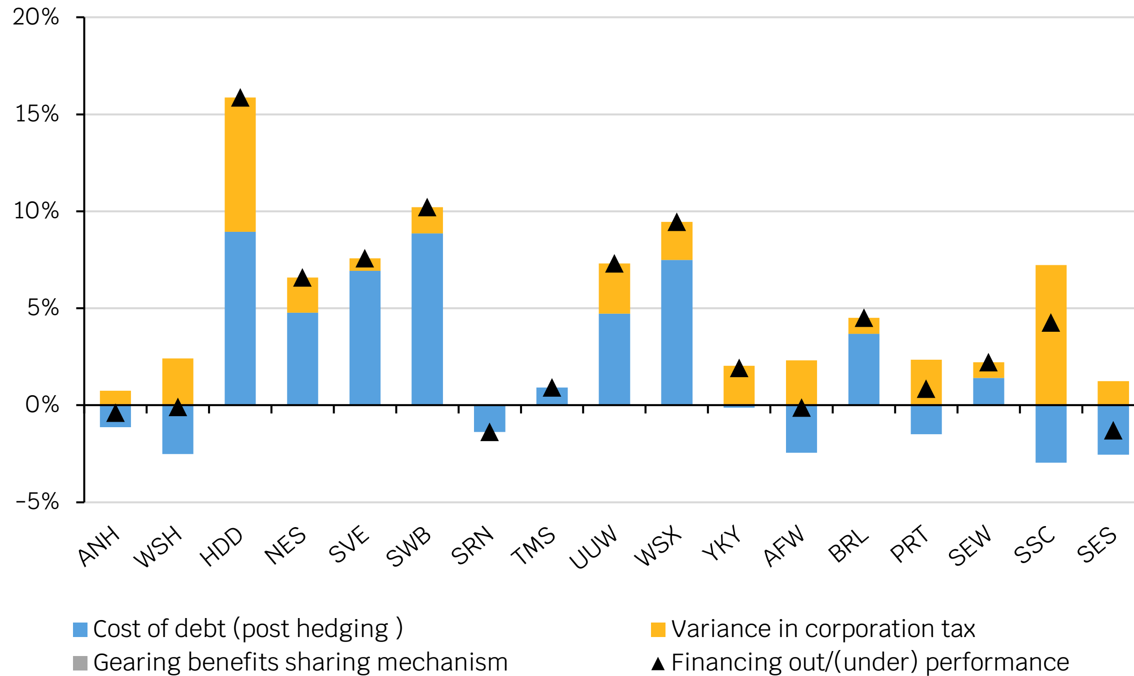

Financing Out /(Under) Performance	High	Low	Simple average 2022-23	Simple average AMP to date
Cost of debt (post hedging)	8.95%	-2.97%	1.95%	0.48%
Variance in corporation tax	7.23%	0.00%	2.07%	1.04%
Gearing benefits sharing	0.00%	0.00%	0.00%	-0.01%
Financing performance	15.86%	-1.37%	4.02%	1.51%

Cost of debt (post hedging): Cost of debt is considered in real terms and compares companies' cost of debt (nominal) adjusted for outturn inflation (CPIH average) to their allowed cost of debt (real).

Drivers of financing performance include:

- The cost of a company's debt in comparison with the allowed cost of debt.
- Outturn inflation compared to the long-term assumptions used to determine the real cost of debt allowance.

Companies with a greater proportion of fixed rate debt typically report a lower interest expense (and greater outperformance) in a high inflation environment, such as Northumbrian, Severn Trent, South West, and Wessex.

Companies with a greater proportion of index-linked liabilities, such as Dŵr Cymru, Affinity, Portsmouth, South Staffs and SES Water, typically report a lower benefit or underperformance due to the impact of inflation indexation and accretion increasing financing costs.

Tax: The majority of companies reported outperformance with tax payable being less than the tax funded in their final determination.

Outperformance has been driven by a range of factors including continued lower than assumed taxable profits and variation in capital allowances (with super deductions and accelerated expenditure).

Gearing outperformance sharing mechanism: High inflation meant that the outturn cost of debt (stated in outturn nominal prices) was higher than the nominal cost of equity (calculated based on a long term inflation figure of 2%). We will consider further whether the calculation on these terms is consistent with the intended operation of the mechanism as part of our decisions at PR24.

RoRE – Operational Out / (Under) performance 2022-23

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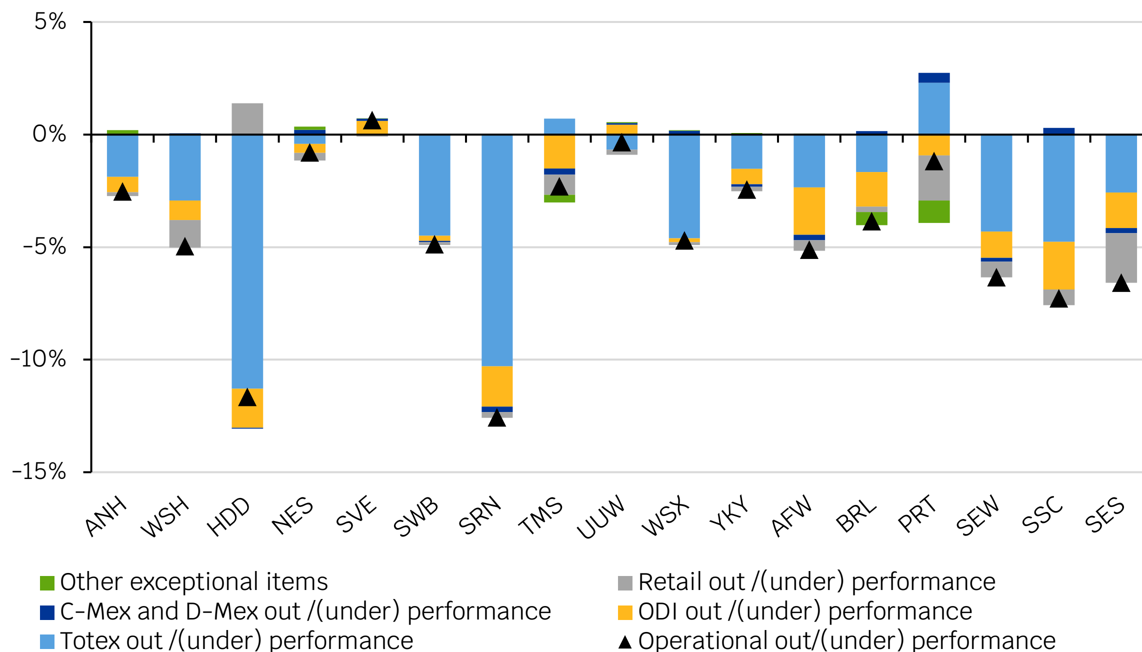


Operational Out/(Under) performance	High	Low	Simple average 2022-23	Simple average AMP to date
Totex out / (under) performance*	2.31%	-11.29%	-2.98%	-1.33%
ODI out / (under) performance	0.59%	-2.13%	-0.97%	-0.65%
C-Mex & D-Mex out / (under) performance	0.43%	-0.28%	0.01%	0.00%
Retail out / (under) performance	1.40%	-2.21%	-0.50%	-0.56%
Other exceptional items	0.17%	-0.98%	-0.08%	-0.24%
Operational performance	0.64%	-12.57%	-4.53%	-2.78%

*Totex out/underperformance is calculated after adjusting for timing differences and the company sharing ratio with customers.

Totex: For 2022-23, most companies reported an overspend against allowed totex for a range of reasons.

Companies have cited that high levels of inflation have impacted on totex performance due to rising input costs, alongside underlying price increases including for power, chemicals and material.

Other reasons include cost overruns, acceleration of spend and investment above determination to for instance address operational performance or events arising in the year.

Hafren's underperformance reflects the relative impact of higher energy costs, and additional investments, on regulated equity.

Southern Water's totex was impacted by additional operational costs incurred in the year, including as a result of its transformation programme to improve operational performance

Outcome delivery incentives (ODIs): Equity returns are impacted by whether companies meet performance commitments set at PR19.

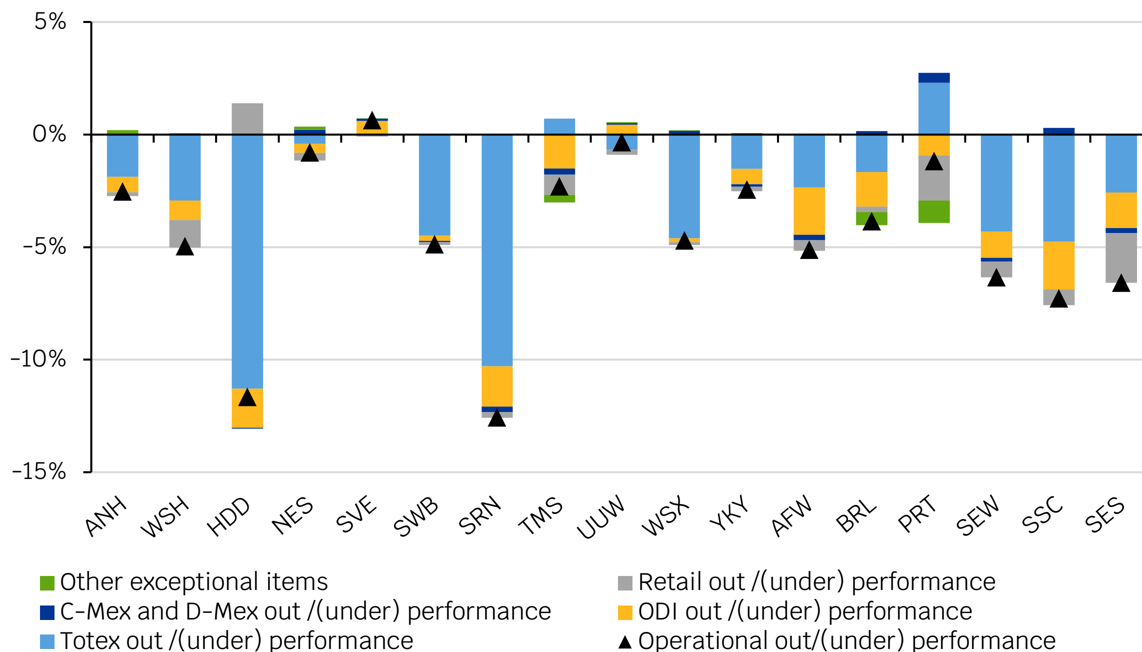
The actual reward or penalty that companies receive may differ to that reported following Ofwat's 2022-23 in-period ODI assessment process.

For 2022-23 nearly all companies underperformed, and after taking account of reported performance against their Per Capita Consumption (PCC) performance commitment (with companies reporting changes to household consumption following the pandemic as a key driver).

Companies' performance against certain expenditure allowances, ODIs, and key performance metrics in 2022-23 is also set out in the Water Company Performance Report. **

** Both the WCPR and in-period outcome delivery incentives draft determinations for 2022-23 were published on 26 September 2023. We highlight that in reporting and presenting Totex and ODI performance, this report will differ to the WCPR in some areas, namely due to the inclusion of certain additional expenditures such as business rates and the impact of the PCC performance.

RoRE – Operational Out / (Under) performance 2022-23



Operational Out/(Under) performance	High	Low	Simple average 2022-23	Simple average AMP to date
Totex out / (under) performance*	2.31%	-11.29%	-2.98%	-1.33%
ODI out / (under) performance	0.59%	-2.13%	-0.97%	-0.65%
C-Mex & D-Mex out / (under) performance	0.43%	-0.28%	0.01%	0.00%
Retail out / (under) performance	1.40%	-2.21%	-0.50%	-0.56%
Other exceptional items	0.17%	-0.98%	-0.08%	-0.24%
Operational performance	0.64%	-12.57%	-4.53%	-2.78%

*Totex out/underperformance is calculated after adjusting for timing differences and the company sharing ratio with customers.

Retail: Retail activities include the provision of customer services, managing bad debt and meter readings. We set separate price controls for companies' residential retail activities, and there is no automatic indexation of allowed revenue within the price control period nor sharing with customers of any retail expenditure variance where incurred.

Whilst most companies are not reporting unexpected or material weakening in cash collections, bad debt provisioning at levels higher than allowed in the final determinations has been impacted by ongoing cost of living pressures.

Other drivers reported include investment on service improvement, inflationary increases of employment and other costs, and increased spend to catch up on services post COVID-19 restrictions.

C-Mex and D-Mex: These are customer / developer measures of experience introduced in AMP7. Overall out and under-performance adjustments are calculated based on the performance of companies relative to one another.

Other: This reflects exceptional items impacting returns. For Thames this is the impact of pollution financial penalties and customer compensation, for Bristol the impact of integration costs following the acquisition by Pennon and bond redemptions costs and for Portsmouth additional costs relating to its defined benefit pension scheme.

RoRE – Average AMP to date

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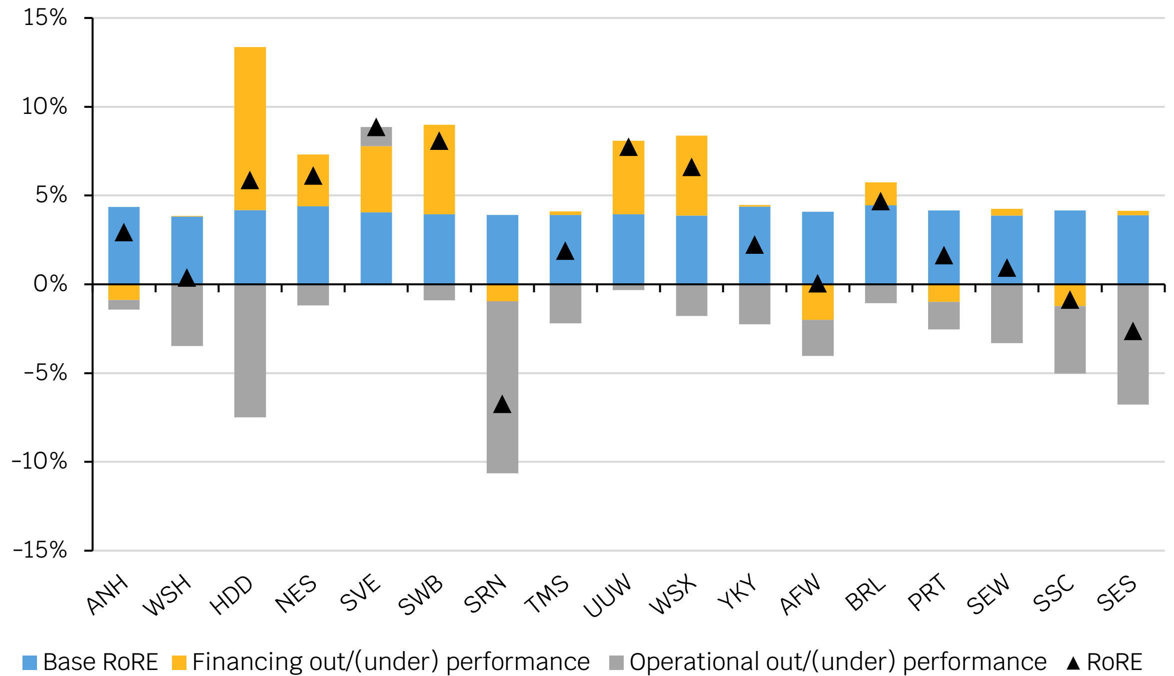


Financing and Operational Performance	High	Low	Simple average AMP to date
Base	4.45%	3.81%	4.08%
Financing performance	9.18%	-2.00%	1.51%
Operational performance	1.08%	-9.68%	-2.78%
RoRE	8.87%	-6.74%	2.81%

This chart compares the average Base return determined at PR19 for each company to the average return on regulatory equity (RoRE) reported for 2020-21 to 2022-23 by reference to the notional capital structure.

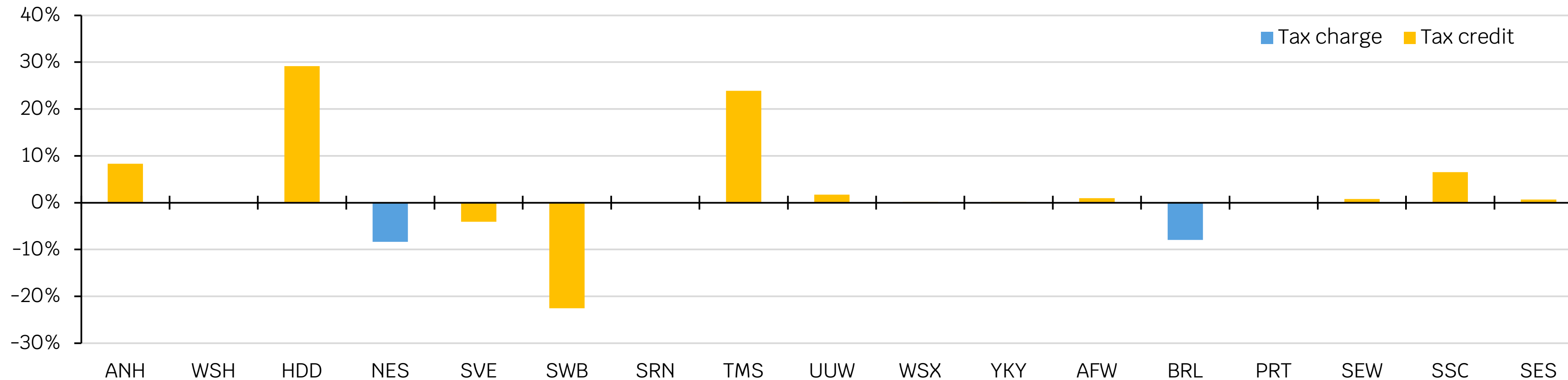
The table presents the range and average impact that financing and operational factors have had on the Base return.

Overall, performance of the sector as a whole in the first three years of the price control has resulted in outturn returns that are below the base allowed return on equity, reflecting lower than expected performance.

Seven companies have reported a RoRE above their Base return, with Severn Trent reporting the highest at 8.87%, with six companies reporting financing outperformance that has more than offset operational underperformance.

However, three companies; Southern Water, South Staffs Water and SES Water all reported a negative RoRE.

Effective Tax Rates as at 31 March 2023



Effective tax rate is the current corporation tax charge/credit recognised in the accounts of the appointed business as a percentage of the profit/loss (before tax and fair value movements) for the appointed business. Tax charges/credits can also reflect receipts from and payments to other group companies for tax losses surrendered.

As well as corporation tax on profits, companies incur a range of taxes, charges and levies, including business rates, employment taxes and environmental taxes.

For 2022-23, only 3 companies reported a tax charge. Companies in general reported lower or no taxable income due to a range of factors including:

- Tax reliefs in excess of depreciation charged in the accounts, including a new first-year super-deduction capital allowance which was introduced in the Finance Act 2021 to encourage and support UK investment*.
- Lower profits.
- The availability of tax relief on pension contributions paid in the year.
- Some income not being taxable.
- Fair value losses on financial instruments

Where actual corporation tax or capital allowance rates differ to those included in our determinations, companies and customers are protected by the tax reconciliation mechanism which adjusts the allowances for the any changes in headline corporation tax rates that apply in the period, any adjustments will be made in the next price review.

* HM Treasury, from 1 April 2021 until 31 March 2023 companies can claim a new 130% first-year capital allowance for qualifying plant and machinery assets and a 50% first-year allowance for qualifying special rate assets.

Financial Derivatives (total mark-to-market) as at 31 March 2023

Company	Total MtM* £million at 31 March 2023	% of RCV at 31 March 2023	% of RCV at 31 March 2022
ANH	-696.9	7.0%	12.4%
WSH	-434.6	6.1%	9.2%
HDD	0.0	0.0%	0.0%
NES	-87.1	1.7%	1.4%
SVE	72.0	-0.6%	-0.2%
SBB	47.9	-1.0%	-
SWB	-	-	-0.5%
BRL	-	-	0.0%
SRN	-1,571.4	24.4%	38.0%
TMS	-738.8	3.9%	9.6%
UUW	224.3	-1.7%	-2.6%
WSX	0.0	0.0%	0.0%
YKY	-2,006.2	23.0%	38.0%
AFW	-16.5	1.0%	2.7%
PRT	0.0	0.0%	0.0%
SEW	0.0	0.0%	0.0%
SSC	-1.6	0.3%	0.0%
SES	0.0	0.0%	0.0%

MtM stands for mark-to-market
Table reflects mark-to-market values reported in Table 4I.

Cells highlighted in orange reflect in the money/asset positions.
Cells highlighted in grey where swap MTM liability is greater than 5% of RCV.

* Derivative financial instruments held by the companies include index-linked inflation swaps, interest rate and cross currency swaps and a small proportion of energy hedges.

Companies may choose to use financial instruments, namely derivatives or swaps, to manage the impact of macroeconomic variables such as interest rates and foreign exchange rates, on their cash interest payments. The value of these instruments can fluctuate materially with movements in financial markets and create volatility.

With both RCV and revenue linked to inflation, several companies have inflation-linked swap portfolios, under which typically a floating or fixed interest rate is swapped to a rate indexed to inflation.

As at 31 March 2023, higher future interest rate expectations have, overall, resulted in reduced liabilities at year end, than in recent reporting periods. The table opposite presents the total mark-to-market liability or asset of all financial derivative instruments* reported as at 31 March 2023 and calculated as a percentage of RCV. An out-of-the-money (liability) position arises where the net present value of the future expected payments under a swap is greater than the receipts.

While balances change over time and do not necessarily reflect future repayment, material liabilities can impact on financial resilience as they can affect credit metrics and ratings, and depending on the arrangement can require the company to pay down some indexation accretion ahead of maturity.

In our 2021 discussion paper on financial resilience and our 2022 decision document, we highlighted the practice used by some highly geared companies to use derivatives as a means to increase levels of borrowing over time or to boost short-term financial ratios. We have strengthened the regulatory reporting requirements to require companies to provide greater detail about their swap portfolios in their Annual Performance Reports.

Our revisions to reporting arrangements increases transparency and provides us and stakeholders with an improved understanding about the risks arising from companies' swap portfolios. The companies with the greatest exposures that will mature in the next 5 years are Yorkshire and Dŵr Cymru with 3.9% and 3.1% of mark-to-market as a percentage of RCV maturing, respectively. Insight into the proportion of swap liabilities maturing in the short- to medium-term is important as it enhances our understanding of potential swap-related financial resilience risks.

Defined Benefit Pension Schemes as at 31 March 2023

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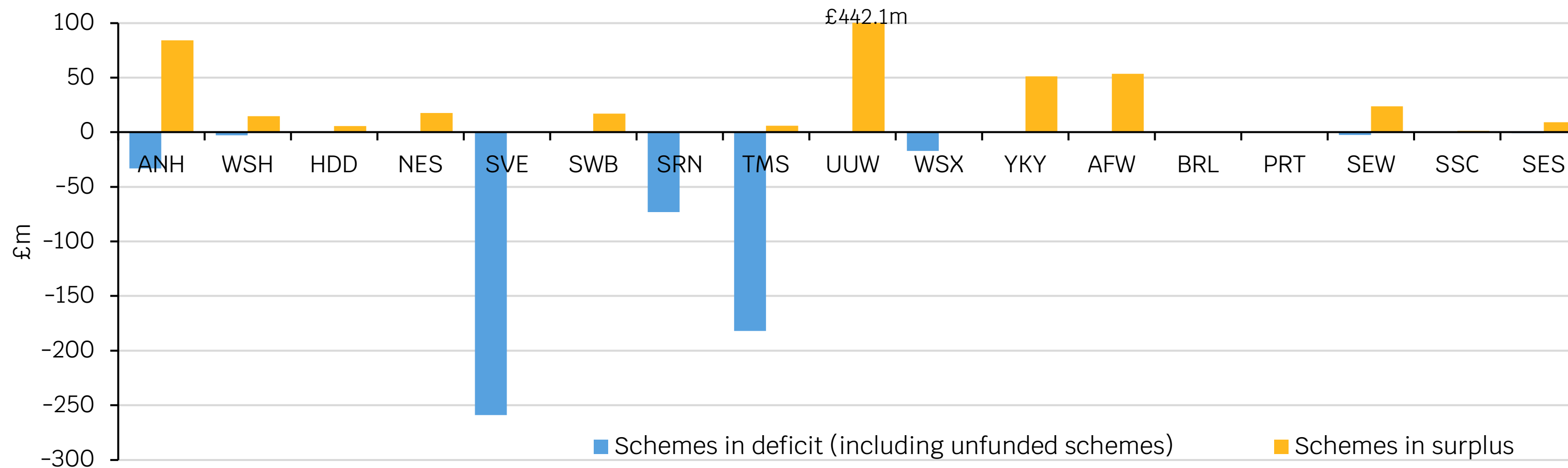

Deficit repair payments 2022-23	
ANH	£21.8m, including prepayment of an October 2023 contribution
NES	£23.4m
SVE	£99.8m, includes a payment of £34.7m that was deferred to April 2022
WSX	£16.6m, reflecting a special contribution made on 1 July 2022
AFW	£1.6m
SEW	£5.3m

All companies in the sector* support one or more defined benefit pension scheme which present long-term financial obligations.

This year companies have generally seen a decrease in their scheme liabilities driven by market movements namely higher interest rate expectations (increasing the discounts rates used to calculate the present value of the estimated future cash outflows that will be required to meet the pension obligations), alongside a decrease in long term inflation expectations since the previous year end. For some companies however this has been partly or fully offset by a fall in the value of their scheme assets in a higher yield environment.

A scheme's pension liability can be calculated using different methods, used for different purposes. The accounting valuation as reported may differ to the valuation that drives a company's funding commitment (which is typically carried out every three years). If on this funding basis the scheme is in deficit, a recovery plan must put in place to repair that shortfall which often involves the company paying an additional cash contribution (which are the responsibility of, and funded by, the shareholders).

Several companies have reported actions taken in 2022-23 to de-risk their schemes and support reaching fully funded positions such as buy-in exercises with insurance companies, acceleration of deficit repair contributions or lump sum payments, including Hafren, South East Water, SES Water and Wessex.

We also note an improvement in the information provided and transparency in pension reporting this year.

*Bristol Water - The pension asset (surplus) remained with the company and did not transfer to South West Water as part of the merger.

Portsmouth Water - The pension scheme has closed (to the future accrual of benefits with future contributions payable by the company expected to cease). The company does not recognise any calculated net pension surplus on its balance sheet. The closure resulted in a 'one-off' settlement cost of £453k reported as an 'exceptional' expense in 2022-23.

Yorkshire Water and South Staffs – The assets and liabilities of the schemes to which the companies are participating employers are reported in the accounts of the parent undertaking and not included on the company balance sheets.

Dividend policies, application and reporting

Dividend Yield

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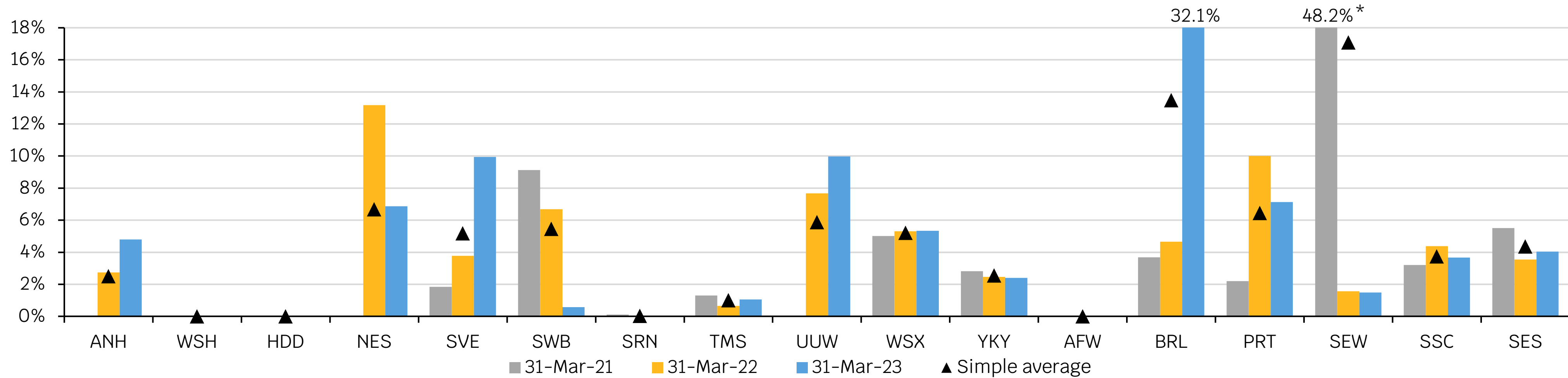

The total dividend declared in respect of the appointed activities across the sector in 2022-23 was £1,421.8 million. There was variation in the dividends declared by companies, with reported dividend yield in the range 0% to 32%**.

- Anglian, Severn Trent, United Utilities, South Staffs and SES Water declared a dividend that is explained as relating to performance across multiple years.
- Hafren and Affinity did not declare a dividend in the year to support future investment. Southern Water had determined not to pay a dividend with the company also in cash lock-up under its financing arrangements. Dŵr Cymru did not pay a dividend as it does not have equity shareholders.
- Bristol Water paid a dividend of £64.1 million, of which £61.1 million was paid to simplify the financing structure of the Bristol Water corporate group as part of its acquisition by Pennon Group, and in readiness for the transfer of business from Bristol Water to South West (excluding this distribution, dividend yield was 1.5%).

Companies are expected to set out how their dividend policies and decisions take account of delivery for customers, the environment and other obligations, the future investment needs of the regulated company and its financial resilience over the long term.

For 2022-23 we have carried out an assessment of companies' reported dividend policies and their application as summarised on the following page.

* In 2020-21 South East paid a dividend of £136 million which was used in full to repay an intercompany loan due to the company.
**Dividend yield is calculated based on regulatory equity being the RCV published in our annual update less reported net debt (the RCV published in our annual update is the RCV stated in the PR19 determinations updated for outturn inflation), and on dividends paid from the appointed business. The regulated companies may decide to pay a dividend in respect of its non-appointed activities. Dividends paid in respect of non-appointed activities in 2022-23 totalled £24.7 million.
PRT dividend is based on regulatory equity reported at year end, and therefore does not reflect the additional equity committed to be provided in 2023-24 or the anticipated uplift in RCV relating to the Havant Thicket project.

Our assessment of dividend policies and their application

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Overall, this year we have seen an improvement in companies' articulation and transparency of dividend policies and decisions, with companies setting out and quantifying the components of their dividend and how they consider the amount to be supported and impacted by out and underperformance.

There are some companies that did not fully meet our expectation in explaining dividend decisions and payments. We will be providing and publishing our feedback to all companies on our assessment of their dividend policy and its application for 2022-23. In summary, some of the key areas we expect to see improvement are:

- At PR19 we set an expectation that a dividend yield of up to 4% was a reasonable level in the context of a company with little real RCV growth to support and that is performing in line with our determination in 2020-25. Several companies continue to refer to a 4% dividend yield as the base yield on which their dividend choice should be made. This is inconsistent with the guidance we have set out which requires companies to consider their own choice of dividend yield, based on their own circumstances and financing needs.
- In determining dividend payments, adjustments for performance is often in direct refence to ODI reward or penalty. We expect companies to better explain how they have taken in to account and reflected overall performance and the need to maintain adequate levels of financial resilience over the long term.
- In setting out the basis for dividend decisions, some companies attributed weight to areas of outperformance that will have been driven to some extent by external factors such as inflation and tax. We have been clear that we expect benefits accruing to equity that are not linked to performance delivery for customers and the environment, such as the consequences of high inflation on fixed rate debt and gearing, should be retained or reinvested and not distributed as outperformance.
- Some companies have referenced levels of potential dividends supported by outperformance that have not been distributed and which could potentially be paid out in future years. We expect the Board of each regulated company to carefully consider financial performance and position, and whether it is appropriate to distribute these amounts, when making decisions on dividends in future years.
- Some companies, reported that dividends declared, fully or in part, are to service wider group obligations and / or head office costs. We reiterate that it is not sufficient for companies to justify their dividend payments on the basis of meeting holding company obligations, and without also considering performance of the regulatory company to support that dividend decision.
- Where dividends have been paid from the non–appointed business, companies have explained based on profits generated after tax. Nonetheless companies could be clearer in how they have considered the reasonableness of their total dividend in the context of the financial position of the regulated company as a whole.

In March 2023 we published our decision to modify the dividend policy licence condition in each water company's licence so that our expectations and licence are aligned. These modifications were made effective from 17 May 2023, and in June 2023 to help companies understand our expectations we also finalised our guidance on factors we consider in assessing dividends. Companies need to ensure they fully align with the licence requirement and published guidance.

Long term viability statements

Long Term Viability Statements as at 31 March 2023

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All companies are required to provide a statement on their long-term viability (the LTVS) either in their APRs and/or annual financial statutory reports. The LTVS is a key piece of information, and it is important that disclosures are clear and specific to each company.

Our expectation is for companies to provide a LTVS that is sufficiently transparent and referenced to allow the reader to understand the basis on which the Board has reached its conclusions, and that evidences the company has carried out a robust assessment through stress testing its resilience under its actual capital structure to those risks that could threaten viability.

We assess the quality and transparency of each company's LTVS across several areas, based on our expectations as set out in IN 19/07, reporting requirements and recognised good practice. We have a particular focus on those companies categorised as higher priority for financial resilience.

Our assessment of the quality of each company's disclosures, and commentary in this report, is not intended to provide any assurance or confirmation of the viability or going concern of the companies. Our review and subsequent feedback is designed to strengthen consistency and transparency in reporting.

For 2022-23, the look forward assessment period selected ranged between 7 and 12 years, with companies noting greater uncertainty in assessing viability beyond the end of the next price setting period in 2030 and whilst business plans for AMP8 are being developed.

All regulated companies made a positive Board confirmation i.e., that the Board, based on their assessment, has a reasonable expectation that the company will be able to continue in operation and meet its obligations and funding needs over that period.

This year there has been an improvement overall in the clarity of, and explanation provided in, statements, with companies reflecting on feedback previously given.

The areas where we continue to see the least consistency in reporting are companies' referencing of viability measures considered, explanation of the stress testing scenarios, namely the sensitivities modelled to test their base case which we expect to be set out, and the results of that testing under each scenario (recognising that the level of detail will be relative to the findings and considering commercial sensitivities).

Long Term Viability Statements as at 31 March 2023

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Several companies' viability conclusions are underpinned by equity commitments made, and/or include key assumptions regarding the availability of new equity and shareholder support in downside scenarios, which we continue to monitor. Such assumptions, and for mitigation in general, will be an area of focus in our review of financial resilience of AMP 8 business plans.

Few companies referred to the potential of cash lock-up as a consequence of Ofwat’s licence modification to increase the trigger level (effective from April 2025) despite reporting the risk of credit metric downgrade, and many companies continued to cite nonpayment of dividends as an available mitigation in those scenarios.

All companies will be given feedback on their 2022-23 LTVS.

Appendices

Appendix 1: Glossary and Abbreviations

Abbreviation	Definition	Abbreviation	Definition
AICR	Adjusted Interest Cover Ratio (cash). Measures scope to make interest payments after meeting costs that have been expensed and assuming RCV run-off cannot be reduced.	**PR24**	The price review which covers the period 2025-2030 (1 April 2025 to 31 March 2030).
AMP	Asset Management Plan, price limit periods in the water sector. AMP periods are five years in duration and begin on 1 April in the years ending in 0 or 5. The current period (2020-25) is commonly known as AMP 7 because it is the seventh price review period since privatisation of the water industry in 1989.	**RAGs**	Regulatory Accounting Guidelines.
APR	Annual Performance Report, published by the appointed companies.	**RCV**	Regulatory capital value, presents a measure of the capital base of a company when setting price limits. The RCV is inflated each year to maintain the RCV at current prices.
Bioresources	Wastewater sludge transport, treatment, recycling and disposal.	**RCV run-off**	The annual depreciation of the RCV (the element of RCV that is recovered in any one year).
bps	Basis points, one hundredth of a percentage point.	**Real**	Interest rates, prices and costs are said to be in real terms if they exclude the impact of inflation e.g. the current value adjusted for inflation.
CPI/CPIH	Consumer Prices Index/ Consumer Prices Index including owner occupiers' housing costs.	**Regulatory equity**	RCV less net debt
FD	The final determination of allowed revenues and costs set out by Ofwat.	**Regulatory gearing**	Net debt divided by RCV
FFO and FFO/Net Debt	Funds from Operations is cash generated from operating activities adjusted to remove changes in working capital, less net interest and tax paid in the period. The FFO ratio measures companies' debt burden in relation to operational income. This is a key financial ratio for rating agencies, although each rating agency may make specific adjustments to FFO and/or net debt for its calculations.	**RoRE**	Return on Regulatory Equity
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.	**RPI**	Retail Price Index
Nominal	Interest rates, prices and costs are said to be in nominal terms if they include the impact of inflation e.g. the current value without taking inflation or other market factors into account	**Securitisation**	A company adopting a set of financing arrangements with highly covenanted features
Notional structure	We set a notional capital structure that is consistent for all companies with a proportion of debt to total regulatory capital at 60% for PR19.	**Totex**	Total expenditure, allowed in, or reported against, a price determination
pps	Percentage points	**WASC**	Water and wastewater company
PR19	The price review which covers the period 2020-2025 (1 April 2020 to 31 March 2025).	**WOC**	Water only company

Appendix 2: Company Glossary

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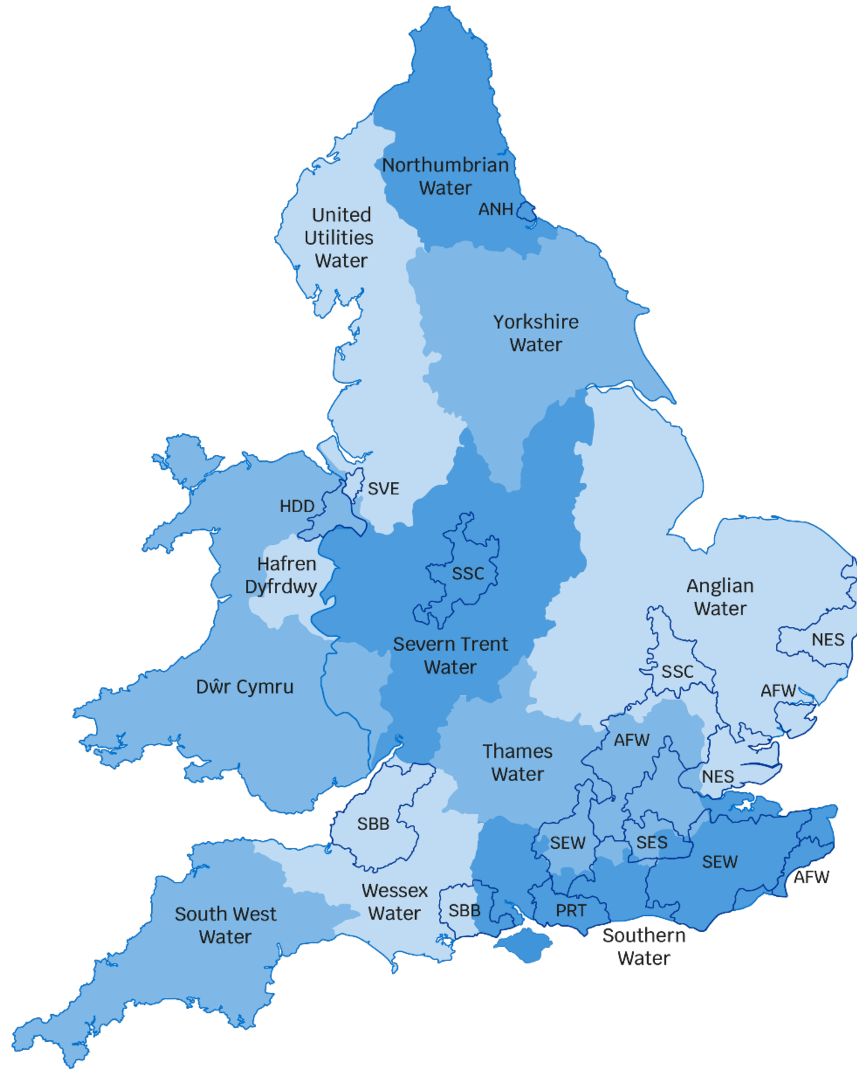

Water and wastewater companies		
Anglian	ANH	Anglian Water Services Limited
Dŵr Cymru	WSH	Dŵr Cymru Cyfyngedig
Hafren Dyfrdwy	HDD	Hafren Dyfrdwy Cyfyngedig
Northumbrian	NES	Northumbrian Water Limited
Severn Trent	SVE	Severn Trent Water Limited
South West Bristol	SBB	South West Water Limited (including the Bristol area)
South West	SWB	South West Water Limited
Southern	SRN	Southern Water Services Limited
Thames	TMS	Thames Water Utilities Limited
United Utilities	UUW	United Utilities Water Limited
Wessex	WSX	Wessex Water Services Limited
Yorkshire	YKY	Yorkshire Water Services Limited
Water only companies		
Affinity	AFW	Affinity Water Limited
Bristol	BRL	Bristol Water Plc
Portsmouth	PRT	Portsmouth Water Limited
SES Water	SES	Sutton and East Surrey Water Plc
South East	SEW	South East Water Limited
South Staffs	SSC	South Staffordshire Water Plc
Infrastructure provider		
Tideway / BTL		Bazalgette Tunnel Limited
Credit Rating Agencies		
Moody's		Moody's Investors Services, Inc.
S&P		S&P Global Ratings
Fitch		Fitch Ratings, Inc.

Appendix 3: Comparability of Data

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

Each company is responsible for the accuracy of its reported data, that it meets our reporting guidance (as set out in the Regulatory Accounting Guidelines) and that information reported in Annual Performance Reports (APR) is clear and transparent.

We continue to keep our reporting guidance under review. We will issue further guidance and clarification where we consider it necessary and will look to incorporate this into the Regulatory Accounting Guidelines (the RAGs).

We 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 its alternative calculations differ from the approach specified for the APR.

Where appropriate we have included the financial results of Bazalgette Tunnel Limited (Tideway)*. 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.

* On 13 August 2015, Ofwat designated Bazalgette Tunnel Limited as an infrastructure provider responsible for the delivery of the Thames Tideway Tunnel project. The RCV for Tideway is calculated based on cost and so uses a different mechanism to the rest of the industry. Tideway does not generate distributable profits rather shareholders receive a return on their investment through a combination of payments of interest on loans and partial repayments of those loans during the construction phase of the project.

Appendix 4: Licence Modifications

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As set out in our decision document published in March 2023, we have implemented a range of modifications to companies' licences. These are as follows:

- Under the existing cash lock-up provisions, companies are prevented from undertaking certain transactions including paying dividends without our approval if their issuer credit rating (as defined in the licence) falls to the lowest investment grade of BBB- / Baa3 with negative outlook. We have raised the trigger for cash lock-up one notch to BBB/Baa2 with negative outlook, effective from 1 April 2025.
- From 17 May 2023, companies must hold two issuer credit ratings (as defined in the licence) from two different credit rating agencies, or to seek our agreement to maintain only one, if appropriate.
- We have given consent to three companies to hold only one credit rating, subject to conditions that reflect the individual circumstances of each company: Hafren Dyfrdwy, Portsmouth and SES Water.
- From 17 May 2023, companies must notify us about any changes to their issuer credit ratings (including changes in rating and/or outlook, new ratings assigned or planned rating withdrawals), with reasons for the change, where appropriate.
- From 17 May 2023, the dividend policy condition in companies' licences was amended to require companies to declare or pay dividends only in accordance with a dividend policy that takes account of delivery for customers and the environment and financial resilience over the longer term. In June 2023 to help companies understand our expectations we also finalised our guidance on factors we consider in assessing dividends declared or paid.
- From 17 May 2023, we also implemented wider modifications to Wessex Water's licence to bring its regulatory ring-fencing conditions in line with other companies' licences.

Appendix 5: Explanatory Notes

1. Published Information

All data and information contained in this report has been taken from companies Annual Performance Reports and resubmissions, or other publicly available sources, for instance statutory accounts and reports from credit rating agencies. All water companies are required to publish information relevant to their financial performance and financial position in their APRs. The APR is a key source of data which we monitor over time.

While we have undertaken a high-level review of the information published by companies, the responsibility for the accuracy and assurance of the information that each company publishes and which we have used when compiling the report remains with each of the appointed companies.

Where companies have restated figures and / or revised their 2022-23 APRs or previously submitted APR data, prior to our publication of this report, we have updated the data in line with the known revisions made by companies. If companies were to restate figures and / or revise their 2022-23 APRs following the publication of this report these changes will not be reflected in this report.

2. Competition and Markets Authority (CMA), PR19 Final Determinations

Four companies: Anglian Water, Bristol Water, Northumbrian Water and Yorkshire Water made an appeal to the CMA asking for a redetermination of their price controls for the 2020-25 period. The CMA published its final redeterminations in March 2021. These included setting a different rate of return for investors, and different cost allowances, for the four affected companies.

3. South West Water and Bristol Water

In June 2021 Pennon Group Plc (Pennon) acquired 100% of the issued share capital of Bristol Water Holdings UK Limited and its subsidiaries, including Bristol Water Plc (Bristol Water). The merger of South West Water and Bristol Water completed on 1 February 2023 with the combined water business now operating under one licence. At that date, the trade and majority of assets and liabilities of Bristol Water were transferred to South West Water. Whilst now operating as one legal and regulated entity, South West Water Limited will continue to operate under the Bristol Water name in the area Bristol Water served. In line with the CMA's merger control decision, South West Water will continue to provide separate reporting information with Ofwat maintaining separate price controls.

On that basis, certain metrics for 2022-23 are presented on a combined entity (SBB) basis as appropriate, with others reflecting the full year of trading in relation to the activities carried out by each of South West and Bristol for the year to 31 March 2023.

4. Havant Thicket Winter Storage Reservoir (HTWSR)

A new reservoir and pipeline is being constructed in Havant, Hampshire by Portsmouth Water and in collaboration with Southern Water. The reservoir, when constructed, will help secure more reliable and resilient water resources for customers in the South East. The reservoir will also provide a new recreational facility/resource and a new wetland habitat. Once Portsmouth has completed construction, HTWSR will be funded by payments from Southern Water to purchase the water it needs to supply its customers.

5. Dŵr Cymru's ultimate parent undertaking is Glas Cymru Holdings Cyfyngedig

As Glas Cymru Holdings Cyfyngedig is a company limited by guarantee, it has no shareholders. Dŵr Cymru does not typically pay any dividends to its parent company, but where it does no monies are transferred out of the Glas Cymru group of companies and all financial surpluses are retained for the benefit of customers. Due to this, Dŵr Cymru's adjusted appointee dividend is deemed to be nil, therefore only a total dividend yield is presented in the dividend chart for Dŵr Cymru.

6. Severn Trent Water and Hafren

On 31 March 2022 Severn Trent Water Limited disposed of its investment in Hafren by way of a dividend in specie (of its holding of the entire share capital of Hafren) to its immediate parent company Severn Trent Draycote Limited*. Severn Trent Plc, listed on the London Stock Exchange, remains the ultimate parent company of both Severn Trent Water Limited and Hafren.

Post disposal transactions impacting on the regulatory gearing of Hafren are namely the settlement of amounts due to Severn Trent Water Limited for services performed on behalf of Hafren, in part offset by a £15m equity injection by Severn Trent Draycote Limited.

Severn Trent Water and Hafren remain separately regulated water and waste businesses, each with its own licence, and produce separate Annual Performance Reports.

7. Regulatory Investigations

Regulatory investigation into Southern Water resulted in a package of undertakings to return revenue to customers, which has impacted on the company's revenue recovery and certain metrics in 2022-23. Thames Water's last year of rebates (as part of a package of commitments it provided) was 2021-22, and so no on-going impact is expected.

We are currently investigating all eleven water and wastewater companies including live enforcement cases with six companies for potential failures at sewage treatment works that may have led to sewage discharges into the environment. These companies are: Anglian Water, Northumbrian Water, South West Water, Thames Water, Wessex Water and Yorkshire Water.

We also have live enforcement cases with Dŵr Cymru and South West Water in relation to the accuracy of leakage and PCC performance figures each have reported.

The outcome of our investigation and enforcement cases and any potential remedial plans can have financial impacts for companies. Published details of our current enforcement investigations can be found at Investigations - Ofwat

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

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