ADDENDUM TO ANNUAL PERFORMANCE REPORT FOR 1 APRIL 2018 TO 31 MARCH 2019

Data tables 1F Financial Flows (pages 144 to 147) and 4H Financial Metrics have been amended to ensure consistency with data submitted to Ofwat in November 2019.

NORTHUMBRIAN WATER living water | ESSEX&SUFFOLK WATER living water

Registered company no: 02366703

1F FINANCIAL FLOWS

For the 12 months ended 31 March 2019 and for the price review to date (Price Base 2012/13 RPI average)

	12 MONTHS ENDED 31 MARCH 2019					
	NOTIONAL RETURNS AND NOTIONAL REGULATORY EQUITY	ACTUAL RETURNS AND NOTIONAL REGULATORY EQUITY	ACTUAL RETURNS AND ACTUAL REGULATORY EQUITY	NOTIONAL RETURNS AND NOTIONAL REGULATORY EQUITY	ACTUAL RETURNS AND NOTIONAL REGULATORY EQUITY	ACTUAL RETURNS AND ACTUAL REGULATORY EQUITY
	%	%	%	£'m	£'m	£'m
Return on regulatory equity	5.64	5.05	5.64	77.7	69.6	69.6
Actual performance adjustment 2010–2015	1.30	1.17	1.30	17.9	16.0	16.0
Adjusted Return on regulatory equity	**6.94**	**6.22**	**6.94**	**95.6**	**85.6**	**85.6**
Regulatory equity (£m)	**1,376.9**	**1,376.9**	**1,233.2**			
Financing						
Gearing	-	0.45	0.51	-	6.3	6.3
Variance in corporation tax	-	0.07	0.08	-	0.6	0.9
Group relief	-	-	-	-	-	-
Cost of debt	-	1.36	1.52	-	18.7	18.7
Hedging instruments	-	0.25	0.27	-	3.4	3.4
Financing total	**6.94**	**8.34**	**9.32**	**95.6**	**114.9**	**114.9**
Operational Performance						
Totex out / (under) performance	-	(0.71)	(0.79)	-	(9.8)	(9.8)
ODI out / (under) performance	-	(0.23)	(0.26)	-	(3.2)	(3.2)
Retail out / (under) performance	-	(0.20)	(0.23)	-	(2.8)	(2.8)
Other exceptional items	-	-	-	-	-	-
Operational performance total	**-**	**(1.14)**	**(1.28)**	**-**	**(15.8)**	**(15.8)**
Total earnings	**6.94**	**7.20**	**8.04**	**95.6**	**99.1**	**99.1**
RCV growth from RPI inflation	**3.06**	**3.06**	**3.06**	**42.1**	**42.1**	**37.7**
Total shareholder return	**10.0**	**10.26**	**11.1**	**137.7**	**142.3**	**136.9**
Net dividend	**4.00**	**8.15**	**9.10**	**55.1**	**112.3**	**112.3**
Retained Value	**6.00**	**2.11**	**2.0**	**82.6**	**29.0**	**24.6**
Dividends reconciliation						
Gross Dividend	4.00	8.15	9.10	55.1	112.3	112.3
Interest Receivable on Intercompany loans	-	-	-	-	-	-
Net dividend	**4.00**	**8.15**	**9.10**	**55.1**	**112.3**	**112.3**

	AVERAGE 2015–19					
	NOTIONAL RETURNS AND NOTIONAL REGULATORY EQUITY	ACTUAL RETURNS AND NOTIONAL REGULATORY EQUITY	ACTUAL RETURNS AND ACTUAL REGULATORY EQUITY	NOTIONAL RETURNS AND NOTIONAL REGULATORY EQUITY	ACTUAL RETURNS AND NOTIONAL REGULATORY EQUITY	ACTUAL RETURNS AND ACTUAL REGULATORY EQUITY
	%	%	%	£'m	£'m	£'m
Return on regulatory equity	5.68	4.91	5.68	77.6	67.1	67.1
Actual performance adjustment 2010–2015	1.35	1.17	1.35	18.4	16.0	16.0
Adjusted Return on regulatory equity	**7.03**	**6.08**	**7.03**	**96.1**	**83.0**	**83.0**
Regulatory equity (£m)	**1,366.6**	**1,366.6**	**1,181.0**			
Financing						
Gearing	-	0.64	0.75	-	8.8	8.8
Variance in corporation tax	-	0.62	0.71	-	8.4	8.4
Group relief	-	0.04	0.05	-	0.6	0.6
Cost of debt	-	0.60	0.73	-	8.2	8.6
Hedging instruments	-	0.05	0.06	-	0.7	0.8
Financing total	**7.03**	**8.03**	**9.33**	**96.1**	**109.7**	**110.2**
Operational Performance						
Totex out / (under) performance	-	1.40	1.63	-	19.2	19.2
ODI out / (under) performance	-	0.18	0.21	-	2.5	2.5
Retail out / (under) performance	-	0.17	0.20	-	2.3	2.3
Other exceptional items	-	0.05	0.06	-	0.7	0.7
Operational performance total	**-**	**1.81**	**2.09**	**-**	**24.7**	**24.7**
Total earnings	**7.03**	**9.84**	**11.42**	**96.1**	**134.4**	**134.9**
RCV growth from RPI inflation	**2.51**	**2.51**	**2.51**	**34.3**	**34.3**	**29.6**
Total shareholder return	**9.54**	**12.35**	**13.93**	**130.4**	**168.7**	**164.6**
Net dividend	**4.00**	**10.84**	**12.54**	**54.7**	**148.1**	**148.1**
Retained Value	**5.54**	**1.51**	**1.39**	**75.7**	**20.6**	**16.4**
Dividends reconciliation						
Gross Dividend	4.00	10.84	12.54	54.7	148.1	148.1
Interest Receivable on Intercompany loans	-	-	-	-	-	-
Net dividend	**4.00**	**10.84**	**12.54**	**54.7**	**148.1**	**148.1**

The purpose of this table is to provide transparency of financial flows to investors, comparing actual flows, and the main elements of performance which contribute to these flows, against the financial flows assumed by Ofwat under the notional structure at the last price review.

This commentary explains the key features of the report for both 2018/19 and cumulative performance for the four years from 2015/16 to 2018/19. Note, all of the financial values are expressed in the same 2012/13 price base as the PR14 price review.

Return on regulatory equity (RORE)

At PR14, the base notional RORE was set at an average 5.73% for the five year period, however this has been reduced to exclude any return on NHH retail from 2017/18 onwards, as a result of NWL exiting the NHH market on 1 April 2017. This has reduced the base notional RORE to 5.64% in 2018/19 and 5.68% average for 2015-19.

In Ofwat's PR14 methodology, certain company-specific changes were made to reflect performance in the previous five year period, 2010-15. For NWL this included an additional return, under Ofwat's Revenue Correction Mechanism, to recover lower than funded revenue received in the previous price control period (from 2010 to 2015) as a result of falling non-household demand. This increased NWL's Adjusted RORE to 6.83% in 2018/19 and 7.00% average for 2015-19.

The regulatory equity base represents the proportion of RCV funded as equity rather than debt. Ofwat's notional structure for PR14 assumed net debt at 62.5% of RCV, equating to base regulatory equity of 37.5%, or £1,377m at March 2019. NWL's average gearing in 2018/19 was 66.8%, resulting in actual regulatory equity of 33.2% of RCV, or £1,233m.

Financing

This section of the report relates to performance from financing, including tax.

Gearing is calculated as net debt divided by RCV. NWL's average gearing has reduced from 69.1% in 2015/16 to 66.8% in 2018/19, remaining above Ofwat's notional structure assumption of 62.5%. This has generated an average benefit of £8.8m per annum over AMP6 to date.

Corporation tax reports the difference current tax funded in the FD and the actual tax rate applied to profit before fair value, adjusted for capital allowances. This has shown a small outperformance of £0.6m in 2018/19. The average performance for 2015-19 of £8.4m is distorted by a one-off gain in 2015/16 whereby we were funded at PR14 for additional tax costs expected to arise upon transition to IFRS which have not subsequently been incurred (though the tax computation has not yet been finalised with HMRC). In our PR19 Business Plan we proposed that we would share the benefit with customers through using interest gained on the unutilized tax funding to support our zero water poverty goal.

There has been only a small outperformance due to Group tax relief over AMP6 to date. All tax losses acquired from related parties in the year were paid for in full.

Cost of debt performance is reported in real terms, rather than nominal. As reported in table 4H, 63% of the Company's debt is at fixed rate and not impacted by indexation. In 2018/19, RPI indexation was higher than assumed in the FD, resulting in NWL reporting a lower real cost of debt and a financing outperformance of £18.7m.

Hedging instruments shows the impact of interest rate swaps on the cost of debt reported in the year, and equates to a benefit of £3.4m in 2018/19.

The net effect of financing and tax in the year was an outperformance of FD allowance by £29.0m, or 2.34% of regulatory equity.

Operational Performance

This section of the report explains how our strong operational performance on wholesale totex, ODIs and retail costs, which has been explained throughout this report, has contributed to higher returns.

Our wholesale totex performance is explained in the commentary to table 4B. The table above shows the proportion of this outperformance which is retained by the Company, being 51.2% or £19.2m on average over AMP6 to date. The remainder of the outperformance is returned to customers through a reduction in RCV at the next price review.

ODI performance against our PCs is reported in table 3A, with a net penalty in 2018/19 of £3.2m, though a net cumulative reward for 2015-19 of £10.1m. The rewards relate mostly to strong performance on sewer flooding and interruptions to supply, partially offset by smaller penalties on drinking water compliance and satisfaction with taste and odour. Our performance against each of these is explained earlier in this report.

The performance of our household retail business is explained in the narrative to table 2C, with higher costs resulting from the implementation of our new customer contact and billing system in the year.

The net effect of operational performance in the year was an underperformance of FD allowance by £15.8m, or 1.28% of regulatory equity. For 2015-19, on average we have outperformed FD by £24.7m per annum, or 2.09%.

Total Shareholder Return

The total shareholder return comprises adjusted RORE, outperformance in respect of financing, tax and operational performance and growth in the RCV as allowed in the FD. Our performance generated a total shareholder return of £136.9m in 2018/19, or 11.1% return on regulatory equity. Of this return, 9.1% was paid as dividend with 2.0% being value retained within the business.

Our dividend policy is set out on **page 167** and we explain how this dividend policy is applied on **pages 131 to 132**.

4G WHOLESALE CURRENT COST FINANCIAL PERFORMANCE

For the 12 months ended 31 March 2019

	WATER	WASTEWATER	TOTAL
	£'m	**£'m**	**£'m**
Revenue	446.6	317.0	763.6
Operating expenditure	(220.1)	(95.9)	(316.0)
Capital maintenance charges	(139.1)	(106.7)	(245.8)
Other operating income	2.6	0.2	2.8
Current cost operating profit	**90.0**	**114.6**	**204.6**
Other income	6.8	2.4	9.2
Interest income	0.3	0.3	0.6
Interest expense	(63.7)	(65.2)	(128.9)
Other interest expense	(1.5)	(0.7)	(2.2)
Current cost profit before tax and fair value movements	**31.9**	**51.4**	**83.3**
Fair value gains/(losses) on financial instruments	(5.7)	(5.8)	(11.5)
Current cost profit before tax	**26.2**	**45.6**	**71.8**

4H FINANCIAL METRICS

For the 12 months ended 31 March 2019

	UNITS	CURRENT YEAR	AMP TO DATE
Financial indicators			
Net debt	£m	2,853.3	
Regulated equity	£m	1,418.3	
Regulated gearing	%	66.8%	
Post tax return on regulated equity	%	12.0%	
RORE (return on regulated equity)	%	6.9%	8.4%
Dividend yield	%	9.2%	
Retail profit margin – Household	%	0.5%	
Retail profit margin – Non household	%	(0.1%)	
Credit rating	n/a	BBB+/Baa1 (negative outlook)	
Return on RCV	%	7.1%	
Dividend cover	dec	1.2	
Funds from operations (FFO)	£m	342.3	
Interest cover (cash)	dec	4.5	
Adjusted interest cover (cash)	dec	2.4	
FFO/Debt	dec	0.1	
Effective tax rate	%	17.0%	
RCF	£m	212.3	
RCF/capex	dec	0.8	
Revenue and earnings			
Revenue (actual)	£m	812.9	
EBITDA (actual)	£m	443.9	
Movement in RORE			
Base return	%	5.6%	5.7%
Totex out / (under) performance	%	(0.4)%	1.5%
Retail cost out / (under) performance	%	(0.2)%	0.1%
ODI out / (under) performance	%	(0.2)%	0.2%
Financing out / (under) performance	%	2.0%	0.9%
Other factors	%	0.0%	0.1%
Regulatory return for the year	**%**	**6.9%**	**8.5%**
Borrowings			
Proportion of borrowings which are fixed rate	%	63.1%	
Proportion of borrowings which are floating rate	%	1.5%	
Proportion of borrowings which are index linked	%	35.5%	
Proportion of borrowings due within 1 year or less	%	1.7%	
Proportion of borrowings due in more than 1 year but no more than 2 years	%	1.4%	
Proportion of borrowings due in more than 2 years but no more than 5 years	%	15.5%	
Proportion of borrowings due in more than 5 years but no more than 20 years	%	55.7%	

Movements in RORE

This commentary explains the differences between the base return at PR14 and the cumulative RORE performance in AMP6 to date, which have contributed to an overall outperformance of 2.73%.

The base RORE is reported before company-specific adjustments related to revenue under-recovered in the previous price review period, under Ofwat's Revenue Correction Mechanism (RCM). The impact of this adjustment is shown in table 1F, Financial Flows, within the actual performance adjustment 2010-15. The PR19 base RORE has been adjusted by -0.05% to remove NHH retail returns from 1 April 2017, when NWL exited the NHH retail market.

Cumulative totex outperformance for AMP6 to date has added 1.5% to RORE. This is explained in the Wholesale totex reconciliation to FD narrative under table 4B.

Retail outperformance against FD has added 0.14% to RORE. This comprises household retail for the four years of AMP6 to date plus NHH retail for 2015/16 and 2016/17 only, before NWL exited the NHH retail market. The outperformance primarily relates to reductions in the doubtful debt charge in 2016/17 and 2017/18, following a comparison of the doubtful debt provision against historical collection rates. The underlying bad debt policy has remained unchanged over AMP6.

ODI rewards earned in AMP6 to date have added 0.15% to RORE. These have been reported each year in table 3A and comprise £7.6m net reward on wastewater services, mostly due to significant improvements in sewer flooding performance, and £2.5m net reward on water services, reflecting rewards for interruptions to supply less penalties for overall drinking water compliance and satisfaction with taste and odour.

Financing outperformance of 0.94% over base RORE reflects 1.33% from outperformance of the PR14 cost of debt, in real terms, due to new debt being raised in AMP6 at favourable market rates, less -0.39% due to actual average RPI being lower than anticipated in the PR14 FD.

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