Hafren Dyfrdwy Cyfyngedig

Annual report and financial statements for the year ended 31 March 2020

Company number: 03527628

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Hafren Dyfrdwy Cyfyngedig

Company information

Company number	03527628
Directors	J B Coghlan A J Duff (retired on 31 March 2020) C M Hodgson (appointed on 1 April 2020) J Bowling O R Garfield A Beynon S Jones-Evans M Mehmet
Secretary	H Woodall-Pagan
Registered office	Packsaddle Wrexham Road Rhostyllen Wrexham Clwyd LL14 4EH
Solicitors	Herbert Smith Freehills LLP Exchange House Primrose Street London EC2A 2EG
Auditor	Deloitte LLP Statutory Auditor 4 Brindley Place Birmingham B1 2HZ

Strategic report

What we do

We are a regulated water and sewerage company in Wales. The principal activity of the Company is the provision of water and waste water services to customers predominantly in North East Wales, from Wrexham and Bretton in the north to Llanidloes and Knighton in Powys.

The Directors of Hafren Dyfrdwy Cyfyngedig are pleased to present their Strategic report on the affairs of the Company, along with the Directors' report, the audited financial statements and the Auditor's report for the year ended 31 March 2020.

Key Facts

Turnover
£32,418,000

(2018/19:£31,983,000)

Loss before interest and tax
£3,714,000

(2018/19: £2,588,000)

Underlying loss before interest and tax
£3,714,000

(2018/19: 2,188,000)

Households and businesses served
107,000
(2018/19: 107,000)

Litres of drinking water supplied each day
59 Ml/d

(2018/19: 61 ML/d)

Litres of waste water treated
6,838 Ml/y

(2018/19: 6,338 Ml/y)

Employees[1]
135 (2018/19: 133)

[1] Average during 2019/20 see note 6 to the Group financial statements.

PURPOSE FIRST

Our Purpose and Values

We believe that if we are united by a clear social purpose we will deliver better outcomes for all our stakeholders – our customers, our colleagues, the society we live in and the environment we depend on. It also makes good business sense. We are first and foremost driven by our purpose – 'Taking care of one of life's essentials' – and we're guided by our values:

Hafren Dyfrdwy Cyfyngedig focuses on the delivery of nine outcomes designed with our customers to meet their needs and those of wider society:

1 A COMPANY **YOU CAN TRUST**	2 A POSITIVE **DIFFERENCE**	3 **LOWEST POSSIBLE** BILLS
4 A SERVICE **FOR EVERYONE**	5 AN OUTSTANDING **EXPERIENCE**	6 GOOD TO **DRINK**
7 WATER **ALWAYS THERE**	8 WASTE WATER **SAFELY TAKEN AWAY**	9 A THRIVING **ENVIRONMENT**

OUR COMMITMENT TO SUSTAINABILITY

We are committed to making decisions for the long term – decisions that add value for our customers, the communities we serve and the environment, and treating all of our employees and other stakeholders fairly. This means we work to achieve our outcomes in a sustainable way – be it through taking care of the environment, helping people thrive or being a trustworthy company. This is integral to the way we operate.

We have a separate target for supporting customers who struggle to pay their bill. We are aiming to help 73% of customers who struggle to pay by 2025. We've been working hard to identify customers in need of support. Our geographic area contains many small, close-knit communities, and the team recognises that building relationships with community groups is vital. In partnership with organisations such as Powys Association of Voluntary Organisations, Warm Wales and Newydd and Mid-Wales Housing, we are proactively contacting customers who are struggling to pay their bills – by telephone, post, or even door-knocking days in communities with a large proportion of customers who could benefit from our support. Customers can also apply for assistance online through Here2Help, which launched in January 2020 and is already helping dozens of customers to access the support they need.

This support is making a real difference to customers:

"I met a lady at a food bank in Wrexham who was looking after a family of four. She was signed off work sick, and her statutory sick pay had ended. I helped her make an application to Here2Help. Within a week, her monthly payment was reduced from £67.50 to £12.35. I checked in with her again to see if she needed anything else, and she was so happy – she couldn't believe how much we were able to help her!"

Katie, Hafren Dyfrdwy

Business model

RUNNING AN EFFICIENT WATER BUSINESS

We provide clean water every time our customers turn on the tap, and remove their waste water in an affordable, sustainable and reliable way.

RESOURCES & RELATIONSHIPS WE RELY ON

RESOURCES

PHYSICAL ASSETS
A resilient, well maintained network of clean water pipes and reservoirs, sewers and pumping stations.

NATURAL RESOURCES
Water from reservoirs, rivers and underground aquifers is essential to support operations and value creation.

We look after some of the UK's most impressive natural resources.

RELATIONSHIPS

OUR CUSTOMERS AND COMMUNITIES
Our customers and communities are at the heart of everything we do. We aim to anticipate and meet changing customers' and wider societal needs.

OUR PEOPLE AND CULTURE
Our culture and values support Doing the Right Thing and drive delivery of our strategy. We look to attract, develop and retain talented people from all backgrounds.

OUR SUPPLIERS AND PARTNERS
Strong supplier relationships support our business operations in line with our modern slavery commitments.

OUR REGULATORS
Our industry is regulated by Ofwat and several other regulators and public bodies.

We work with our regulators to shape our industry.

THE WATER CYCLE

WATER IS COLLECTED
We pay the Environment Agency and Natural Resources Wales for the water we collect from reservoirs, rivers and underground aquifers across our region.

WATER IS CLEANED
Our groundwater and surface water treatment works clean raw water to the highest standards, making it safe to drink.

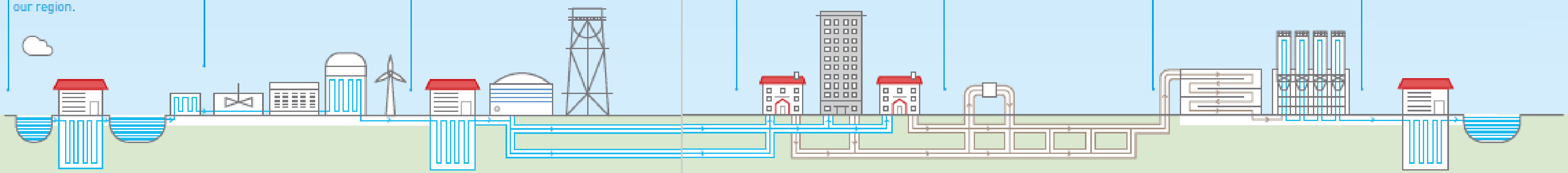
CLEAN WATER IS DISTRIBUTED
Our network of pipes and our enclosed storage reservoirs bring a continuous supply of clean water right to our customers' taps.

CUSTOMERS ENJOY OUR SERVICES
We provide safe, reliable supply of water and collect waste water seven days a week, every day of the year.

WASTEWATER IS COLLECTED
Our network of sewers and pumping stations collect waste water from homes and take it to our treatment works.

WASTE WATER IS CLEANED
Waste water is carefully screened, filtered and treated in our sewage treatment works to meet stringent environmental standards.

WATER IS RECYCLED TO THE ENVIRONMENT
We pay the Environment Agency and Natural Resources Wales annual consent fees to return the treated water to the water system.



GENERATING & PRESERVING LONG-TERM VALUE

PHYSICAL ASSETS
Completed the replacement of Llwyn Onn treated water tank, Sugn-y-Pwll service reservoir, Berwyn service reservoir, and the completion of roof membranes at eight service reservoirs.

NATURAL RESOURCES
Published our first Sustainability Report demonstrating our commitment to improving the natural environment through activities such as biodiversity, reducing water use through leakage and per capital consumption and committing to the triple carbon pledge.

OUR CUSTOMERS AND COMMUNITIES
The lowest combined average bills in England and Wales.

OUR PEOPLE AND CULTURE
Developing people from all backgrounds in line with our Social Mobility Programme.

OUR SUPPLIERS AND PARTNERS
Building sustainable relationships that provide mutual benefit.

OUR REGULATORS
We stimulate regulatory debates to improve services for customers across the industry.

Our COVID-19 response

The impacts of COVID-19 are being felt across the globe. As a socially purposeful company, we have carefully considered how we can make a positive impact for the good of our stakeholders but also for wider society.

This section provides a snapshot of how we have approached the COVID-19 crisis since mid-March 2020; from managing our operational response, to mitigating as much risk as possible while providing the widest range of support possible to our stakeholders. It also directs you to sections of the Annual Report where you can find more detail on each of the matters below. Our Group-level Strategic Incident Team led the swift implementation of plans and Hafren Dyfrdwy continued to provide services to customers while keeping our people safe and well.

SUPPORTING OUR CUSTOMERS	**Maintaining normal business operations for our customers**	• Our teams continue to work tirelessly to provide a great experience for our customers – keeping them on supply and taking their waste safely away. We've received some wonderful feedback from customers recognising the dedication of our teams at this time. • Our priority remains the safety and wellbeing of our customers and people. We've implemented revised working practices, with virtual remote technicians, at-home network monitoring, and kept small teams together, to ensure we keep people as safe as possible while delivering essential services. • We have kept customers reassured and informed throughout the COVID-19 period through regular content across a number of channels, including emails and social media.
	Protecting our vulnerable customers	• Making sure our vulnerable customers know we are there for them with targeted communications and support through our Priority Services Register. • We continue to partner and support Local Resilience Forums by providing advice and guidance in respect of vulnerable customers and ensuring that they have access to the most up to date information to support vulnerable people in our region.
	Supporting customers who are struggling to pay	• We have a range of initiatives for those struggling to pay their bills. These schemes have historically helped lots of people when they needed our support the most. At this critical time for many, we have redoubled our efforts to raise awareness of these schemes for customers.
TAKING CARE OF OUR COLLEAGUES	**Caring for our colleagues**	• Our priority remains the safety and wellbeing of our people and customers. We are supporting our key workers with the processes, personal protective equipment and other equipment they need to continue to deliver our essential services. Our IT infrastructure has proved to be stable and resilient which has allowed over half our workforce to work safely from home so we can be there for our customers 24 hours a day, seven days a week. • We will not be making any redundancies or furloughing any of our employees as a result of COVID-19 and we are maintaining our all-employee bonus in recognition of our colleagues' hard work over the last year. • Launched a 'Caring for our Colleagues' campaign, providing support on mental and physical wellbeing, and agreed individual care plans for our colleagues living in a vulnerable situation.
	Key workers	• As a major employer and provider of essential frontline services, the health and safety of our colleagues is paramount and additional safety protocols have been implemented. Our priority remains protecting the health and safety of our people.

HELPING TO MAKE A DIFFERENCE TO OUR COMMUNITIES	**Social responsibility**	• In addition to helping our customers directly, we have established a COVID-19 emergency fund to support charities and community projects at the forefront of our region's COVID-19 response. • We launched a virtual education zone to help parents with home-schooling – through activities, games and stories to inspire the next generation of water users. • We've prioritised our services to ensure that schools serving key workers and hospitals have access to uninterrupted services.
WORKING WITH OUR SUPPLIERS AND CONTRACTORS	**Supporting our supply chain**	• We're working closely and collaboratively with our whole supply chain, including our smaller suppliers, to provide support in respect of their underlying COVID-19 plans and continuing to invest in our capital construction projects when it is safe to do so. This is an important focus given their roles as key employers in our region.
ENSURING THE LONG-TERM SUCCESS OF OUR COMPANY	**Financial resources and assumptions**	• The Strategic Incident team has continually monitored the situation to ensure early detection of any deteriorating trends. We have modelled plausible and extreme scenarios to determine expected impacts and test the Group's financial resilience. Our strong financial position means that we are well placed to withstand the economic shocks that COVID-19 might bring. Read more in our viability statement on page 26.
	Risk management	• We continue to monitor the impact of the COVID-19 pandemic across all areas of the Company as part of our established Enterprise Risk Management ('ERM') processes and a detailed COVID-19 statement can be found on page 27.

Engagement with our stakeholders

Stakeholder engagement is central to our strategy. We are focused on driving long-term sustainable performance for the benefit of our customers, communities and wider stakeholders. This section provides some insight into how the Board engages with our stakeholders to understand what matters to them and further inform the Board's decision making and the actions taken as a consequence. You can read more in our formal s.172 statement on page 12, which sets out our approach to s.172 and provides examples of decisions taken by the Board, including how stakeholder views and inputs have been considered in its decision making.

This section also includes high-level detail of stakeholder engagement below Board level. The principles underpinning s.172 are not something that are only considered at Board level, they are part of our culture. It is embedded in all that we do and impacts on stakeholders are considered in the business decisions we make across the Company, at all levels, and strengthened by our Board setting the right tone from the top.

Customers	**Communities**	**Employees**	**Suppliers and Contractors**	**Regulators and Government**
In serving our customers, we want to provide both value and a great experience.	Our aim is to be a force for good in the communities we serve and, in doing so, create value for all our stakeholders.	Our greatest asset is our experienced, diverse and dedicated workforce. Our relationship with them is open and honest, and they are appropriately supported, developed and rewarded to be their best in all that they do.	Along with our employees, our suppliers support us in delivering for our customers. Strong supplier relationships ensure sustainable, high quality delivery for the benefit of all stakeholders. Our geographic area contains many small suppliers and we recognise that fostering relationships with them is vital to the communities we serve.	The policy framework for the water sector in Wales is set by the Welsh Government. We seek to engage constructively and proportionally to achieve the best outcomes for customers and the environment. Below the policy framework, our industry is regulated by Ofwat and others. We agree commitments with our regulators and continually report our performance against these. We work closely with our regulators to shape our industry to help ensure the right outcomes for customers and the environment.
What matters to them	**What matters to them**	**What matters to them**	**What matters to them**	**What matters to them**
• Customer service and performance • Leakage and supply reliability • Affordability and value for money • Assistance in times of need • Responsible investment	• Operational impact and disruption • Local employment • Economic contribution • Protection of the environment	• Health, safety and wellbeing • Diverse and inclusive workplace • Opportunities to reach full potential • Open and honest environment • Fair Pay and reward	• Fair engagement and payment terms • Collaboration • Responsible supply chain	• Outcomes for customers, the environment and long-term resilience. • Performance against regulatory targets • Trust and transparency • Governance and compliance • Environmental impact

How we engage at Board Level	**How we engage at Board Level**	**How we engage at Board Level**	**How we engage at Board Level**	**How we engage at Board Level**
• Customer Delivery performance is discussed at every Board meeting. • Customer engagement in shaping our Business Plan. • The Board met with members of the Welsh Assembly to understand upcoming Welsh language standards and their impact on customers. • Members of the Board met with Senedd Cymru (Welsh Parliament[1]) to discuss Welsh Language best practice. • Our engagement in partnership with organisations such as Powys Association of Voluntary Organisations, Warm Wales and Newydd and Mid-Wales Housing has helped us reach more customers struggling to pay their bills.	• We created our COVID-19 Community Fund to benefit organisations in our region. The Board receives regular updates on the work of the Fund. • Employees who live and work in our communities met members of the Board during the year. • Representatives from Welsh Government attended the Board Strategy Day to discuss environmental priorities in Wales. • Representatives from Natural Resources Wales attended the November 2019 Board meeting to discuss collaborative working and receive a dedicated update on the Company's Lake Vyrnwy Project. • The Board met with CBI Wales Council to discuss the Social Partners Act, supporting students and Carbon Neutral efforts in Wales. • Environmental matters are regularly considered by the Board, including biodiversity. • Members of the Board met with Public Health Wales to discuss our contribution to a healthier global community. • Members of the Board attended a CBI event discussing Carbon Reduction.	• Employee voice and workforce engagement are discussed at Board meetings. • Diversity and Inclusion are regularly considered by the Board. • Directors meet employees at site visits, both during and outside of the Board meeting calendar, including at our Llwyn Onn Water Treatment Works and Llandinam Water Treatment Works, where they observed water treatment processes first-hand and met the teams involved. • Company purpose and culture discussed at Board meetings. • Board considers QUEST survey results and steps taken to address feedback.	• Commercial performance is discussed at every Board meeting, including an update on relationships with suppliers.	• Regulatory matters are regularly considered by the Board, including PR19 plans, Water Resources Management Plan and Scheme of Wholesale Charges. • Regulatory stakeholders attend Board meetings and dinners, including from Welsh Government and Natural Resources Wales during the year. • Regulatory consultation updates are considered by the Board. • Members of the Board attended the Welsh Government – PR19 Water Forum. • The Board met with the Welsh Government and representatives from CCW, NRW and DWI to discuss AMP7 security programmes and resilience. • Annual attendance at the CCW Wales Annual Board meeting. • The Company arranged a meeting with the Powys Public Service Board. This is being rearranged due to COVID-19 impacts. • Regular engagement with Government officials and elected representatives on water and environment related issues.

How we engage across the Company	How we engage across the Company	How we engage across the Company	How we engage across the Company	How we engage across the Company
• Regular meetings with CCW Wales at management level discussing issues such as leakage performance and supply interruptions, including a visit to the HD main operational site during the year. • The Company met with Senedd Cymru (Welsh Parliament[1]) to discuss Welsh Language best practice. • The Company arranged a meeting with the Welsh Language Commissioner, this is being rearranged due to COVID-19 impacts. • Met with Powys County Council and the Welsh Language Officer to understand ways in which the Company could work with local partners.	• Regular meetings with Natural Resources Wales and other key stakeholders to discuss environmental regulation matters. • Regular attendance at the Wales Land Management Forum, Agri-Pollution sub forum with Natural Resources Wales, DCWW and other key water sector organisations to discuss Agri-pollution regulations. • Regular engagement with Government officials and elected representatives on water and environment related issues. • Engagement with CBI Wales Council to discuss the Company's COVID-19 response and activity being taken to support the community we serve.	• In addition to Board attendance, our Group Employee Forum brings together around 20 employee representatives at quarterly meetings, including union representatives. • Employee engagement survey ranked us in the top 5% of utility companies globally this year. • All employee CEO roadshow, 'Journey to Patagonia', launched in March 2020. • A large number of employees were engaged in developing our new Purpose and Values.	• The Board met with the Welsh Government to discuss water contract matters and alternative supply consideration.	• Regular meetings with our regulators at management level including, Welsh Government, Natural Resources Wales and Ofwat. • Regular engagement with Government officials and elected representatives on water and environment related issues.

[1] On 6 May 2020 the National Assembly changed its name to Senedd Cymru/Welsh Parliament.. The Assembly Members are now known as Members of the Senedd or in Welsh Aelodau o'r Senedd.

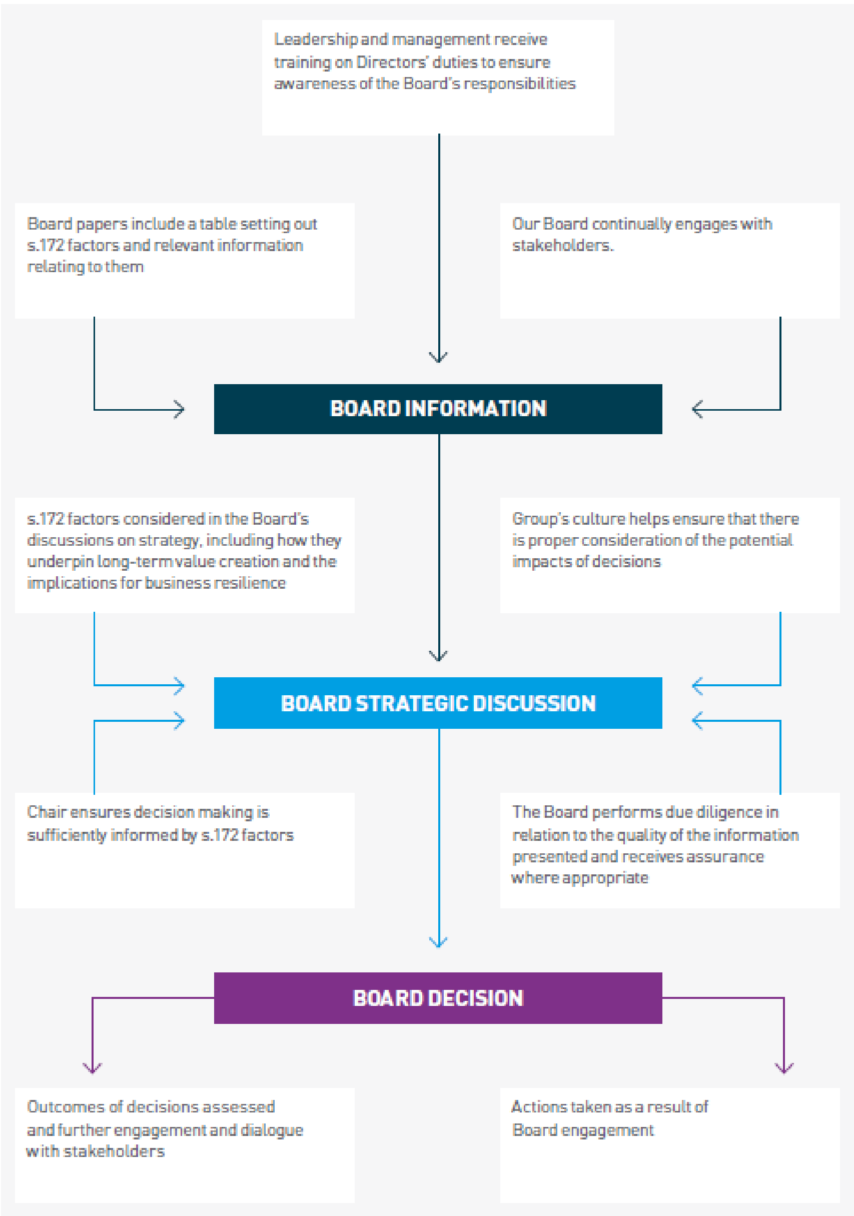
Section 172 statement

This year is the first time that we are sharing our s.172 statement with stakeholders. The following pages set out our approach to s.172, along with examples of decisions taken by the Board and how stakeholder views and inputs have been considered in its decision making. This disclosure is not intended to be a compliance statement, but rather provide visibility of the considerations of the Directors in the performance of their duties. This draws together the relevant information that has previously been disclosed elsewhere in our Annual Report.

Our s.172 Approach

The Board's role is not to balance the interests of the Company and those of stakeholders; rather its role is to carefully consider all the relevant factors and select the course of action that best leads to the success of Hafren Dyfrdwy in the long term. The principles underpinning s.172 are not something that are only considered at Board level, they are part of our culture. It is embedded in all that we do as a company. The differing interests of stakeholders are considered in the business decisions we make across the Company, at all levels, and are reinforced by our Board setting the right tone from the top.

Our stakeholder engagement processes enable our Board to understand what matters to stakeholders and carefully consider all the relevant factors and select the course of action that best leads to the high standards of business conduct and success of Hafren Dyfrdwy in the long term. Our approach to s.172 is set out below and is followed by examples of decisions taken by the Board and how stakeholder views and inputs as well as other s.172 considerations have been considered in its decision making.



= likely consequences of decisions in the long term

= the interests of the Company's workforce

= the need to foster relationships with suppliers, customers and others

= impact of operations on the community and environment

= high standards of business conduct

= the need to act fairly between members of the Company

Key Decisions made in 2019/20	s.172 Considerations	Consideration of s.172 impacts by the Board in its Decision Making	Outcomes and Actions
Biodiversity for Wales		In December 2019 the Board considered and reviewed the publication of its first report to the Welsh Government, setting out the actions taken and future commitments to ensure that the Company maintains and enhances biodiversity and promotes the resilience of ecosystems. The Board considered the Company's role in preserving and enhancing the natural environment and associated benefits that could result for the Company's stakeholders as follows: **Customers –** In the development of its 2020-25 Business Plan, proposals for environmental improvements were strongly supported by customers who recognised the importance of protecting and improving their local environment. This insight was vital in the Company's development of its AMP7 plan and the Board took an opportunity to put this into practice through the Lake Vyrnwy project. **Regulators –** The Board recognises the importance of working with the Welsh Government and regulators in development plans and commitments that will deliver benefits for multiple stakeholders whilst also enhancing the quality of water resource assets. **Workforce** – The Board encourages employees to volunteer as Community Champions and engage in biodiversity improvement projects within the Company's region. The Board considered the feedback from employees in respect of Community Champion participation, noting that this supported high engagement levels in the Company's QUEST survey. **Environment and the Community** – The Board considered the valuable feedback from its community on environmental matters and the work already underway with Natural Resources Wales, local wildlife trusts, the RSPB and neighbouring water companies to deliver the most benefit for the local environment and local communities from its investment. **Suppliers –** The Board considered the benefits of working in partnership with industry partners to pool resources to identify and deliver the most benefit for stakeholders and increase the resilience of eco-systems in response to climate change. The Board listened to the views of partners and local communities, who were focused on enhancing biodiversity at publicly accessible sites, and factored these views in Board discussions.	The Board agreed that the Biodiversity report should place additional focus on the Company's long-term biodiversity ambitions, with particular reference to stewardship of the Lake Vyrnwy estate and the Company's triple carbon pledge. The Board further agreed that it should be involved in planning for meetings with Public Service Boards ('PSBs') and a date was secured to attend the Wrexham PSB during the year.
Public Interest Commitment		To demonstrate Hafren Dyfrdwy's commitment to being a socially purposeful Company, the Board considered the sector wide Public Interest Commitment that could be established and communicated to the Company's stakeholders as follows: **Customers –** The Board considered that agreeing to the pledges set out within the Public Interest Commitment would demonstrate its social responsibility as a Company, to do the right thing for all of our customers. **Workforce –** The Board considered that the pledges would demonstrate the Company's commitment to making decisions for the long-term, for the benefit of the Company, its employees and future generations of employees and also provide employment opportunities for employees from social mobility cold spot areas. **Environment and the Community** – The Board considered that the Public Interest Commitment would support the Company's commitment to	The Board agreed and committed to the Public Interest Commitment and five challenging sector goals as follows: • To triple the rate of leakage reduction across the sector by 2030; • To make bills affordable as a minimum for all households, with water and sewerage bills not more than

		environmental matters and align with partnership working already underway, such as the Company's refill project. The environmental pledges would also deliver long-term benefits for the local environment and communities. **Long-term Success of the Company –** The Board considered that the Public Interest Commitment would support the long term success of the Company whilst also delivering benefits to multiple stakeholders, including customers, employees, suppliers, the community and the environment.	5% of their disposable income by 2030, and to develop a strategy to end water poverty; • Achieve net zero carbon emissions for the sector by 2030; • Prevent the equivalent of four billion plastic bottles ending up as waste by 2030; and • Be the first sector to achieve 100% commitment to the Social Mobility Pledge.
Employee Terms and Conditions		During the year, the Board carried out a thorough review of the terms and conditions of existing Hafren Dyfrdwy employees to assess whether the packages between Hafren Dyfrdwy and Severn Trent were broadly comparable. A dedicated discussion was tabled at the March 2020 Board meeting and considered stakeholder impacts as follows. **Workforce –** The Board recognises the importance of employee views being heard and for the Company to listen and respond to feedback. The Board regularly engages with the workforce both directly, when meeting them on operational site visits, and indirectly through consideration of the annual employee survey results to understand their views. The Board considers equality and inclusion to be important in developing a culture where employees can be themselves, thrive and feel supported. **Long-term Success of the Company –** The Board considers that employee terms and conditions are a key contributor to the long term success of the Company as they are an important factor in employee engagement. A highly engaged workforce is more productive and delivers better organisational performance, for the benefit of multiple stakeholders, including customers, employees, suppliers, the community and the environment in the long term. **Environment and the Community** – Highly engaged teams are strongly connected to the social purpose of their organisation and are committed to making a difference in the communities they serve. **Customers –** Highly engaged teams deliver a better customer service and are committed to doing the right thing.	The Board reviewed the terms and conditions of existing Hafren Dyfrdwy employees and concluded that the packages between Hafren Dyfrdwy and Severn Trent were broadly comparable and fair across the Group's businesses. It was observed that the Company's employee survey (QUEST) had highlighted that employees acknowledged the additional benefits that had been introduced to Hafren Dyfrdwy following its acquisition by Severn Trent, including the all-employee company bonus, Sharesave scheme (77% of Hafren Dyfrdwy employees participate in the Group's Sharesave scheme) and other flexible benefits. It was agreed that the Company would engage further with its employees to communicate and explain the terms of conditions in additional detail.

Business overview

Hafren Dyfrdwy is a wholly owned subsidiary of Severn Trent Water Limited. The Company was launched on 1 July 2018 and is one of 11 water and waste water companies operating in England and Wales. It provides wholesome water to 77,000 customers in North East Wales and waste water services to 27,000 customers in Powys and Monmouthshire. As a company that covers a highly rural area, with a relatively small population base, it can be difficult to achieve our stretching targets, many of which are set in reference to levels achieved by more localised companies, or the larger sewerage companies. However we remain committed to seek more innovative and efficient ways to improve performance for our customers.

This strategic report covers the year ended 31 March 2020, which represents the first full year of operation for the Company as well as the final year of the five-year regulatory period. In January 2020 we accepted our Final Determination from Ofwat for the period 2020-25. The settlement confirmed the revenue allowances and performance expectations for the next five years. Hafren Dyfrdwy was also identified as being upper quartile for efficiencies compared to the industry.

During the year changes have been made to support a more agile and focused delivery of Hafren Dyfrdwy's targets. These changes reflect the relative size of the Company as part of the Severn Trent Group. A single Executive level lead was appointed to oversee operational delivery and a series of steering groups were established to consider:

- Investment in maintaining our existing asset base and construction and commissioning of new assets through the capital expenditure programme;
- Operational expenditure to deliver key performance measures as well as support services and consumables; and
- An oversight of performance including operational measures, capital delivery and customer metrics.

This report covers a period of transition from the completion of key, multi-year programmes of work to the preparation work to ensure we deliver against our customer commitments moving forward. Our preparations for 2020/21 include the evolution of our five-year regulatory settlement in to a delivery plan for the Company. This includes building our investment programmes around the asset base to ensure delivery of our commitments to our customers.

These commitments were delivered despite Hafren Dyfrdwy maintaining the lowest combined average bills in England and Wales.

Performance against ODIs

Our performance on our key ODIs in Wrexham and in Powys and Monmouthshire is set out below.

Wrexham

Description	Unit	Actual performance	Target performance
Discoloured water contacts	Number per 1,000 properties	1.32	1.01
Mean zonal compliance	%	99.92%	100%
Delivery of the outcomes of the service reservoir water quality risk management schemes	Text	Complete	Complete
Average duration of interruptions - 3 hours or longer (planned and unplanned interruptions)	Hours per property per year	0.19	0.20
Sustainable economic level of leakage	Litres per property per day	85.6	90.8
Security of supply index (SOSI)	SOSI	100	100
Number of bursts	Number	188	155
Gross operational greenhouse gas emissions	tCO_{2}^{e}	3,950	7,535
Customers' perception based on market research[1]	%	68	Improved
Non-household Service incentive mechanism	Score	89.4	80
Per capita consumption and water efficiency	Litres per capita per day	141.25	127.28
Service incentive mechanism (SIM)[2]	Score	72.9	80

Powys and Monmouthshire

Description	Unit	Actual performance	Target performance
Internal sewer flooding	Number	10	7
External sewer flooding	Number	32	59
Minutes without supply	Minutes	31.60	8.00
Service Incentive Mechanism	SIM	77.40	UQ
Number of Category 3 pollution incidents	Number	4	10
Drinking water quality complaints	Number	124	70
Mean zonal compliance	%	100%	100%
Asset stewardship – coliform failures	Number	0	0
Leakage	Ml/d	6.87	7.7

[1] A survey was conducted in 2015/16 to assess satisfaction with our service and establish a baseline for the 'value for money' component. A baseline of 80% was established against which the target was to improve.
[2] Ofwat will determine relative rankings. This information will be published later this year.

Operational review

The last 12 months have been some of the wettest on record, with cumulative rainfall between June 2019 and February 2020 in the whole Hafren Dyfrdwy region more than 150% of the long-term average. In February 2020 in parts of Wales, rainfall exceeded three and half times the monthly average. The timing of three severe storms; Ciara, Dennis and Jorge, in quick succession is a critical factor in understanding the severity of the impact.

Despite this, our first full year operating as Hafren Dyfrdwy is notable for its successful delivery of critical investment programmes to secure the future water quality across our region. We also closed out negotiations with our regulators to agree our final determination in the PR19 process, setting our revenue and performance measures for the 2020-25 period. This agreement is the culmination of nearly two years' detailed work and conversations with hundreds of our customers and stakeholders.

Delivering strategic schemes

Throughout the 2015-20 period we agreed with the Drinking Water Inspectorate that we would complete a programme of work was designed to replace existing reservoirs that were nearing the end of their useful life with new assets, securing the water quality in the area for generations to come. In total we would replace three distribution service reservoirs and upgrade the membranes on a further 8 reservoirs in the Wrexham operating area. We had already completed one reservoir replacement (Llwyn Onn) and four of the membrane upgrades.

This year we completed the programme with completion of two large capital reservoir schemes; the replacement of Sugn-y-Pwll and a new reservoir at Llangollen. This extensive programme of work required large scale capital work with the replacement of Llwyn Onn treated water tank, Sugn-y-Pwll service reservoir, Berwyn service reservoir, and the completion of roof membranes at eight service reservoirs.

The new assets will reduce the water quality risk to customers, improve the resilience of water supplies for local communities for generations to come and allow the decommissioning of the 140-year old Victorian reservoir at Berwyn.

Supporting our customers

We're keeping our bills the lowest in Wales in AMP7. The average water and sewerage bill will be £300 per year compared to the average bill in the rest of Wales of £451. Despite this, we're committed to help those customers who may be in difficult circumstances and need additional support.

This year we've been working in partnership with organisations such as Powys Association of Voluntary Organisations, Warm Wales and Newydd and Mid-Wales Housing. This collaboration has helped us reach more customers that were struggling to pay their bills than we hoped.

We're pleased to see a 26% reduction in the overall number of household complaints this year and an even better 38% reduction in stage 2 complaints, indicating that when customers are dissatisfied we've significantly improved our resolution.

Delivering exceptional waste service performance

We deliver waste water services to customers in Powys and Monmouthshire and while incidents are rare, when they do occur they are the worst failure our customers can experience. It can also impact on the environment if that spillage occurs near a water course or natural space.

It's this part of our network that has been most impacted by the severe wet weather we experienced over the autumn and winter period. At times the waste water network would become overloaded as rainfall fell on already saturated ground; this increased the risk of flooding for our customers. Our continued focus from the operational teams ensured that we minimised the impact this would have on our customers and the environment.

Over recent years this has been a key focus area for us through targeting proactive work to keep the sewers clear, preventing the build up a fats, oils and greases working with local food establishments and a wide-scale education programme aimed at understanding what should and should not be flushed down the drain. We continue to see the benefits of these activities as we recorded low levels of pollution incidents and external sewer flooding incidents. More customers experienced internal flooding than we consider acceptable and we'll continue to work to drive improvements in this area moving forward.

Improving our water service performance

This is the last year we're reporting our performance separately for our customers in Wrexham and Powys/Monmouthshire. We've seen notable year on year improvement on some of the core water service commitments such as leakage and supply interruptions.

In Powys we've hit 100% on the Drinking Water Inspectorate's measures of water quality (mean zonal compliance), and hit our leakage target putting us in a great position to deliver the stretching targets for the 2020-25 period.

Our aim is to have a calm network. This mainly means reducing pressure changes which can lead to burst pipes. Every burst leads to water being lost through leakage, a more turbulent flow leading to increased water quality complaints, and brings a risk of customers being off supply and increases the likelihood of low pressure.

It's going to take time as we implement the improvements across our network, focusing on the areas that are highest risk to our customers. So we're also looking at how we can respond when things do go wrong to ensure the impact on our customers is minimised.

In Wrexham our water quality performance was slightly worse with a mean zonal compliance score of 99.92% and a small year-on-year increase in drinking water complaints. We did, however, hit our target on leakage putting us in a strong position for AMP7.

Improving our environment

Our customers are placing an increasingly high value on the natural environment. We share this view and our commitments are aligned with Welsh Government's Well-being of Future Generations Act. Our aim is to operate in a way that considers the impact of our operations on the environment. We are fully committed to protecting and improving our environment and so we're particularly delighted with our performance in this area.

This year we've published the first ever Sustainability Report as part of the Severn Trent Group. This demonstrates our commitment to improving the natural environment through activities such as improving biodiversity, reducing water use through leakage and per capita consumption and committing to the carbon triple pledge.

Looking forward

In December we formally agreed with Ofwat our plans for 2020-25. Our plans were developed with our customers and key stakeholders. We've committed to:

- deliver a 15% reduction in leakage;
- improve biodiversity on over 450 hectares of land;
- reduce household use by 4% reduction;
- reach more vulnerable customers than ever before who need our help; and
- ensuring we do everything we can to minimise the risk of sewer flooding and pollution from our waste water service.

Financial performance

Our financial performance reflects the first full year of operation following significant organisational change in July 2018. These changes brought in new customers, significant assets and new waste water activities in Powys, alongside additional costs due to the more rural characteristics of the region.

The period is also the final year of the five year regulatory period, with activity targeted at both completion of previous programmes and work to prepare to deliver against our new customer commitments moving forward. As a result, we saw continued investment in our networks to improve our performance for our customers now and in the future, including:

- Completion of large capital service reservoir schemes bringing our five-year water quality risk management programme, a key regulatory output, to a close. This will improve water quality for customers and improve the future resilience of water supplies for local communities.

- Continued investment in our ice-pigging activity, proactively targeting areas of the network and preventing the build up a fats, oils and greases continues to deliver benefits with lowest ever levels of pollution incidents and external sewer flooding incidents

- Increased investment in two key areas – mains renewal and leakage. This investment has helped deliver improved performance on supply interruptions, leakage and drinking water discolouration.

These investments are reflected in our financial results for this year but we expect to see ongoing resulting benefits in better customer service and improved financial returns in future.

The very low population density of the supply area drives a relatively high cost and complexity of operating and maintaining our water distribution network, increasing the cost of serving customers in comparison to the previous geographical area.

Performance and associated costs in the period were also impacted by severe weather events. Parts of Wales saw rainfall exceed three and half times the average level in February; there were also three severe storms in quick succession

Turnover increased marginally, by 1.0% to £32.4 million (2018/19: £32.0 million). Customers continue to pay the lowest combined average bills in England and Wales, and the vast majority of customers saw price increases below 5% despite the increasing network costs above.

The increase in revenue was predominantly the result of an additional £1.3m from the full year impact of service agreements relating to reservoir assets transferred from Severn Trent Water in July 2018. This is offset by a decrease of £1.1m following the boundary change, with a net reduction in customer numbers.

Operating costs before exceptional items saw an increase, by 5.7% to £36.1 million (2018/19: £34.2 million). Within this, outsourced activity to deliver targeted leakage improvements led to an additional £0.9m of cost. Increased levels of infrastructure maintenance and mains renewal activity in particular increased costs by further £1.0 million and depreciation on a growing asset base also saw a £0.6 million increase. A full year impact of an amended property portfolio following the boundary change has increased business rates by £0.4m and property management fees by £0.4m.

A cost reduction of £1.1 million was the result of higher levels of capital project activity, alongside £0.3m of lower direct employment costs (excluding exceptional items) reflecting a full year of support activity being provided by Group functions.

There were no exceptional costs incurred in the year, compared to £0.4 million in the prior year as a result of the High Court's judgment relating to gender equality in Guaranteed Minimum Pension rights that had an impact on the Company's defined benefit pension liabilities.

The loss before interest and tax was £3.7 million (2018/19 restated[3]: loss of £2.6 million).

Net finance income for the year was £0.5 million (2018/19 restated[3] finance costs: £2.0 million). The change is due to lower inter-company debt payable to Severn Trent Water as a result of the asset transfers from the boundary realignment. This debt was repaid via the de-gearing exercise carried out in the prior year (see below) and we expect lower finance costs ongoing as a result.

Our full effective tax rate was below the statutory rate at 12.5%, excluding the exceptional deferred tax charge arising from the corporation tax rate for 2020/21.

We are committed to paying the right amount of tax at the right time. We pay a range of taxes, including business rates, employers' national insurance and environmental taxes such as Climate Change Levy, as well as corporation tax which is included in our tax charge in the income statement

The loss for the year was £4.3 million (2018/19 restated[3]: £2.9 million).

Our defined benefit pension scheme surplus was £21.3 million (2019: £18.6 million). The funding level remains strong at 149% (2019: 139%).

We finished the year with a strong balance sheet, net assets of £145.8 million (2019 restated[3]: £148.3 million), net current assets of £3.6 million (2019: £13.3 million) and RCV gearing of 77.5% (2019: 66.7%).

On 10 July 2020 the Company approved the issue of 20 million ordinary shares of £1 each to its parent company, Severn Trent Water Limited in exchange for cash. The cash was applied to pay down £20 million of the floating rate loan (see note 17).

Also on 10 July 2020 the Company accepted the offer of a £30 million revolving credit facility from its ultimate parent company, Severn Trent Plc. Amounts drawn under the facility bear interest at 1.7% above LIBOR. The facility is committed until 1 July 2022.

[3] For details of the restatement see note 1 to the financial statements.

Risk management

OUR APPROACH TO RISK

Risk is all about uncertainty. We recognise that uncertainty can manifest itself as both negative and positive impacts. All of the Company's risks are identified and managed through a continuous corporate risk management process. Our goal is to identify risk, minimise the threats and maximise the opportunities for the benefit of our customers, shareholder, employees, supply partners and the environment.

The well-established Severn Trent Plc Enterprise Risk Management (ERM) approach has been implemented within Hafren Dyfrdwy to manage and mitigate risks.

The Board has overall accountability for ensuring that risk is effectively managed within the Company. The Board's mandate includes defining risk appetite and monitoring risk exposure to ensure significant risks are aligned with the overall strategy of the Group. The management of risk is embedded in our everyday business activities, with employees encouraged to play their part.

On behalf of the Board, the Audit Committee of Severn Trent Plc assesses the effectiveness of the Group's ERM process and internal controls to identify, assess, mitigate and manage risk. The Group Internal Audit function supports the Audit Committee of Severn Trent Plc in evaluating the design and effectiveness of internal controls and risk mitigation strategies implemented by management.

The Executive Committee reviews strategic objectives and assesses the level of risk taken in achieving these objectives. This 'top down' risk process helps to ensure the 'bottom up' ERM process, described below, is aligned to current strategy and objectives.

Across the Group, we manage risks within the overall governance framework which includes clear accountabilities, delegated authority limits and reward policies. These are designed to provide employees with a holistic view of effective risk management. The management of risk is embedded in our everyday business activities.

Within Hafren Dyfrdwy, our approach reflects our status as a regulated utility providing essential services and operating as part of the Critical National Infrastructure for the UK. The nature of our business is such that there are some significant inherent risks. We aim to have a strong control framework in place to enable us to understand and manage these risks in accordance with our risk tolerance and appetite. Given the relative size of Hafren Dyfrdwy in the Group, the Severn Trent Plc Audit Committee is managing risks which are material at a Company level as well as at a Group level.

The Directors have carried out a robust risk assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. The principal risks are summarised in the following table. For each risk we state what it means for us and what we are doing about it.

The principal risks facing Hafren Dyfrdwy are illustrated on pages 22 to 25.

Risk appetite

The Board keeps the relationship between our strategic ambitions and the management of risk under continual review. The ERM process establishes target risk positions for each of our significant risks. The Board formally discusses the progress towards this position and the mitigating actions being undertaken every six months.

OUR PRINCIPAL RISKS

The Directors have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. For each risk we state what it means for us and what we are doing to manage it.

Customer Perception			
Ref	**What is the risk?**	**What does it mean for us?**	**What are we doing to manage the risk?**
1	Failure to maintain or improve customer service performance in line with expectations	In March 2020 Ofwat's new customer satisfaction measure called customer measure of performance (C-MeX) came into force. During 2019/20 Ofwat ran a shadow year for the new measure. We recognise that our regulators and customers expect more from us and demand an improved and more consistent experience.	Ofwat's regulatory processes place customers at the heart of the business and so do we with our ongoing investments to deliver significant improvements in the quality of product and service. We have focused on Ofwat's new customer measure of performance (C-MeX) during 2019/20 shadow year and improved on the previous customer satisfaction measure of Service Incentive Mechanism. We have a programme to deliver improvements across our retail, water, waste and experience areas and also are committed to delivering an improved core water and waste water service.

Legal and Regulatory Environment			
Ref	**What is the risk?**	**What does it mean for us?**	**What are we doing to manage the risk?**
2	Ongoing regulatory reform and the potential for increased complexity in regulations	Our operational environment is highly regulated. Our policies and procedures ensure compliance with the regulatory framework. But market reform and the potential for differences in policy between the two governments creates risks. Regulatory changes may introduce additional complexity into the regulatory regime with associated increased costs of administration, reduce income and margin and greater variability of returns.	As a wholly Welsh company since July 2018, we are committed to working with the Welsh Government to develop its water strategy for its people. We have strong relationships, good engagement and open dialogue with the Welsh Government, local and national Welsh Assembly Members, Wales Water Forum, Natural Resources Wales, the Drinking Water Inspectorate and Ofwat to assist the Company in managing any risks presented by future regulatory reform.

3	Failure to meet regulatory performance targets	Ofwat has set the Company some challenging performance targets for AMP6 and AMP7, with financial penalties and loss of credibility if we fail to meet these.	As with all companies, there are both good aspects of performance (e.g. water quality as measured through the Compliance Risk Index ('CRI'), low pressure, mains bursts) and areas for improvement (e.g. water supply interruptions, water quality contacts). Since the creation of HD, we have invested above the level assumed in the Final Determination to improve the asset base to sustainably deliver service for customers. We will continue our investment programme, using a proactive approach to identify where improvements are required.

Operations, Assets and People			
Ref	**What is the risk?**	**What does it mean for us?**	**What are we doing to manage the risk?**
4	Failure to maintain a constant supply of water that meets Drinking Water Standards	Failure of certain important assets could cause widespread loss of supply to customers with the risk of regulatory sanction, loss of reputation and higher operating costs. Water quality failures caused by an historical issue could result in regulatory sanctions, adversely affect our reputation and cause an increase in our costs.	Our approach to supply interruptions follows 'Prevent, Restore, Repair' strategy which focuses on preventing asset failure where possible, and restoring supply at speed if this happens. We also have contingency plans provide for major failures. These include bringing in water from other parts of the supply area, providing emergency supplies and mutual aid agreements with other water companies. We track performance through leading measures through comm cells and at performance meetings. Assets are managed through condition monitoring and maintenance. When appropriate, risk-based asset investment planning identifies assets for replacement, which is a continuing process. We take a risk-based approach and use the Drinking Water Safety Plan to address the management of water quality risks throughout the supply

			system from catchment to customer. Our performance on CRI is amongst the best in the sector.
5	Business interruption and/or data loss resulting from cyber threats	Loss or corruption of computer systems or data is a real and growing threat and potentially, could have far reaching effects, particularly within our administrative and equipment operations.	We continue to commit significant resources and financial investment to maintain the integrity and security of our assets and data. We follow guidance from the National Cyber Security Centre and have defence through multiple layers of software and processes including web gateways, filtering, firewalls, intrusion and advanced threat detection. We have strengthened our security and network operations capability this year and have improved the controls around third-party access to our systems and data. We have reviewed our cyber risk methodology and are using this to prioritise future investment to ensure that we protect ourselves in-line with GDPR, Network and Information Systems Regulation and Payment Card Industry Data Security Standard (PCI DSS) best practices. We have also participated in several internal cyber security incident exercises to test our response capability to cyber-attacks. There has been no material change in the net risk exposure.

Legal and Regulatory Environment			
Ref	**What is the risk?**	**What does it mean for us?**	**What are we doing to manage the risk?**
6	Health and Safety	Our work requires our employees and contractors to use equipment and carry out tasks which have the potential to cause serious harm. In addition, we undertake a lot of work in dynamic public places such as busy streets. We take every precaution to prevent injury, however the failure of a	We have alignment with the well-established Health, Safety and Wellbeing Framework within Hafren Dyfrdwy to ensure all of our operations and processes are conducted in compliance with Health and Safety legislation and in the interests of the safety of our people and our contractors.

		procedure or the breakdown of an asset could lead to injury.	In April 2019 we launched our refreshed Goal Zero strategy, comprising four key elements, which provide the routine requirements to manage risk, information for people to drive their own performance, data to drive targeted interventions and consistent focus on the four areas that hurt us the most; driving for work, manual handling, slips trips and falls and mental ill health. At a Group level we saw a 33% improvement in LTI performance compared with 2018/19. Hafren Dyfrdwy recorded three lost time incidents during the year; as this is the first full year of operation for Hafren Dyfrdwy a year on year comparison is not provided.

Non-Financial Information Statement

This section of the Strategic report constitutes the non-financial information statement of Hafren Dyfrdwy Cyfyngedig, produced to comply with sections 414CA and 414CB of the Companies Act. The information listed in the table below is incorporated by cross reference.

Reporting requirement	Policies and standards which govern our approach	Additional information and risk management
STAKEHOLDERS	• Customer policy • Group data protection policy • Group commercial policy	Stakeholder engagement, **page 9** s.172 statement, **page 12** Board activities, **page 36**
ENVIRONMENTAL MATTERS	• Group environment policy	Sustainability statement, **page 4** Sustainability report, **pages 12 - 28** available at severntrent.co.uk.
EMPLOYEES	• Group health, safety and wellbeing policy • Group speak up policy	Stakeholder engagement, **page 8** Our Purpose and Values, **page 4** Governance report, **pages 32 to 57**
RESPECT FOR HUMAN RIGHTS	• Modern Slavery Statement	Modern Slavery Act, **page 46** Governance report, **pages 32 to 57**
ANTI-CORRUPTION AND ANTI-BRIBERY	• Group financial crime and anti-bribery and anti-corruption policy • Group conflicts of interest policy • Group security policy • Group competition and competitive information policy	Governance report, **pages 32 to 57**
SOCIAL MATTERS	• Doing The Right Thing • Group environment policy • Customer policy	Directors' report, **pages 51 to 56**
DESCRIPTION OF PRINCIPAL RISKS AND IMPACT OF BUSINESS ACTIVITY		Principal risks, **pages 21 to 24** Business model, **page 6**
DESCRIPTION OF THE BUSINESS MODEL		Business model, **page 6**
NON-FINANCIAL KEY PERFORMANCE INDICATORS		Strategic report, **pages 3 to 30** ODI performance **page 19**

The policies mentioned above form part of Severn Trent's Group policies, which act as the strategic link between our Purpose and Values and how we manage our day-to-day business. During the year, the Severn Trent Plc Board approved the relaunched Doing the Right Thing and supporting Group policies, and it was determined that the policies remain appropriate, are consistent with the Group's values and support its long-term sustainable success.

Assessment of current position and long-term prospects

The Directors' assessment of the Company's current financial position is set out in the Financial Performance on pages 19 to 20.

The Company operates a regulated long-term business characterised by multi-year investment programmes and stable revenues. The water industry in England and Wales is currently subject to economic regulation rather than market competition and Ofwat, the economic regulator, has a statutory obligation to secure that water companies can (in particular through securing reasonable returns on their capital) finance the proper carrying out of their statutory functions. Ofwat meets this obligation by setting price controls for five year Asset Management Periods (AMPs) including mechanisms that reduce the risk of variability in revenues from the regulated business in the medium term by adjusting future revenues to balance over or under recovery compared to the original plan.

AMP6 ended on 31 March 2020 and Ofwat has made its determination of price controls for the Company for the AMP period 2020-25 (AMP7). The Company has developed its plans to deliver the operational and financial performance set out in the determination and we have based our assessment of prospects for the next five years on these plans, subject to modifications resulting from the impacts of the COVID-19 outbreak (see below).

When considering the Company's prospects beyond 2025, it is necessary to make assumptions about the price review process for the period 2025-30 (PR24), which will take place in 2024. In making this assessment we have taken account of:

- Ofwat's statutory duty to secure that companies can finance the proper carrying out of their functions;
- The Company's financial structure, which, following the equity injection in July 2020, is close to the Ofwat notional capital structure and our plan to retain this; and
- The Company's plans for AMP7, the successful execution of which would deliver benefits to all stakeholders and financial incentives that would help to further strengthen our financial resilience in the period beyond 2025.

The Company has significant investment programmes that are largely funded through intra-group borrowing under multi-year agreements and facilities. The tenor of the facilities is set out in note 9 to the financial statements. There are no financial covenants included in these agreements.

The Company's strategic funding objectives reflect the long-term nature of its business and the Company seeks to obtain a balance of securing long-term funding at the best possible economic cost and maintaining financial ratios that would support an investment grade credit rating. The Directors have concluded that the Company's financial ratios at 31 March 2020, after taking account of the equity injection in July 2020 would support such a rating.

The Severn Trent Group's Treasury Policy requires that it maintains sufficient liquidity to cover cash flow requirements for a rolling period of at least 18 months in order to mitigate the risk of restricted access to capital markets. The Company's refinancing requirements are managed within the Group Treasury department to spread the timing of refinancing requirements and to enable such requirements to be met under most market conditions. The weighted average maturity of debt at the balance sheet date was 8 years.

The Company has an established process to assess its prospects. The Board undertakes a detailed assessment of the Company's strategy on an annual basis and the output from this assessment sets the framework for the Company's medium-term plan, which is updated annually.

The Company's medium-term plan assesses its prospects and considers the potential impacts of the principal risks and uncertainties. Stress tests are performed to assess the potential impact of combinations of those risks and uncertainties. The plan also considers mitigating actions that the Company might take to reduce the impact of such risks and uncertainties, and the likely effectiveness of those mitigating actions.

Impact of COVID-19 on the Company's prospects

The Office for Budget Responsibility has identified the Water industry as likely to be amongst the least affected by the COVID-19 outbreak. But we are not immune to the impacts on the wider economy and we expect to see a reduction in consumption from non-household customers following the restrictions implemented by the Government, and an increase in bad debt costs from household customers, even after allowing for an increase in the use of our range of social tariffs. Some independent forecasters are also predicting a sharp reduction in inflation during calendar years 2020 and 2021 that would impact our revenue in financial years 2021/22 and 2022/23. We have modelled the likely impacts on our medium-term plan and developed an updated assessment of our prospects allowing for the anticipated impacts of COVID-19 based, inter alia, on the Office for Budgetary Responsibility's Reference Scenario published on 14 April 2020; Government advice; and Water sector specific guidance from our regulator Ofwat. We have applied our stress tests, including more severe impacts of the COVID-19 outbreak, to this adjusted plan.

Period of assessment

The Board considered a number of factors in determining the period covered by the assessment. The long-term nature of our principal business, together with relatively stable revenues and a model of economic regulation that places a duty on the regulator to secure that water companies can finance the proper carrying out of their functions, support a longer period of assessment.

However, the changing nature of regulation of the Water industry increases the uncertainty that is inherent in our financial projections. We have an established planning and forecasting process and the Board considers that the assessment of the Company's prospects is more reliable if based on an established process. Our latest medium-term plan extends in detail to the end of the AMP7 period in 2025, with less detailed projections looking beyond this.

A longer period of assessment introduces greater uncertainty because the variability of potential outcomes increases as the period considered extends.

Bearing in mind the long-term nature of our business; the enduring demand for our services; our established planning process; and the changing nature of the regulation of the Water industry in England and Wales, the Board has determined that seven years is an appropriate period over which to assess the Company's prospects and make its viability statement this year.

Assessment of viability

In assessing our future prospects, we have considered the potential effects of risks and uncertainties that could have a significant financial impact under severe but plausible scenarios. The risks and uncertainties considered were identified in the Company's ERM process, which is described on pages 20 to 21, and from the key assumptions in the financial model. Where the risk occurs at a point in time we have assumed that it occurs at the point in the plan with the lowest headroom.

The scenarios tested are described below.

Scenario tested	Related principal risk	Mitigating actions
1. *A severe impact from the COVID-19 outbreak resulting from a prolonged 'lockdown' period resulting in lower economic activity, higher unemployment and lower inflation.* The adjustments that we have made to our medium-term plan to reflect the anticipated impacts of COVID-19 are based on a number of assumptions including a 'lockdown' period of three months followed by another period of three months when Government restrictions are partially lifted. We have modelled longer periods of 'lockdown' and a partial lifting of restrictions of six months each which might result in more severe impacts on total revenues and household bad		The regulatory model includes mechanisms to adjust future revenues to balance out any under recovery when compared to the original price review. The application of these mechanisms would not necessarily take into account affordability of customers' bills and therefore might be spread into the next AMP period. Reduce discretionary expenditure to mitigate the impact of lower revenue in the affected years.

debts, together with a larger and longer reduction in inflation.		
2. *The Company experiences a severe climate event or other exceptional event with a very significant financial impact* The Company's Enterprise Risk Management process has identified a number of risks including extreme weather events and failure of key assets that might have a significant impact on the Company's operational and financial performance.	Risk 1: Breach of raised reservoir Risk 4: Impact of extreme weather/climate change	Reduce discretionary expenditure to cover any extra costs resulting from the event. Secure additional debt or equity finance from the Severn Trent Group.
3. *The Company underperforms against its performance commitments* The Company operates under a regulatory model that encourages companies to deliver what customers want, using performance related rewards and penalties. Failure to deliver performance at the committed level can lead to significant penalties. We have assessed the impact of a penalty equivalent to 3% of Return on Regulated Equity (RoRE).	Risk 3: Failure to deliver what our customers want	Reduce discretionary expenditure to cover any extra costs resulting from penalties.
4. *The Company incurs higher costs than planned that are not funded* Significant overspending could result in a deterioration in financial metrics and performance, which might adversely impact the Company's solvency. We have assessed the impact of a 10% overspend on capital and operating expenditure in each year of the plan.	Risk 2: changes in the regulatory environment for the UK water industry	Reduce discretionary expenditure in the short term. In the medium term implement a cost reduction programme to deliver sustainable cost savings and efficiencies to bring costs back in line with regulated allowances. Secure additional debt or equity finance from the Severn Trent Group.

5. *The Company incurs a financial penalty for non-compliance with legislation* The Company operates in a regulatory and legal environment that is complex and changing. Failure to keep pace with changes in legislation or regulation could lead to non-compliance and result in financial penalty of 3% of one year's revenue.	Risk 2: changes in the regulatory environment for the water industry	Reduce discretionary expenditure to cover any extra costs resulting from penalties.
6. *A combination of scenarios 3-5*	See above	Reduce discretionary expenditure in the short term. Reduce working capital to support cash flow. Secure additional debt or equity finance from the Severn Trent Group.
7. *The Company experiences a severe failure of a key asset.* The Company's Enterprise Risk Management process has identified a risk relating to the failure of key assets that might have a significant impact on the Company's operational and financial performance. We have assessed the effects of an incident with an impact of £150 million.	Risk 4: Catastrophic breach of a raised reservoir	Reduce discretionary expenditure in the short term. In the medium term implement a cost reduction programme to deliver sustainable cost savings and efficiencies to bring costs back in line with regulated allowances. Secure additional debt or equity finance from the Severn Trent Group.

The combined scenario represents a situation where several of the severe but plausible scenarios occur simultaneously. In this situation, the same mitigating actions would be available but their application would be deeper.

The Company has significant funding requirements for the Company's capital programme. Since the Company's principal source of funding is the Severn Trent Group, the Company has considered the outcome of the Severn Trent Group's assessment of viability in making its own assessment. The Company has also considered its parent company's willingness and ability to provide additional funding when required.

Under all scenarios considered, the Company would remain solvent and have access to sufficient funds in normal market conditions. The Group's Treasury Policy requires that it retains sufficient liquidity to meet its forecast obligations, including debt repayments for the next 18 months.

In making its assessment, the Board has made the following key assumption:

- Any period in which the Group is unable to access capital markets to raise finance during the period under review will be shorter than 18 months.

On this basis, the stress tests indicated that none of these scenarios, including the combined scenario, would result in an impact to the Company's expected liquidity, solvency or debt covenants that could not be addressed by mitigating actions and are therefore not considered threats to the Company's viability.

Governance and assurance

The Board reviews and approves the medium-term plan on which this viability statement is based. The Board also considers the period over which it should make its assessment of prospects and the viability statement. The Audit Committee supports the Board in performing this review. Details of the Audit Committee's activity in relation to the viability statement are set out in the Severn Trent Plc Audit Committee report on page 95 of the Severn Trent Plc Annual Report and Accounts. Since the onset of the COVID-19 outbreak, the Board has received regular and frequent updates of its likely impact and the results of stress tests based on more severe scenarios.

This statement is subject to review by Deloitte, our external auditor. Their audit report is set out on pages 60 to 70.

Assessment of viability

The Board has assessed the viability of the Company over a seven year period to March 2027, taking into account the Company's current position and principal risks.

Based on that assessment, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to 31 March 2027.

Going Concern Statement

In preparing the financial statements the Directors considered the Company's ability to meet its debts as they fall due for a period of one year from the date of this report. This was carried out in conjunction with the consideration of the viability statement above.

In making this assessment the directors took into account the new issue of shares of £20 million and agreement of a further £30 million revolving credit facility from Severn Trent Plc as set out in note 21 to the financial statements.

On this basis the Directors considered it appropriate to adopt the going concern basis in preparing the financial statements.

The Strategic report has been approved by the Board.

By order of the Board

James Bowling
Director

14 July 2020

Governance Report

2018 UK Corporate Governance Code Compliance Statement

The Hafren Dyfrdwy Cyfyngedig Board is fully committed to Ofwat's principles for Board leadership, transparency and governance with its emphasis on the importance of strong board leadership and the special responsibilities attached to regulated monopoly companies providing an essential public service. As Hafren Dyfrdwy is not a listed company, it is not required to comply with the 2018 UK Corporate Governance Code (the "2018 Code"). However, Hafren Dyfrdwy has elected to comply with the 2018 Code, where appropriate and reasonably practicable, to ensure the highest standards of governance.

For the whole of the financial year ended 31 March 2020, Hafren Dyfrdwy was compliant with the 2018 Code, with the following exceptions:

1. Audit and Remuneration Committees at Company level

The Remuneration Committee at Severn Trent Plc Group level operates on behalf of Hafren Dyfrdwy. There have been no Remuneration matters for consideration by the Hafren Dyfrdwy Board during the year. In the event such consideration is required, the matters will also be considered at Hafren Dyfrdwy Board level.

The Audit Committee at Severn Trent Plc Group level operates on behalf of Hafren Dyfrdwy, with the Committee providing advice, assurance and recommendations only, ahead of the Hafren Dyfrdwy Board making final decisions.

Any associated assurance in respect of Hafren Dyfrdwy is conducted at a materiality relevant to the size of Hafren Dyfrdwy and risks are considered and managed from an individual Board perspective, with clear and effective governance at individual Board level.

Hafren Dyfrdwy Directors receive comprehensive updates from the Company Chair in respect of all matters considered by the Severn Trent Plc Audit Committee meetings in relation to Hafren Dyfrdwy. Directors have access to all relevant papers and external assurers as appropriate. Additionally, there is a separate Hafren Dyfrdwy Nominations Committee that comprises Hafren Dyfrdwy Non-Executive Directors only.

The Severn Trent Plc Audit Committee's terms of reference include, but are not limited to, reviewing:

- the integrity of the processes that ensure the quality and reliability of regulatory statements and information to regulatory bodies, including the Annual Regulatory Compliance Statement and Annual Performance Report, submitted to Ofwat; and
- the integrity of the processes that ensure compliance with the requirements of regulatory submissions to regulatory bodies; in respect of Hafren Dyfrdwy.

The Severn Trent Plc Board Committees outlined above comprise a majority of Independent Non-Executive Directors of Severn Trent Plc. In respect of the Severn Trent Plc Remuneration Committee, one member of the Committee also serves as a Non-Executive Director on the Board of Hafren Dyfrdwy. In respect of the Severn Trent Plc Audit Committee, the Hafren Dyfrdwy Chair is also the Chair of the Severn Trent Plc Audit Committee.

The respective committees provide advice, assurance and recommendations only, ahead of the Hafren Dyfrdwy Board making final decisions. Details of the respective Severn Trent Plc committees can be found in the Severn Trent Plc Annual Report and

Accounts. A copy of the Hafren Dyfrdwy Governance Framework can be found on page 37.

2. **Provisions relating to relations with shareholders**
The Company does not comply with the provisions relating to Relations with Shareholders which covers Dialogue with Shareholders and Constructive use of the AGM, as it would not be appropriate to do so. However, Severn Trent Plc does fully comply with these requirements.

LEADERSHIP AND EFFECTIVENESS

Board of Directors

1. Ann Beynon, OBE, BA (Hons)

Independent Non-Executive Director – Appointed to the Board on 1 April 2018

Ann is a Non-Executive Director on the Board of Farmers' Union of Wales Insurance Services, an Independent Advisor to the National Assembly for Wales* and a CBI Wales representative for the SE Wales Business Council. Previously, Ann was a Director for BT Wales, S4C's Head of Political and International Affairs and Equality and Human Rights Commissioner for Wales. Prior to this, Ann was a member of the Royal Commission on Reform of the House of Lords.

Other roles

- Independent Advisor to the National Assembly for Wales
- Member of CBI Wales Council
- Chair of the Clwstwr Creadigol project for Cardiff University
- Director of Cwmni Ann Beynon CYF
- Director of FUW Insurance Services Limited

*On 6 May 2020 the National Assembly changed its name to Senedd Cymru/Welsh Parliament. The Assembly Members are now known as Members of the Senedd or in Welsh Aelodau o'r Senedd.

2. James Bowling, BA (Hons) Econ, ACA

Chief Financial Officer – Appointed to the Board on 17 February 2017

James is a chartered accountant, who started his career with Touche Ross and brings significant financial management, M&A and business transformation expertise to the Board. James has been the Chief Financial Officer of Severn Trent Water and Severn Trent Plc since April 2015. Prior to that, James was interim Chief Financial Officer of Shire Plc, where he had been since 2005, first as Head of Group Reporting and from 2008 as Group Financial Controller. Before joining Shire, James spent nine years at Ford Motor Company in various finance roles of increasing responsibility.

James has recent and relevant financial experience as a member of the Institute of Chartered Accountants in England and Wales.

Other roles

- Executive Director of Severn Trent Water Limited, the Group's licenced entity in England, and Severn Trent Plc

3. John Coghlan, BCom, ACA

Chair – Appointed to the Board on 17 February 2017

John has a wealth of experience in financial and general management. He spent 11 years at Exel PLC as Chief Financial Officer and ultimately as Deputy Chief Executive Officer until retiring in 2006. Since then, he has been a Director of publicly-quoted and private companies across several sectors. John has recent and relevant financial experience as a member of the Institute of Chartered Accountants in England and Wales.

Other roles

- Non-Executive Director of O.C.S. Group Limited
- Non-Executive Director of Clarion Housing Association
- Non-Executive Director of Severn Trent Water Limited, the Group's licenced entity in England, Severn Trent Plc and Chair of the Audit and Treasury Committees

4. Andrew Duff, BSc, FEI

Independent Non-Executive Director – Appointed to the Board on 17 February 2017. Retired from the Board on 31 March 2020.

Andrew's extensive experience of international and regulated business, strategic management and customer service in high profile, dynamic environments equipped him well for the role of Director on the Hafren Dyfrdwy Board. Andrew spent 16 years at BP Plc in marketing, strategy and oil trading. He joined National Power in 1998 and the Board of Innogy Plc upon its demerger from National Power in 2000. He played a leading role in its restructuring and transformation through the opening of competition in energy markets culminating in its subsequent sale to RWE in 2003.

He became Chief Executive Officer of the successor Company and a member of the RWE Group Executive Committee until his retirement in 2010. He was a Non-Executive Director of Wolseley Plc from July 2004 until November 2013.

Other roles

- Non-Executive Chairman of Elementis Plc
- Non-Executive Director of UK Government Investments Limited
- Member of the CBI President's Committee
- Fellow of the Energy Institute
- Senior Trustee of Macmillan Cancer Support
- Chairman of Severn Trent Plc and Severn Trent Water Limited (until retirement on 31 March 2020)

5. Olivia Garfield, BA (Hons)

Chief Executive – Appointed to the Board on 17 February 2017

Olivia (Liv) brings to the Board a wealth of experience managing customer service delivery and complex infrastructure and organisations in a regulated environment. Liv was Chief Executive Officer of Openreach, part of the BT Group, where she spearheaded and oversaw the commercial roll-out of fibre broadband to two-thirds of the country. She joined BT in 2002 and held the pivotal roles of Group Director of Strategy and Regulation, Managing Director Commercial and Brands, Global Services and UK Customer Services Director. From 1998 to 2002, Liv worked for Accenture as a consultant in the Communications and High Tech Market Unit, designing and implementing business change solutions across a number of industry sectors.

Other roles

- Non-Executive Director of Water UK
- CEO of the Council for Sustainable Business
- Member of the Takeover Panel and its Hearings Committee
- Director of Water Plus Limited – joint venture with United Utilities
- Member of The 30% Club

- Executive Director of Severn Trent Water Limited, the Group's licenced entity in England, and Severn Trent Plc

6. Christine Hodgson, CBE, BSc (Hons), FCA

Independent Non-Executive Director – Appointed to the Board on 1 April 2020

Christine brings extensive board and governance experience to the Company as well as a deep understanding of business, finance and technology leadership. She is a committed advocate of the need for companies to serve all of their stakeholders effectively and deliver their social purpose. Until her appointment as Chair of the Severn Trent Board, she was the Executive Chair of Capgemini UK Plc, one of the world's largest technology and professional services groups. Christine joined Capgemini in 1997 and built her career in a variety of roles including CFO for Capgemini UK Plc and for the Global Outsourcing business, CEO of Technology Services North West Europe and the Global Head of Corporate Social Responsibility. Christine was previously an Independent Non-Executive Director of Ladbrokes Coral Group PLC until 2017. She is a fellow of the Institute of Chartered Accountants in England and Wales.

Other roles

- Senior Independent Director of Standard Chartered Plc
- Trustee and Member of the Board of The Prince of Wales' Business in the Community
- Chair of The Careers and Enterprise Company Limited
- Chair of Severn Trent Water Limited, the Group's licenced entity in England, and Severn Trent Plc

7. Sally Jones-Evans, FCIB, MSC, MBA

Independent Non-Executive Director – Appointed to the Board on 1 April 2018

Sally is a Non-Executive Director of the Principality Building Society where she also chairs the Remuneration Committee and sits on the Audit Committee and she is a Trustee Director at Tearfund, the Christian relief and development charity. Sally's executive career was at Lloyds Banking Group for 30 years' where she held a wide range of management roles. Sally has previously served as a Non-Executive Director of Welsh Athletics and the Student Loans Company and a member of the Welsh Government Financial and Professional Services Sector Advisory Panel.

Other roles

- Non-Executive Director at the Department for International Development
- Non-Executive Director of Principality Building Society
- Non-Executive Director of Saga Services Limited, a general insurance subsidiary of Saga Plc
- Non-Executive Director of Delio Limited
- Trustee Director of Tearfund

8. Dr Mohammed Mehmet, BSc (Hons), PhD

Independent Non-Executive Director - Appointed to the Board on 1 April 2018

Mohammed has been Chief Executive of two local authorities: Denbighshire County Council between April 2009 until April 2018 and interim CEO for Powys County Council from May 2018 to February 2019. Mohammed has served on several National Boards, including the Public Services Leadership Panel. He was the first chair of the National Procurement Board. He has led a number of regional programmes including the establishment of the North Wales School Improvement Service. Earlier in his career Mohammed was Director of Regeneration and Education in Islington and Assistant Director of Education in the London Boroughs of Camden and Hackney.

Other roles

- Trustee for Macmillan Cancer Support
- Director of MIND in Enfield

Board meeting attendance 2019/20

The following table shows the attendance of Directors at scheduled Board meetings during the year:

Director	Position	Board Meetings
Ann Beynon	Independent Non-Executive Director	4/4
James Bowling	Chief Financial Officer	4/4
John Coghlan	Chair	4/4
Andrew Duff	Non-Executive Director	4/4
Olivia Garfield	Chief Executive Officer	4/4
Sally Jones-Evans	Independent Non-Executive Director	4/4
Mohammed Mehmet	Independent Non-Executive Director	4/4

All meetings are structured to allow open discussion. Minutes of Board and Committee meetings are circulated to all Directors after each meeting.

In the event a Director is unable to attend a meeting, they still receive related papers in advance of the scheduled meeting and any input they have provided is fully considered.

Our Board

As at 31 March 2020, our Board comprised the Chair, three Independent Non-Executive Directors, one Non-Executive Director and two Executive Directors. The details of their career background, relevant skills, Committee membership, tenure and external appointments can be found within their individual biographies on pages 32 to 34. Andrew Duff retired from the Board with effect from 31 March 2020.

The Chair and Non-Executive Directors are appointed for a three-year term and continuation of Board appointments are conditional on satisfactory performance and recommendation by the Nominations Committee as to reappointment following the annual Board Effectiveness evaluation process. This term can be renewed by mutual agreement, up to a maximum total tenure of nine years.

The composition and effectiveness of the Board is subject to review by the Nominations Committee which, in particular, considers the balance of skills, experience and independence of the Board, in accordance with the Group's Board Diversity Policy. The Board Diversity Policy Statement is available on the Severn Trent Plc website.

Any new appointments to the Board result from a formal, rigorous and transparent procedure, responsibility for which is delegated to the Nominations Committee (although decisions on Appointments are a matter reserved to the Board). Further information on the work of the Nominations Committee can be found on pages 45 to 48.

Severn Trent Plc and Hafren Dyfrdwy Cyfyngedig operate as distinct legal entities. The Hafren Dyfrdwy Board's role is to ensure the long-term success of Hafren Dyfrdwy. Maintaining the highest standards of governance is integral to the effective delivery of our strategy and ensuring that the Board take decisions that create sustainable long-term value for the mutual benefit of our stakeholders, customers, employees and the communities we serve. The operation of our Board is supported by the collective experience of the Directors and the diverse skills and experience they possess. This enables the Board to reach decisions in a focused and balanced way, supported by independent thought and constructive debate between the Directors. Trust and mutual respect are the cornerstones of relationships between our Directors, with a Board dynamic that supports open and honest conversations to ensure decisions are taken for the benefit of the Company in full consideration of the impact on all stakeholders. Responsibility to all of our stakeholders for the approval and delivery of the Company's strategy and for creating and overseeing the framework to support its delivery sits with the Board.

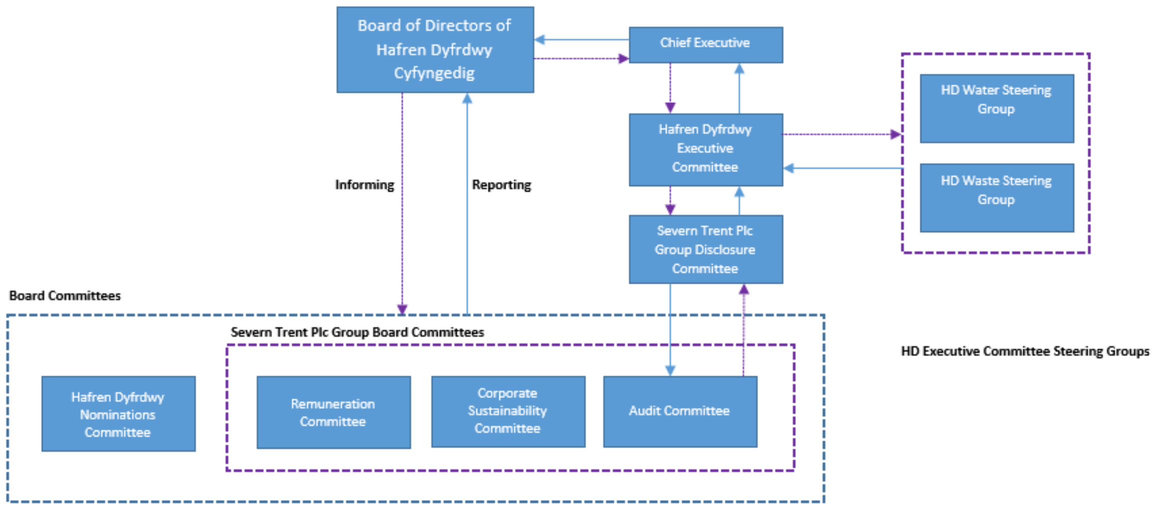
The requirements of the Board are clearly documented in the Hafren Dyfrdwy Articles of Association and Schedule of Matters Reserved to the Board. They are assisted through the management of agendas, meetings and minutes by Company Secretariat and advised in their meetings by the Company Secretary, where appropriate. There is a clear division of responsibilities between the roles of Chair and CEO. To allow these responsibilities to be discharged effectively, the Chair and CEO maintain regular dialogue outside of the Boardroom, to ensure an effective flow of information. The Non-Executive Directors have direct access to senior management at all times. Informal as well as formal contact with the wider business is encouraged to develop a deeper understanding of the Company's operations and requests for further information are welcomed. This broadens the Non-Executive Directors' sources of information and enables them to consider the wider impact of any Board decisions on stakeholders more broadly.

Governance Framework

We pride ourselves on having a high-functioning, well-composed, independent and diverse Board and being transparent in all that we do. Maintaining the highest standards of governance is integral to the successful delivery of our strategy. Our governance framework ensures that the Board is effective in both making decisions and maintaining oversight, whilst also adhering to our well-established culture of Doing the Right Thing.

The Hafren Dyfrdwy Board is supported by a Governance Framework, which is set out below. The Governance Framework comprises the Board, Executive Committee and their respective Committees.

In line with the 2018 Code, the Board delegates certain roles and responsibilities to its various Committees. The Committees assist the Board by fulfilling their roles and responsibilities, focusing on their specific activities, reporting to the Board on decisions and actions taken, and making any necessary recommendations to the Board in line with their terms of reference. They also review whether they have discharged their duties under their terms of reference. The Severn Trent Plc Board regularly reviews the terms of reference of each Committee, with the exception of the Hafren Dyfrdwy Nominations Committee (which are reviewed by the Hafren Dyfrdwy Board). The individual Committee terms of reference are available on the Severn Trent Plc website. The Governance Framework was updated in November 2019 to ensure optimal oversight of operational, customer and financial performance.



Stakeholder engagement

Hafren Dyfrdwy's success depends on the Board taking decisions that deliver mutual benefit to our customers, communities and other stakeholders, as set out in section 172 of the Companies Act. Please read more in our separate s.172 statement on page 12. The Board also engages with stakeholders throughout the year, a summary of which can be found on page 9.

KEY BOARD ACTIVITIES IN 2019/20

The key activities considered by the Board during the year are set out below. The Board recognises the value of maintaining close relationships with its stakeholders, understanding their views and the importance of these relationships in delivering our strategy and the Company's purpose.

In order for the Company to manage risk effectively, the Board monitors financial performance and reporting and also ensures that appropriate and effective succession planning arrangements and remuneration policies are in place. Below are details of the main topics discussed by the Board during the year.

Board meetings follow a carefully tailored agenda that is agreed in advance by the Chair, in conjunction with the Company Secretary. A typical Board meeting will comprise reports on operational and financial performance, legal and governance updates and one or two detailed deep dives into areas of particular strategic importance. Details of the Directors' attendance at the scheduled meetings that took place during the year can be found on page 35.

Main topics discussed by the Board during the year:

Regular Updates

- Performance Review Reports from CEO
- Performance Review Reports from CFO
- Operational Performance Reports

Financing Strategy

- Budget and AMP7 Plan
- Long-term Viability and Going Concern
- Regulatory Financial Model

Governance and Stakeholders

- Stakeholder Engagement Reports
- Governance and Regulatory Updates
- Board Effectiveness Evaluation

Regulatory

- PR19
- Annual Report and Accounts
- Annual Performance Report
- Social Purpose Licence Modification
- Wholesale Charges for 2020/21
- Final Charges for 2020/21
- C-MeX

Strategy

- Biodiversity Strategy
- Environmental Leadership in Wales
- AMP7 Plan
- Communications Strategy

Culture and Values

- Health, Safety and Wellbeing
- Employee Engagement – QUEST 2019
- Purpose and Values Update
- Employee Terms and Conditions

Risk Management

- Regulatory Updates
- Enterprise Risk Management Reports
- Deep Dives on Risk – Reservoir Risk
- Renationalisation
- COVID-19
- Review of Effectiveness of Internal Controls and Risk Management

Site Visits

- Llwyn Onn Water Treatment Works
- Llandinam Water Treatment Works

Stakeholder Engagement and Attendance

- Stakeholder Engagement – National Resources Wales
- Lake Vyrnwy Project
- Stakeholder Engagement – Welsh Government Environmental Priorities

Our Purpose and Values

We believe that if we are united by a clear social purpose we will deliver better outcomes for all our stakeholders – our customers, our colleagues, our investors, the society we live in and the environment we depend on. It also makes good business sense. So at Hafren Dyfrdwy, we are first and foremost driven by our purpose – ‘Taking care of one of life’s essentials’ – and we’re guided by our values:

The Severn Trent Plc Board also has oversight of a number of accompanying Group policies. These policies, together with Doing the Right Thing, codify how to identify and deal with suspected wrongdoing, fraud or malpractice; how to ensure that the highest standards of safety are maintained; and how to apply good ethics and sound judgment.

The Board monitors and assesses the culture of the Company by regularly meeting with the Executive Committee and management, and reviewing the outcomes of employee surveys. We believe that our strong culture is a unique strength and we see the benefits in employee engagement, retention and productivity.

During the year, the Board has focused on deepening its understanding of the Company's culture even further, through a dedicated Company Purpose and Culture session in January 2020. The session was centred on the results of our employee survey, 'QUEST', and other relevant data. The Board considered the positive and more challenging aspects revealed by the survey and discussed the Company's approach to addressing areas of employee focus. Members of the Board also regularly visit our sites, to listen directly to our employees' views.

We do not see corporate governance as something we do because we have to. We choose to see it as something that should be ingrained in the way we behave, how we make decisions, how we run our business and ultimately, how we build trust.

Board evaluation

Our annual Board evaluation provides the Board with an opportunity to consider and reflect on the quality and effectiveness of its decision making, the range and level of discussion and for each member to consider their own contribution and performance.

The 2019/20 evaluation was internally conducted by the Chair with support from the Company Secretary through a series of one-to-one meetings in January and February 2020. The Board agreed actions and that six monthly reviews of progress against recommendations in the report would be tabled for Board discussion.

<u>Evaluation Process</u>

STEP 1 – 2019/20 Process Planning	The Company Secretary undertook a detailed review of the Board Effectiveness evaluation process in 2018/19 and restructured our interview matrix to cover matters highlighted in the prior year review and recommendations of the 2018 Code, Parker Review and FRC Guidance on Board Effectiveness.
STEP 2 – One-to-One Meetings	Board members participated in comprehensive one-to-one meetings with the Company Secretary, with additional input from the Chair.
STEP 3 – Evaluation and Reporting	The Company Secretary compiled the individual responses, including analysis of themes and proposed actions. A detailed report, setting out the findings of the evaluation was provided to the Chair for consideration. The Company Secretary and the Chair presented the report to the Board in March 2020.
STEP 4 – Agree Actions and Monitor Progress	The findings of the evaluation exercise were fully considered when making recommendations in respect of the re-election of individual Directors and included an assessment of their independence, time commitment and individual performance.

The key theme highlighted in the 2019/20 evaluation was positive Board dynamics and effective operation of the Board. It was noted that all Directors fostered a culture of open, high quality and balanced debate, and was characterised by a mutual sense of trust and respect between Executives and Non-Executives. The evaluation noted that the Board was considered to be of the right size and has an appropriately diverse and complementary mix of background, skills and cognitive thought. Meetings were noted as being well chaired, with all having an opportunity to contribute. The Chair was commended for the significant time commitment made to Hafren Dyfrdwy and the way in which he navigated the Board through the recently implemented governance enhancements. Board dynamics outside of formal meetings were considered to be excellent.

Minor areas identified during the review for incremental improvement in terms of the Board's overall effectiveness included:

- **Strategic Debate:** Opportunity for a more timely follow up to strategic discussions;
- **Workforce Engagement:** Better line of sight on workforce issues and culture in the HD workforce specifically;
- **Group-level Topics:** Directors felt well informed on Severn Trent Plc Audit Committee matters considered at Group level. There was an opportunity for Directors to have better line of sight on 'Non-Audit Committee' Group level topics such as:
  - Talent and Succession Planning, including career planning;
  - The Group's new Purpose and Values; and
  - Future challenges at Group level that have potential to impact HD.

Progress has been made in respect of areas for further focus identified in the 2019/20 review as detailed below:

- **Strategic Debate:** More regular updates would be provided to the Board throughout the year as part of the Board forward planning process;
- **Workforce Engagement:** A Hafren Dyfrdwy specific QUEST update was tabled to the Board at its January Strategy Day to inform the Board on the views of the workforce. Regular updates would be provided to the Board following each employee survey and informal interaction with the workforce would be further facilitated at Board site visits;
- **Group-level Topics:** Annual ST Plc Board Committee updates would be provided to the Board, providing updates on topics considered at Group level of relevance to Hafren Dyfrdwy. This is incorporated into the Chair's Report on Severn Trent Plc Oversight Activity, with supporting papers being made available in the Hafren Dyfrdwy Directors' Resources Room with follow up sessions being offered to Directors as appropriate.

Board training and development

The environment in which we operate is continually changing. It is therefore important for our Directors to remain aware of recent, and upcoming, developments and keep their knowledge and skills up to date. Our Board Effectiveness process includes training discussions with the Company Secretary and, as required, we invite professional advisers and subject matter experts to provide in-depth updates. These updates are not solely reserved for legislative developments but aim to cover a range of strategic issues including, but not limited to, the economic and political environment, environmental, technological and social considerations. Our Company Secretary also provides regular updates to the Board on regulatory and corporate governance matters. The Board activities schedule on page 38 sets out further detail on the topics covered during the year.

The aim of the training sessions is to continually refresh and expand the Board's knowledge and skills. In doing so, the Directors can contribute to discussions on technical and regulatory matters more effectively. The sessions also serve as an opportunity for the Board to discuss strategy and risks with management below Executive Committee level and gain further direct insight into our businesses and management capability.

Informal Board interactions

The Board also meets more informally, in the form of Board dinners, outside of the scheduled Board meeting calendar. These sessions are important in building and maintaining successful relationships and promoting a culture of openness in Board discussions. Senior management and external stakeholders are often invited to attend these sessions.

Directors' resources

Directors also have access to our online resource library, which is continually reviewed and updated. The library includes a Corporate Governance Manual, briefings on Board training session topics and a further reading section which covers updates and guidance on changes to legislation and corporate governance best practice.

Directors' skills and experiences

An effective Board requires the right mix of skills and experience. Our Board is a diverse and effective team focused on promoting the long-term success of the Company. The matrix below details some of the key skills and experience that our Board has identified as particularly valuable to the effective oversight of the Company and execution of our strategy.

BOARD SKILLS AND EXPERIENCE	Olivia Garfield	James Bowling	Ann Beynon	Sally Jones-Evans	John Coghlan	Mohammed Mehmet	Christine Hodgson
STRATEGY	✓	✓	✓	✓	✓	✓	✓
M&A	✓	✓		✓	✓	✓	✓
CORPORATE FINANCE / TREASURY		✓			✓		✓
ACCOUNTING		✓			✓		✓
REGULATION	✓	✓	✓	✓	✓	✓	✓
TECHNOLOGY / INNOVATION	✓		✓	✓	✓		✓
CUSTOMER	✓		✓	✓		✓	✓
BRANDS				✓			✓
ENGINEERING							
UTILITY SECTOR	✓	✓	✓		✓		✓
ENVIRONMENTAL SCIENCE							✓
PEOPLE MANAGEMENT	✓	✓	✓	✓	✓	✓	✓
COMMERCIAL PROCUREMENT	✓		✓	✓		✓	✓
CONSTRUCTION/ INFRASTRUCTURE DELIVERY	✓		✓		✓	✓	
LARGE CAPITAL PROGRAMMES	✓	✓		✓	✓	✓	✓
POLITICAL AFFAIRS	✓		✓	✓		✓	✓
LOCAL COMMUNITIES			✓	✓		✓	

Induction programme

We develop a detailed, tailored induction for each new Director. This includes one-to-one meetings with the Chair and each of the existing Directors. They have one-to-one meetings with the CEO, CFO and the Company Secretary along with other members of the Executive Team. They also meet members of the operational teams and visit our key operational sites and capital projects to ensure they get a first-hand understanding of the water and waste water businesses.

New Directors receive a briefing on the key duties of being a Director of a regulated water company and they also meet with the regulator as part of the appointment process. We continually enhance the Board's induction process, in full consideration of feedback from new appointees and the Board Effectiveness evaluation.

Operational and Site Visits

The Board, and individual Directors, undertake site visits during the year, to deepen their understanding of the Company's operations and further inform the Board's decision making in creating sustainable long-term value for the mutual benefit of stakeholders.

In November 2019, the Board visited Llwyn Onn Water Treatment Works

Members of the Board also visited Llandinam Water Treatment Works during the year.

Nominations Committee Report

Nominations Committee meeting attendance 2019/20

There were no meetings of the Committee during the year. The members of the Committee in 2019/20 were the Non-Executive Directors of the Board. Andrew Duff retired from the Board on 31 March 2020. Only members of the Committee have the right to attend Committee meetings. Other individuals such as the Chief Executive, senior management and external advisers may be invited to attend meetings as and when appropriate.

Members of the Committee

J B Coghlan	(Chairman)
A J Duff	(Retired on 31 March 2020)
C M Hodgson	(Appointed on 1 April 2020)
A Beynon	
S Jones-Evans	
M Mehmet	

Diversity

The Board and Nominations Committee continue to drive the agenda of diversity across the Company and are proud of the progress made, especially in respect of female representation on the Board (now at 57%). At an all-employee level, 80% of employees are male and 20% are female.

Parker Review – BAME diversity

The Board remains focused on promoting broader diversity, and creating an inclusive culture in line with the recommendations of the Parker and McGregor-Smith reviews. A diverse organisation benefits from differences in skills, regional and industry experience, background, race, gender, sexual orientation, religion, belief and age, as well as culture and personality.

The Severn Trent Group Board Diversity Policy (the 'Policy') was reviewed in April 2020, with recommended updates approved by the Board. As part of Board discussions, recognition was given to the importance and benefits of greater diversity, including gender diversity, social and ethnic background and cognitive and personal strengths throughout the organisation, including on the Board itself. The objectives and targets of the Policy, and an update against each of them, are set out below. A copy of the Policy is available on the Severn Trent Plc website.

Board Diversity Policy – Objectives and progress against targets

Policy objectives	Implementation	Progress against objectives
Ensure the Board comprises an appropriate balance of skills, experience and knowledge required to effectively oversee and support the management of the Company.	Annual review of the Board's composition with particular consideration being given to the balance of skills, experience and independence of the Board. The Board Effectiveness evaluation specifically considers the composition of the Board and the contribution, commitment	A formal review was undertaken in March with regards to the composition of the Board and the performance, contribution and commitment of individual Directors in the context of the Board Effectiveness evaluation. No concerns were raised in relation to the composition of the Board.

	and independence of individual Directors.	
Ensure consideration is given to candidates for Non-Executive Director Board appointments from a wide pool.	The Board recognises the importance and benefits of greater diversity, including gender diversity, social and ethnic background and cognitive and personal strengths, throughout the organisation, including on the Board itself.	All recommendations in respect of Board appointments will be conducted in full consideration of the Policy, 2018 Code and additional relevant guidance. No Board appointments were made during the year.
Ensure Board appointment 'long lists' include diverse candidates, including diversity of social and ethnic backgrounds and cognitive and personal strengths.	The Board recognises the importance and benefits of greater diversity, including gender diversity, social and ethnic background and cognitive and personal strengths, throughout the organisation, including on the Board itself.	All recommendations in respect of Board appointments will be conducted in full consideration of the Policy, 2018 Code and additional relevant guidance, with a selection of diverse candidates being included in the long lists. No Board appointments were made during the year.
Ensure the Board only engages executive search firms that have signed up to the voluntary code of conduct on gender diversity and best practice.	The Company only engages with executive search firms that have signed up to the voluntary code of conduct on gender and BAME diversity and best practice.	We continue only to engage with executive search firms that have signed up to the voluntary code of conduct on gender and BAME diversity and best practice.
Ensure focus is given to the development of a pipeline of diverse high calibre candidates for Board level roles and report annually on the diversity of the Executive pipeline as well as the diversity of the Board.	Regular Board consideration of the importance and benefits of greater diversity including gender diversity, social and ethnic background and cognitive and personal strengths. This includes representation of these cohorts in the Company's talent pipeline and on the Board itself.	Consideration was given during the year to diversity and inclusion within the Company.

Policy Targets	Progress against Target
33% female representation on the Board by 2020.	43% female representation on our Board as at 31 March 2020.

Minimum of one Board Director from an ethnic minority background by 2021.	One ethnic minority Director on our Board as at 31 March 2020. Hafren Dyfrdwy has excelled at this measure following the appointment of Mohamed Mehmet to the Board on 1 April 2018.

Talent development

We continue to recognise the importance of developing our people and, as such, talent management remains a key topic of discussion. The Group's five year talent plan focuses on building both technical and leadership capability, and creating talent pipelines for the future.

Director conflicts and independence

Severn Trent Plc has a Conflicts of Interest Policy in place for all Group companies, including Hafren Dyfrdwy, and the Hafren Dyfrdwy Board considers potential conflicts at the outset of every meeting. The first agenda item at every Board meeting ensures that actual and potential conflicts are considered, declared and managed. The Board also formally reviews the authorisation of any potential conflicts of interest every six months.

Additionally, the Hafren Dyfrdwy Board conducted an annual review of individual Director conflict authorisations as recorded in our Conflicts of Interest Register in 2020. The Conflicts of Interest Register sets out any actual or potential conflict of interest situations which a Director has disclosed to the Board in line with their statutory duties and the practical steps that are to be taken to avoid conflict situations. When reviewing conflict authorisations, the Board considers any other appointments held by the Director as well as the findings of the Board effectiveness evaluation.

The policy continues to be applied practically throughout the year, for example in considering the potential conflict presented by Directors having roles on other Group companies. For example, in September 2018 modifications were made to the Severn Trent Plc Group Audit Committee meeting structure to facilitate dedicated Committee focus for Hafren Dyfrdwy regulatory matters and remove a potential conflict of interest scenario in relation to John Coghlan who is a Director of both Severn Trent Water and Hafren Dyfrdwy.

The independence of Directors is formally reviewed annually by the Board and as part of the Board evaluation exercise. The Board considers that there are no business or other circumstances that are likely to affect the independence of any Non-Executive Director and that all Non-Executive Directors continue to demonstrate independence.

Human rights and modern slavery

We are committed to protecting the human rights of our employees and contractors as we have clearly set out in our Code of Conduct, Doing the Right Thing. We have a responsibility to understand our potential impact on human rights and to mitigate potentially negative impacts. Whilst not having a specific human rights policy, we have Company policies on Human Resources, Anti-Bribery and Anti-Fraud, Whistleblowing ('Speak Up') and Procurement, and a separate Anti-Slavery and Human Trafficking Statement.

We will always treat people in our business and supply chain fairly and have a clear zero-tolerance approach to modern slavery. To date we have had no instances of modern slavery raised, but we are not at all complacent and are fully committed to protecting against modern slavery in our business and supply chain. We know modern slavery is a growing global issue and know our customers and stakeholders share our concern. Our highest risk is through our supply chain.

Therefore, we work with our suppliers to ensure they operate to the same standards we set ourselves, and we have also been working closely with our suppliers to ensure they understand the risks involved in their own supply chains. All suppliers are required to sign up and operate in line with our Code of Conduct, which clearly states zero tolerance, and this is built into our procurement tender process. This year we have focused on education and raising awareness, creating a bespoke e-learning training. Targeted awareness will be rolled out to our customers teams over the next 12 months.

Our full Anti-Slavery and Human Trafficking Statement can be found on our website.

Whistleblowing

Our employees, and wider workforce, know they can raise concerns to their line manager or by contacting a member of the Executive, the HR, Legal and Internal Audit teams or through our independent whistleblowing helpline, ‘Safecall’. Every single allegation is independently investigated.

Freedom of association and collective bargaining

We recognise the right of all employees to Freedom of Association and Collective Bargaining. We seek to promote co-operation between employees, our management team and recognised Trade Unions.

We meet with our Trade Unions on a regular basis and see mutual benefit in sharing information with our colleagues and seek their feedback and suggestions. We believe this fosters a common understanding of business needs and helps to deliver joint solutions aimed at making our business successful.

Hafren Dyfrdwy Cyfyngedig (formerly Hafren Dyfrdwy Limited)

Directors' Remuneration report

Remuneration details

Non-Executive Directors' fees

The three independent Non-Executive Directors of Hafren Dyfrdwy Cyfyngedig received an annual fee for the year ended 31 March 2020. All fees were recharged to the Company.

Non-Executive Director fees will increase by 2.3% to £30,700 from 1 July 2020; in line with the wider workforce increase.

	2019/20	2018/19	Increase %
Fee paid to all Non-Executive Directors	£30,000	£30,000	0%

Non-Executive Directors normally serve for terms of three years. The current expiry date of Sally Jones-Evans', Ann Beynon's and Mohammed Mehmet's Letters of Appointment is 1 April 2021. This term of appointment may be extended for a further three year term by mutual agreement of the Board. However, continuation of their reappointment is conditional on satisfactory performance and recommendation by the Hafren Dyfrdwy Nominations Committee.

The total single figure of remuneration below sets out the remuneration received by the Directors for 2019/20:

	Year ended 31 March 2020		Year ended 31 March 2019	
Non-Executive Directors	**Salary and Fees (£'000)**	**Total (£'000)**	**Salary and Fees (£'000)**	**Total (£'000)**
Sally Jones-Evans	**30.0**	**30.0**	**30.0**	**30.0**
Ann Beynon	**30.0**	**30.0**	**30.0**	**30.0**
Mohammed Mehmet	**30.0**	**30.0**	**30.0**	**30.0**

Chair fees

John Coghlan was remunerated as a Director of Hafren Dyfrdwy Cyfyngedig and received an additional fee of £10,000 in relation to his responsibilities as Chairman of Hafren Dyfrdwy Cyfyngedig. Andrew Duff received no additional remuneration in respect of his role as a Director of Hafren Dyfrdwy Cyfyngedig during 2019/20.

Executive Directors' remuneration

The Executive Directors of Hafren Dyfrdwy mirror those of Severn Trent Plc. A recharge is made to Hafren Dyfrdwy in respect of a proportion of their time for duties carried out by the Executive Directors on behalf of the Company in 2019/20 and this amounts to £19,078 (1.3%) in relation to the Chief Executive and £13,153 (1.4%) in relation to the Chief Financial Officer.

The recharge for Executive Directors time during 2019/20 reflects the fully embedded resource provided by other senior Severn Trent employees in respect of Hafren Dyfrdwy.

The remuneration of the Executive Directors is determined by the Remuneration Committee of Severn Trent Plc ('the Committee'), and any payments made in relation to the annual bonus scheme or LTIP are determined by Group performance and paid out of Group earnings.

The Remuneration Report of Severn Trent Plc (which can be found in the Severn Trent Plc Annual Report and Accounts on the Severn Trent Plc website) sets out the Remuneration Policy for Executive Directors and other senior executive managers, and the total remuneration paid to those Directors.

Hafren Dyfrdwy Cyfyngedig (formerly Hafren Dyfrdwy Limited)

Summary of the implementation of the Remuneration Policy in 2020/21
Shareholders approved the Severn Trent Remuneration Policy ('the Policy') at the Severn Trent Plc AGM in 2018 (99.18% voted in favour). Full details of the Policy can be found on the Severn Trent Plc website and a summary is contained in the Severn Trent Plc Remuneration Report on page 108.

A key feature of our remuneration package is that it strongly incentivises improvements in service to every single customer, irrespective of whether they are served under the HD or Severn Trent instrument of appointment. For the annual bonus and LTIPs this is achieved by adding a performance measure, to ensure that all customers are treated equally.

The Committee believes that the fundamental architecture of the Executive Directors' remuneration package is appropriate and the policy remains to attract, retain and motivate its leaders and to ensure they are focused on delivering business priorities within a framework designed to promote the long term success of Severn Trent, aligned with shareholder interests.

Annual Bonus 2020/21
The annual bonus performance measures, weightings and total bonus opportunity remain unchanged. However, any members of the Severn Trent Plc Executive Committee who are appointed to the Hafren Dyfrdwy Board will have 3% of the Group Profit element of their bonus specifically linked to Hafren Dyfrdwy performance. We have also looked at how we can make the ODI measures more meaningful to employees which directly impact these metrics, and in the 2020/21 scheme we will articulate the ODIs in language which brings to life how we work. The annual bonus performance measures and weightings for 2020/21 financial year will be as follows:

- Group Profit Before Interest & Tax – 49%
- Customer and Environment ODIs – 35%
    - Minimise disruption to customers (12%)
    - Prevent failure in our network and our sites (11%); and
    - Improve the environment we live in (12%)
- Customer Experience – 8%
- Health and Safety (Lost Time Incidents) – 8%

The Committee considers the forward-looking performance targets to be commercially sensitive and has, therefore, determined not to disclose them in advance. Details of the targets used will be disclosed in next year's Remuneration Report.

Hafren Dyfrdwy Cyfyngedig (formerly Hafren Dyfrdwy Limited)

Directors' report

The Directors' report for the year ended 31 March 2020 comprises pages 52 to 57 of this report, together with the sections of the Annual Report incorporated by reference. The Governance report set out on pages 32 to 58 is incorporated by reference into this report and, accordingly, should be read as part of this report.

As permitted by legislation, some of the matters required to be included in the Directors' report have instead been included in the Strategic report on pages 3 to 30, as the Board considers them to be of strategic importance.

Specifically, these are:

- Performance Review which provides detailed information relating to the Company, its business model and strategy, operation of its businesses, future developments and the results and financial position for the year ended 31 March 2020;
- Future business developments (throughout the Strategic report);
- Details of the Company's policy on addressing the principal risks and uncertainties facing the Company are set out in the Strategic report on pages 22 to 25;
- Employee Engagement (page 9); and
- Business relationships (throughout the Strategic report).

For information on our approach to social, environmental and ethical matters, please refer to our Group Sustainability Report, available at severntrent.co.uk.

Principal activity

The principal activity of the Company is to treat and provide water and remove waste water in Wales. There have not been any significant changes to the Company's principal activities in the year under review. The Directors are not aware, at the date of this report, of any likely major changes in the Company's activities in the next year.

Areas of operation

During the course of 2019/20, the Company had activities and operations in the UK.

Directors and Directors' Interests

The Directors who held office during the year were as follows:

J B Coghlan
A J Duff (retired on 31 March 2020)
C M Hodgson (appointed on 1 April 2020)
J Bowling
O R Garfield
A Beynon
S Jones-Evans
M Mehmet

Biographies of the Directors currently serving on the Board are set out on pages 32 to 34. None of the Directors have any beneficial interest in the share capital of the Company. The beneficial interests of the Directors in the share capital of the Company's ultimate holding company, Severn Trent Plc, are disclosed within the accounts for Severn Trent Plc.
No Director has any rights to subscribe for shares in, or debenture of the Company.

Directors' remuneration is disclosed on page 50.

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Directors' indemnities

The Company maintains Directors' and Officers' liability insurance in respect of legal action that might be brought against its Directors and Officers. As permitted by the Company's Articles of Association (the 'Articles'), and to the extent permitted by law, the Company indemnifies each of its Directors and other Officers against certain liabilities that may be incurred as a result of their positions. The indemnity was in force throughout the tenure of each Director during the last financial year and is currently in force. Hafren Dyfrdwy Cyfyngedig does not have in place any indemnities for the benefit of the External Auditor.

Employees

The average number of employees within the Company is shown in note 6 to the financial statements. Hafren Dyfrdwy Cyfyngedig believes a diverse and inclusive workforce is a key factor in being a successful business. Through our Diversity and Equal Opportunities Policy, the Company seeks to ensure that every employee, without exception, is treated equally and fairly and that all employees are aware of their responsibilities. This means more than ensuring we do not discriminate in any way – we want to create and maintain a culture open to a diverse population. Hafren Dyfrdwy Cyfyngedig believes that no one should be hurt or made unwell by what we do. We did not experience any major safety incidents and there were no fatalities during the year.

We are an equal opportunities employer and welcome applications from all individuals, including those with a disability. We are fully committed to supporting applications made by disabled persons and make reasonable adjustments to their environment where possible (having regard to their particular aptitudes and abilities).

We are also responsive to the needs of our employees. As such, should any employee become disabled during their time with us, we will actively re-train that employee and make reasonable adjustments to their environment where possible, in order to keep them in employment with us.

All our training, promotion and career development processes are in place for all our employees to access, regardless of their gender, race, age or disability. The provision of occupational health programmes is of crucial importance with the aim of keeping our employees fit, healthy and well, including an employee assistance programme.

Employee engagement

We continuously engage with our employees in a number of ways to accommodate different working patterns.

We provide opportunities for employees to give their feedback to the Company in a number of ways, from team or shift meetings and our employee survey, QUEST. More information on employee engagement can be found on page 9.

Research and development

Innovative use of existing and emerging technologies will continue to be crucial to the successful development of new products and processes for the Company and our products must continue to deliver value for customers. Expenditure on research and development is set out in the Company financial statements.

Internal controls

The Board is responsible for the Company's Internal Control systems and for reviewing their effectiveness. The Severn Trent Plc Audit Committee regularly monitors and reviews the effectiveness of the Severn Trent Group's systems of Internal Control, including Risk management, financial, operational and compliance aspects, in accordance with the requirements of the 2018 Code and the Guidance, and appropriate systems have been in place for the year ending 31 March 2020 and up to the date of the Annual Report. This is described in the Severn Trent Plc Audit Committee report on page 94 of the Severn Trent Plc Annual Report. The Internal Control system can provide only reasonable and not absolute assurance against material misstatement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives.

Treasury management
Details on our Treasury Policy and management are set out in the Severn Trent Plc Treasury Committee Report within the Severn Trent Plc Annual Report on pages 97 to 98.

Post balance sheet events
Details of post balance sheet events are set out in the Company financial statements.

Capital structure
Details of the Company's issued share capital and of the movements during the year are shown in note 19 to the Company financial statements. The Company has one class of Ordinary Shares which carries no right to fixed income. Each share carries the right to one vote at General Meetings of the Company. The issued nominal value of the Ordinary Shares is 100% of the total issued nominal value of all share capital.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights.

No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

On 10 July 2020 the Company approved the issue of 20 million ordinary shares of £1 each to its parent company, Severn Trent Water Limited in exchange for cash. The cash was applied to pay down £20 million of the floating rate loan (see note 17 to the Financial Statements).

Also on 10 July 2020 the Company accepted the offer of a £30 million revolving credit facility from its ultimate parent company, Severn Trent Plc. Amounts drawn under the facility bear interest at 1.7% above LIBOR. The facility is committed until 1 July 2022.

With regard to the appointment and replacement of Directors, the Company is governed by its Articles, the 2018 Code (on a voluntary basis), the Companies Act 2006 and related legislation. The Articles may be amended by Special Resolution of the shareholders. The powers of Directors are described in the Hafren Dyfrdwy Cyfyngedig Matters Reserved to the Board document, the Articles of Association and the Governance report.

Group Structure
The Company's position within the Severn Trent Plc Group can be found on the Severn Trent Plc website.

Dividends
No dividends (2018/19: £nil) have been paid in the year. The Directors do not recommend the payment of a dividend (2018/19: nil).

Contributions for political and charitable purposes
Donations to charitable organisations during the year amounted to £Nil (2019: £Nil). Following year end, the Company established a COVID-19 emergency fund to support charities and community projects at the forefront of our region's COVID-19 response. You can read more on page 7.

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The Company's policy is to make donations to charities whose projects align closely with our aim to promote the responsible use of water resources and waste water services which provide the opportunity for longer-term partnerships. In addition, we provide donations to employee nominated charities through a matched funding scheme and health and safety reward schemes. We are also committed to supporting WaterAid, the UK's only major charity dedicated to improving access to safe water, hygiene and sanitation in the world's poorest countries.

Our policy is not to make any donations for political purposes in the UK, or to donate to EU political parties or incur EU political expenditure. Accordingly, Hafren Dyfrdwy did not make any political donations or incurred political expenditure in the financial year under review.

Supplier payment policy
Individual operating companies within the Hafren Dyfrdwy Cyfyngedig Group are responsible for establishing appropriate policies with regard to the payment of their suppliers, in accordance with the Prompt Payment Code ('PPC'). The companies agree terms and conditions under which business transactions with suppliers are conducted. It is Company policy that provided a supplier is complying with the relevant terms and conditions, including the prompt and complete submission of all specified documentation, payment will be made in accordance with agreed terms. It is also Company policy to ensure that suppliers know the terms on which payment will take place when business is agreed.

Relevant audit information
The Directors confirm that:

- so far as each of them is aware, there is no relevant audit information of which the Company's Auditor is unaware; and
- each of them has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's Auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

External Auditor
Having carried out a review of its effectiveness during the year, details of which can be found in the Severn Trent Plc Audit Committee report on page 93 of the Severn Trent Plc Annual Report and Accounts, the Severn Trent Plc Audit Committee has recommended to the Board the reappointment of Deloitte LLP. The reappointment and a resolution to that effect will be on the agenda at the Severn Trent Plc AGM. Deloitte LLP indicated its willingness to continue as Auditor. The Severn Trent Plc Audit Committee will also be responsible for determining the audit fee on behalf of the Board.

We reduce our carbon footprint

We play a leading role in reducing our greenhouse gas emissions. For Severn Trent Group, we have committed to achieving net zero operational carbon emissions by 2030, building on our long track record of making year-on-year reductions in our emissions. We have now also made commitments to generate or procure 100% renewable electricity and move our fleet to 100% electric vehicles by 2030. We have also now committed to setting targets under the stringent 'Science-Based' methodology.

Hafren Dyfrdwy is only a small part of Severn Trent Plc's total carbon footprint, but we take the same approach as we do for the rest of the business.

As the majority of our carbon emissions are driven by our use of energy, managing carbon also means managing costs. We therefore aim to reduce carbon emissions and increase our generation of renewable energy.

We have held the Carbon Trust Standard continuously since 2009, which recognises our consistent emissions reductions and effective carbon management processes. We continue to

Hafren Dyfrdwy Cyfyngedig (formerly Hafren Dyfrdwy Limited)

report to the Carbon Disclosure Project ('CDP') each year which means our climate change information is publicly accessible. CDP requests information about climate change from companies on behalf of investors and scores each company on the quality and completeness of their responses. In 2019/20 our CDP score was B, an improvement from C in 2018/19.

To reduce our operational emissions further we will continue to focus on improving our energy efficiency to offset the additional demands of a growing population and more stringent treatment quality requirements and increase the amount of renewable-backed energy we buy. We will also continue to decarbonise our fleet and encourage employees to take up low-carbon electric cars.

Pursuing these measures will continue to reduce our key sources of emissions, reduce our reliance on the electricity grid and bring financial benefits for our customers and investors.

As we have successfully reduced our Scope 2 emissions, we are now focusing more on our Scope 1 emissions, which are not as clearly aligned with financial incentives and will require more innovation to solve.

Hafren Dyfrdwy is required to report greenhouse gas ('GHG') emissions in the Directors' report. This year, in line with new environmental reporting guidelines, we have also included additional energy data and more detail on how we manage energy use.

Our GHG emissions are reported in tonnes of carbon dioxide equivalent (tCO2e), for the period 1 April 2019 to 31 March 2020. Our total net emissions have fallen again this year, due to increased generation of renewable energy and a reduction in the emissions intensity of UK grid electricity, including from accredited renewable energy sources procured in our contract supply. We have reported this market-based benefit separately in the table below.

Hafren Dyfrdwy Carbon Footprint kt CO2e

Our gross emissions total in the table below applies the 'location-based' accounting methodology for grid emissions, which is consistent with previous years.

The Hafren Dyfrdwy Gross emissions can be found below

Operational Greenhouse Gas Emissions (Tonnes CO_2e)	2019-20	
Scope 1 Emissions (Combustion of fuel and operation of facilities)	1,804	Sum of scope 1 above
Scope 2 Emissions (Electricity purchased for own use)	5,058	Sum of scope 2 above
Total Annual Gross Operational Emissions	6,861	Sum of scope 1 and 2

Our GHG data is reported internally during the year to the Corporate Sustainability Committee and to the Board. We have subjected our GHG data and processes to external assurance by Jacobs. Our approach to reporting is based on the GHG Protocol Corporate Accounting and Reporting Standard. We have included only emissions from the assets which we own and operate and which we can directly influence and reduce, known as the financial control boundary. In accordance with the reporting regulations, we have not reported on emissions we can influence, but which we are not responsible for, referred to as indirect emissions. We do report these indirect 'Scope 3' emissions in our CDP Disclosure and we will report on these in our Annual Report in future years.

For the appointed UK water businesses, both Severn Trent Water Limited and Hafren Dyfrdwy Cyfyngedig, we have calculated our emissions using the updated 'Carbon accounting in the UK Water Industry: methodology for estimating operational emissions, Version 13' (released April 2020). This is a peer-reviewed calculation tool developed and used by all the major water companies in the UK. It is updated each year to include the latest available emissions factors. For non-appointed business emissions, we have used the latest Defra emissions factors. All emissions arise in the UK.

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Annual Performance Report of Hafren Dyfrdwy Cyfyngedig
The Annual Performance Report for Hafren Dyfrdwy Cyfyngedig is prepared and sent to Ofwat. A copy of this will be available on the website of Hafren Dyfrdwy or on request to the Company Secretary. There is no charge for this publication.

By order of the Board

James Bowling
Director
14 July 2020

Directors' Responsibilities statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 101 "Reduced Disclosure Framework". Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

Each of the Directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the Strategic report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- The Annual Report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Hafren Dyfrdwy Cyfyngedig (formerly Hafren Dyfrdwy Limited)

Auditor and disclosure of information to the auditor

In the case of each of the persons who are Directors of the Company at the date when this report is approved:

- so far as each of the Directors is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- each of the Directors has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Relevant audit information means information needed by the Company's auditor in connection with preparing its report. This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Deloitte LLP has indicated its willingness to continue as auditor.

This responsibility statement was approved by the Board of Directors on 14 July 2020 and is signed on its behalf by:

By order of the Board

John Coghlan
Chair
14 July 2020

James Bowling
Director
14 July 2020

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HAFREN DYFRDWY CYFYNGEDIG

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of Hafren Dyfrdwy Cyfyngedig (formerly Hafren Dyfrdwy Limited) (the 'company') give a true and fair view of the state of the company's affairs as at 31 March 2020 and its loss for the year then ended;

- the financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and

- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, which comprise:

- the income statement;
- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity;
- the related notes to the financial statements 1 to 23.

The financial reporting framework that has been applied in the preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

2. Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • valuation of the provision for trade and other receivables; • valuation of the retirement benefit surplus; and • classification and valuation of capital expenditure.

	Within this report, key audit matters are identified as follows: Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used for the financial statements was £648,000 which was determined on the basis of 2% of revenue.
Scoping	Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

4. Conclusions relating to going concern, principal risks and viability statement

4.1. Going concern

We have reviewed the Directors’ statement on page 31 of the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the company’s ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We considered as part of our risk assessment the nature of the company, its business model and related risks including where relevant the impact of the Covid-19 pandemic and Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the Directors’ assessment of the company’s ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the Directors’ plans for future actions in relation to their going concern assessment.

Going concern is the basis of preparation of the financial statements that assumes an entity will remain in operation for a period of at least 12 months from the date of approval of the financial statements.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

4.2. Principal risks and viability statement

Based solely on reading the Directors’ statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the Directors’ assessment of the company’s ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 21 to 25 that describe the principal risks, procedures to identify emerging risks, and an explanation of how these are being managed or mitigated;
- the Directors' confirmation on page 21 that they have carried out a robust assessment of the principal and emerging risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity; or

Viability means the ability of the company to continue over the time horizon considered appropriate by the Directors.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

- the Directors' explanation on page 26 to 31 as to how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

5.1. Valuation of the provision for trade and other receivables

Key audit matter description	A portion of household customers do not, or cannot, pay their bills which results in the need for provisions to be made for non-payment of the related receivables. Management makes estimates regarding the expected future loss rate for current receivables when calculating the appropriate level of bad debt provision. The bad debt provision recorded as at 31 March 2020 was £3.8 million (31 March 2019: £3.0 million). The bad debt charge of £1.1 million (2019: £1.4 million) represents 3.3% of household revenue and amounts billed relating to customers of Welsh Water. The company's provisions against trade and other receivables are included in note 14. We identified a key audit matter relating to the valuation and accuracy of the bad debt provision, in particular the appropriateness of management's use of Severn Trent Water Limited provision rates to derive the company's provision, and the additional provision recorded to recognise the risk arising from the impact of Covid-19 on the economy. Due to the level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance. The accounting policy for the provision for trade receivables is disclosed in note 1(m) to the financial statements.
How the scope of our audit responded to the key audit matter	Our procedures included the following: • Obtaining an understanding of relevant management review controls over the bad debt provision model; • Testing the completeness and accuracy of data used in the bad debt model; • Assessing the rationale for rates used based on current and expected cash collection performance, in particular the appropriateness of

	calculating these by reference to blended or historical Severn Trent Water collection rates; • Evaluating management's assumptions applied to the Covid-19 additional provision and challenging the reasonableness of economic forecast data within the calculation by comparing against independent economic forecasts and searching for contradictory evidence; and • Reconciling the debtor ageing for each debt category to source data.
Key observations	We are satisfied that the assumptions applied in assessing the overall bad debt provision are reasonable.

5.2. Valuation of the retirement benefit surplus

Key audit matter description	Valuation of the retirement benefit surplus is an area involving significant estimation because the process is complex and requires management (after taking advice from their actuarial advisers) to make a number of assumptions concerning the discount rate, inflation rate, pension increases, and the longevity of current pensioners in order to determine the value of the scheme's liabilities. The key audit matter is focused on the valuation of the pension scheme liabilities and the appropriateness of the actuarial assumptions that are used to calculate it, specifically with reference to the discount rate, and the related volatility of those assumptions during the Covid-19 pandemic. The company's retirement benefit surplus as at 31 March 2020 is £21.3 million (2019: £18.6 million) as set out in note 13 to the financial statements. The accounting policy for the provision for retirement benefit schemes is disclosed in note 1(n) and management has included this is a key source of estimation uncertainty in note 2 to the financial statements.
How the scope of our audit responded to the key audit matter	Our procedures included the following: • Obtaining an understanding of management's controls over the appropriateness of the assumptions; • Challenging the discount rate and inflation rate assumptions used in the calculation of the pension scheme deficit as detailed in note 13, with the support of pension specialists within our audit team, including whether the assumptions reflect the increased degree of volatility in current Covid-19 circumstances; and • Assessing whether there have been any changes in the methodology to determine the assumptions since the prior year; and if any changes in methodology exists, challenging the appropriateness of the revised methodology.
Key observations	We are satisfied that the assumptions used by management in the valuation of the retirement benefit surplus are derived based on a consistent methodology with those applied in prior years and are appropriate.

5.3. Classification and valuation of capital expenditure

Key audit matter description	The company has a substantial capital programme which has been agreed with the regulator ("Ofwat") and therefore incurs significant expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets. During the year the company invested £14.4 million (2019: £12.3 million) in capital expenditure projects out of total additions of £16.4 million (2019: £12.7 million) disclosed in note 12. As the classification of capital expenditure, operating expenditure and infrastructure maintenance expenditure directly affects the company's reported financial performance, we identified a key audit matter relating to an overstatement of capital expenditure, whether caused by changes to the capital expenditure policy implementation guidance or by incorrect application of this guidance. Due to the level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance. Management has included this as a critical accounting judgement in note 2 to the financial statements.
How the scope of our audit responded to the key audit matter	Our procedures to respond to this key audit matter included the following: • Reviewing the company's capitalisation policy and implementation guidance to understand any changes in the current year and to determine compliance with the relevant accounting standards; • Obtaining an understanding of, and testing, relevant controls over the application of the policy to expenditure incurred on projects within the capital programme during the year; • Testing whether there have been any changes in the application of the policy; and • For a sample of capital projects, assessing the application of the capitalisation policy to the costs incurred by reviewing the business cases and invoices, and obtaining further explanations and evidence for significant changes in capital expenditure from budget.
Key observations	We are satisfied that the classification and valuation of assets capitalised in the year is appropriate.

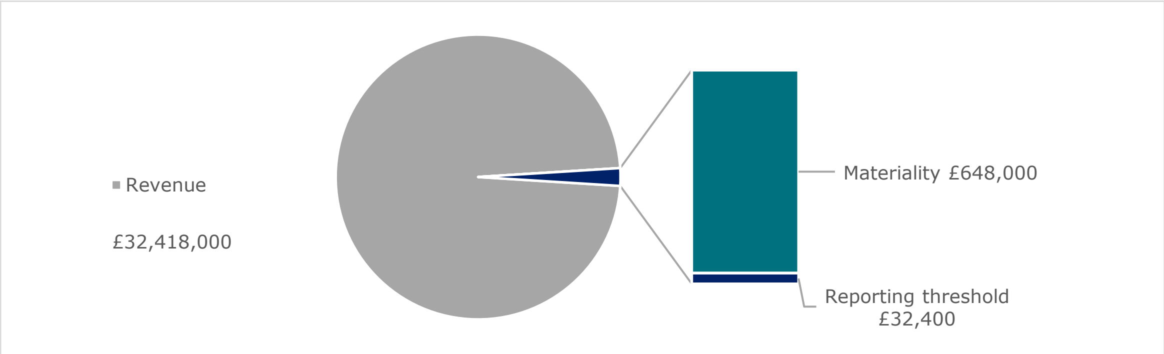
6. Our application of materiality

6.1. Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	£648,000 (2019: £606,000)
Basis for determining materiality	Materiality has been determined based on 2% of revenue for the year (2019: 2% of revenue)
Rationale for the benchmark applied	Revenue has been used as the benchmark as it is a key driver of financial performance.



6.2. Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Performance materiality was set at 80% of materiality for the 2020 audit. In determining performance materiality, we considered our assessment of the control environment, our ability to rely on general information technology controls, as well as the continuity of the business year on year. We also considered the value of uncorrected misstatements identified in previous years.

7. An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the company and its environment, including internal control, and assessing the risk of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

8. Other information

The Directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- **Fair, balanced and understandable** – the statement given by the Directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit Committee reporting** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of these matters.

9. Responsibilities of Directors

As explained more fully in the Directors' Responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

10. Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements

11. Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the Directors' report.

12. Matters on which we are required to report by exception

12.1. Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

12.2. Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made.

We have nothing to report in respect of this matter.

13. Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Deloitte LLP

Kate Hadley, FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP, Statutory Auditor
Birmingham, United Kingdom.
15 July 2020

Hafren Dyfrdwy Cyfyngedig

Income statement
For the year ended 31 March 2020

	Note	**2020** £'000	2019 Restated (see note 1) £'000
Turnover	3	**32,418**	31,983
Operating costs before exceptional items and charge for bad and doubtful debts	4	**(35,028)**	(32,816)
Charge for bad and doubtful debts	4	**(1,104)**	(1,355)
Exceptional items	5	**–**	(400)
Total operating costs	4	**(36,132)**	(34,571)
Loss before interest, tax and exceptional items		**(3,714)**	(2,188)
Exceptional items	5	**–**	(400)
Loss before interest and tax		**(3,714)**	(2,588)
Finance income	8	**1,602**	1,700
Finance costs	9	**(1,140)**	(3,667)
Net finance income/(cost)		**462**	(1,967)
Loss on ordinary activities before taxation		**(3,252)**	(4,555)
Current tax	10	**1,678**	6,772
Deferred tax excluding exceptional deferred tax	10	**(1,270)**	(5,110)
Exceptional deferred tax	10	**(1,430)**	–
Taxation on loss on ordinary activities	10	**(1,022)**	1,662
Loss for the year		**(4,274)**	(2,893)

All results are from continuing operations in both the current and preceding year.

Hafren Dyfrdwy Cyfyngedig

Statement of comprehensive income
For the year ended 31 March 2020

	2020	2019 restated (see note 1)
	£'000	£'000
Loss for the year	**(4,274)**	(2,893)
Other comprehensive income for the year		
Items that will not be reclassified to the income statement:		
Net actuarial gains	**2,400**	400
Tax on net actuarial gains	**(426)**	(68)
Deferred tax arising on rate change	**(218)**	–
	1,756	332
Total comprehensive loss for the year	**(2,518)**	(2,561)

Hafren Dyfrdwy Cyfyngedig

Balance sheet

At 31 March 2020

	Note	2020 £'000	2019 restated (see note 1) £'000
Non-current assets			
Intangible assets	11	**7,906**	8,772
Property, plant and equipment	12	**202,411**	192,369
Right-of-use assets		**4**	–
Retirement benefit surplus	13	**21,345**	18,644
		231,666	219,785
Current assets			
Inventory		**554**	522
Trade and other receivables	14	**29,304**	30,819
Current tax receivable		**–**	258
Cash and cash equivalents	15	**484**	328
		30,342	31,927
Current liabilities			
Trade and other payables	16	**(26,393)**	(17,994)
Borrowings	17	**–**	(612)
Current tax payable		**(326)**	–
		(26,719)	(18,606)
Net current assets		**3,623**	13,321
Non-current liabilities			
Borrowings	17	**(60,881)**	(58,946)
Trade and other payables	16	**(11,259)**	(11,837)
Deferred tax	18	**(17,355)**	(14,011)
		(89,495)	(84,794)
Net assets		**145,794**	148,312
Equity			
Called up share capital	19	**133,051**	133,051
Other reserves		**614**	614
Fair value reserve		**11,685**	11,685
Total retained earnings		**444**	2,962
		145,794	148,312

The financial statements were approved by the Board of Directors on [Date] 2020. They were signed on its behalf by:

James Bowling
Director
July 2020
Company Number: 03527628

Hafren Dyfrdwy Cyfyngedig

Statement of changes in equity

For the year ended 31 March 2020

	Share capital	Other reserves	Fair value reserve	Retained earnings	Total
	£'000	£'000	£'000	£'000	£'000
At 1 April 2018	240	614	11,685	32,990	45,529
Restatement (see note 1)	–	–	–	(27,467)	(27,467)
At 1 April 2018 restated	240	614	11,685	5,523	18,062
Loss for the year restated	–	–	–	(2,893)	(2,893)
Net actuarial gains	–	–	–	400	400
Tax on net actuarial gains	–	–	–	(68)	(68)
Total comprehensive loss for the year	–	–	–	(2,561)	(2,561)
Share issue	132,811	–	–	–	132,811
At 31 March 2019 restated	133,051	614	11,685	2,962	148,312
As at 1 April 2019 as previously reported	133,051	614	11,685	11,086	156,436
Restatement (see note 1)	–	–	–	(8,124)	(8,124)
As at 1 April 2019 restated	133,051	614	11,685	2,962	148,312
Loss for the year	–	–	–	(4,274)	(4,274)
Net actuarial gains	–	–	–	2,400	2,400
Tax on net actuarial gains	–	–	–	(426)	(426)
Deferred tax arising on rate change	–	–	–	(218)	(218)
Total comprehensive loss for the year	–	–	–	(2,518)	(2,518)
At 31 March 2020	**133,051**	**614**	**11,685**	**444**	**145,794**

1. Accounting policies

a) Accounting convention

The financial statements have been prepared on the going concern basis (see Strategic report) under the historical cost convention as modified by the revaluation of certain financial assets and liabilities at fair value, and in accordance with applicable United Kingdom Accounting Standards and comply with the requirements of the Companies Act 2006. The principal accounting policies, which have been applied consistently in the current and preceding year are set out below.

Hafren Dyfrdwy Cyfyngedig (the Company) is a private company limited by shares incorporated in the United Kingdom under the Companies Act 2006 and is registered in Wales.

b) Basis of preparation

(i) General

The Company is a wholly owned subsidiary of Severn Trent Plc and is included in the consolidated financial statements of Severn Trent Plc.

The Company meets the definition of a qualifying entity under FRS 100 Application of Financial Reporting Requirements. Accordingly, the Company has elected to apply FRS 101 Reduced Disclosure Framework. Therefore the recognition and measurement requirements of EU-adopted IFRS have been applied, with amendments where necessary in order to comply with the Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) as these are Companies Act 2006 accounts.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to share based payment, financial instruments, capital management, presentation of comparative information in respect of certain assets, presentation of a cash flow statement, standards not yet effective, impairment of assets and related party transactions.

Where required, equivalent disclosures are given in the Group financial statements of Severn Trent Plc which are available to the public and can be obtained as set out in note 23.

(ii) Changes in accounting policies – IFRS 16

In the current year the Company has adopted IFRS 16 ‘Leases’. There is no material impact on the financial statements from the adoption of this accounting standard.

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

1. Accounting policies (continued)

b) Basis of preparation (continued)

(iii) Restatement

The financial statements have been restated to reflect the 2017 novation of an external loan from the Company to Severn Trent Water Limited and its replacement with an intercompany loan.

Severn Trent Water acquired the Company's then ultimate holding company on 15 February 2017. Following acquisition, an external, index-linked loan of notional principal value £35.0 million was novated from the Company to Severn Trent Water in exchange for an intercompany loan on identical terms. The principal amount of the loan increases by changes in the Retail Prices Index and interest is paid at 3.625% on the indexed amount. At the point that the original loan was novated the accreted principal was £53.2 million but its fair value was £87.2 million, because the coupon was above the market rate for index-linked debt at that point.

Under IAS 39, which was applicable at the time, the new intercompany loan should have been initially recognised at its fair value of £87.2 million. The £34.0 million difference between the fair value of the new debt and the carrying value of the debt novated should have been charged to the income statement. The finance cost of the debt in future periods will comprise the coupon, paid in cash and calculated on the indexed principal amount, plus the indexation amount added to the principal, less an element of the difference between the initial fair value and the principal amount, calculated to eliminate this difference over the life of the debt. This results in the effective interest rate on the debt reflecting the market rate at initial recognition.

On 28 March 2019, £34 million of the intercompany loan was repaid by the Company at a premium on redemption of £21.9 million in exchange for 55.9 million ordinary shares of £1 each at par. The premium on redemption was recognised by the Company as an exceptional finance cost at the time. However, if the inter-company loan had originally been recognised at its fair value, then the £21.9 million premium on redemption would already have been included in its carrying value and there would have been no exceptional finance cost because the cost would already have been recognised when the loan was recognised.

We have restated the remaining portion of the intercompany loan to reflect the amount that would have been recognised if it had originally recognised at fair value. The adjustments to the comparative income statement and balance sheet are summarised below:

Income statement extract

Year ended 31 March 2019

	As previously reported £'000	Restatement £'000	Restated £'000
Finance costs	(5,023)	1,356	(3,667)
Exceptional finance costs	(21,949)	21,949	–
Deferred tax	(1,148)	(3,962)	(5,110)

Balance sheet extract

Year ended 31 March 2019

	As previously reported £'000	Restatement £'000	Restated £'000
Non-current borrowings	(49,158)	(9,788)	(58,946)
Deferred tax	(15,675)	1,664	(14,011)
Retained earnings	11,086	(8,124)	2,962

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

1. Accounting policies (continued)

c) Revenue recognition

Revenue includes turnover and interest income.

Turnover represents the fair value of consideration receivable, excluding value added tax, trade discounts and inter-company sales, in the ordinary course of business for goods and services provided.

Turnover is not recognised until the service has been provided to the customer and it is probable that it will be received.

Water and waste water revenue is recognised when the service is provided and includes an estimate of the amount of mains water and waste water charges unbilled at the year end. The accrual is estimated using a defined methodology based upon a measure of unbilled water consumed by tariff, which is calculated from historical billing information.

Commission income is earned on amounts billed on behalf of other water companies for the sewerage services they provide to the Company's customers. Commission is recognised when the bill is sent to the customer.

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable.

d) Exceptional items

Exceptional items are income or expenditure, which individually or, if of a similar type, in aggregate should, in the opinion of the Directors, be disclosed by virtue of their size or nature if the financial statements are to give a true and fair view.

e) Taxation

Current tax payable is based on taxable profit for the year and is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is provided in full on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred taxation is measured on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Current and deferred tax are recognised in profit or loss, except where they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity, respectively.

A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future to utilise it.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities.

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

1. Accounting policies (continued)

f) Intangible assets

Intangible assets acquired separately are capitalised at cost. Following initial recognition, finite life intangible assets are amortised on a straight-line basis over their estimated useful economic lives as follows:

	Years
Software	3-10

Amortisation charged on intangible assets is taken to the income statement through operating costs.

Finite life intangible assets are reviewed for impairment where indicators of impairment exist (see note 1 j below).

Intangible assets with indefinite useful lives are carried at cost less accumulated impairment losses. Such assets are reviewed for impairment at least annually and where indications of impairment exist.

Development expenditure is capitalised as an intangible asset and written off over its expected useful economic life where the following criteria are met:

- it is technically feasible to create and make the asset available for use or sale;
- there are adequate resources available to complete the development and to use or sell the asset;
- there is the intention and ability to use or sell the asset;
- it is probable that the asset created will generate future economic benefits; and
- the development costs can be measured reliably.

Research expenditure is expensed when it is incurred.

g) Property, plant and equipment

Property, plant and equipment is held at cost less accumulated depreciation. Expenditure on property, plant and equipment relating to research and development projects is capitalised and depreciated over the expected useful life of those assets.

The costs of like-for-like replacement of infrastructure components are recognised in the income statement as they arise. Expenditure which results in enhancements to the operating capability of the infrastructure networks is capitalised.

Where items of property, plant and equipment are transferred to the Company from customers or developers, the fair value of the asset transferred is recognised in the balance sheet. Fair value is determined based on estimated depreciated replacement cost. Where the transfer is in exchange for connection to the network and there is no further obligation, the corresponding credit is recognised immediately in turnover. Where the transfer is considered to be linked to the provision of ongoing services the corresponding credit is recorded in deferred income and released to operating costs over the expected useful lives of the related assets.

Where assets take a substantial period of time to get ready for their intended use, the borrowing costs directly attributable to the acquisition, construction or production of these assets are added to their cost.

Property, plant and equipment is depreciated, using the straight-line method, to its estimated residual value over its estimated useful life, with the exception of freehold land which is not depreciated. Assets in the course of construction are not depreciated until commissioned.

The estimated useful lives are:

Fixed asset category	Type of asset	Estimated useful life
Land and buildings	Buildings	30 – 80 years
Infrastructure assets	Impounding reservoirs	250 years
	Raw water aqueducts	250 years
	Water mains	80 – 150 years
	Sewers	150 – 200 years
Fixed plant and equipment	Fixed plant	20 – 40 years
	Equipment	20 – 40 years
	Mobile plant and vehicles	2 – 15 years

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

1. Accounting policies (continued)

h) Leases

Where the Company enters into a contract that contains a lease, it recognises a right-of-use asset and a lease liability. The right-of-use asset is measured at cost, which includes: the amount of the initial measurement of the lease liability (see below); any lease payments made at or before the commencement date less any lease incentives received; any initial direct costs incurred by the Company; and an estimate of any remediation or similar costs required by the lease contract.

At the commencement date the lease liability is measured at the present value of the future lease payments discounted using the interest rate implicit in the lease or, if that cannot be readily determined, the Company's incremental borrowing rate. Lease liabilities are included in borrowings.

Lease payments are treated as consisting of a capital element and a finance charge; the capital element reduces the lease liability and the finance charge is written off to the income statement at a constant rate over the period of the lease in proportion to the capital amount outstanding. Depreciation of the right-of-use asset is charged over the shorter of the estimated useful life and the lease period unless ownership is expected to transfer to the Company at the end of the lease, in which case the right-of-use asset is depreciated to the end of the useful life of the underlying asset.

Where the lease term is less than one year or the underlying asset is low value, the Company does not recognise a right-of-use asset or lease liability. Payments under such leases are charged to operating costs.

i) Grants and contributions

Grants and contributions received in respect of non-current assets, including certain charges made as a result of new connections to the water and sewerage networks, are treated as deferred income and released to operating costs over the useful economic life of those non-current assets.

Grants and contributions which are given in compensation for expenses incurred with no future related costs are recognised in operating costs in the period that they become receivable.

j) Impairment of non-current assets

If the recoverable amount of goodwill, an item of property, plant and equipment, or any other non-current asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Recoverable amount is the higher of fair value less costs to sell or estimated value in use at the date the impairment review is undertaken. Fair value less costs to sell represents the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing third parties, less costs of disposal. Value in use represents the present value of future cash flows expected to be derived from a cash-generating unit, discounted using a pre-tax discount rate that reflects current market assessments of the cost of capital of the cash-generating unit or asset.

The discount rate used is based on the estimated cost of capital adjusted for the risk profiles of the business.

Impairment reviews are also carried out if there is an indication that an impairment may have occurred, or, where otherwise required, to ensure that non-current assets are not carried above their estimated recoverable amounts.

Impairment losses are recognised in the income statement.

k) Inventory

Inventory is stated at the lower of cost and net realisable value. For properties held for resale, the cost includes the cost of acquiring and developing the sites.

Net realisable value is the estimated selling price less all estimated costs of completion and costs to be incurred in selling and distribution.

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

1. Accounting policies (continued)

l) Loans receivable

Loans receivable are measured at fair value on initial recognition, less issue fee income received. All loan receivables are held for collection of contractual cash flows, which represent solely payments of principal and interest. After initial recognition, loans receivable are subsequently measured at amortised cost using the effective interest rate method whereby interest and issue fee income are credited to the income statement and added to the carrying value of loans receivable at a constant rate in proportion to the loan amount outstanding.

The Company assesses on a forward-looking basis the expected credit losses associated with its loans receivable. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition of the loan receivable.

m) Trade receivables and accrued income

Trade receivables and accrued income are measured at fair value on initial recognition. If there is objective evidence that the asset is impaired, it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense in operating costs.

The Company applies the simplified approach permitted by IFRS 9 for estimating expected credit losses on trade receivables. For trade receivables that are assessed not to be impaired individually, expected credit losses are estimated based on the Company's historical experience of trade receivable write-offs.

n) Retirement benefits

(i) Defined benefit schemes

The difference between the value of defined benefit pension scheme (the scheme) assets and defined benefit pension scheme liabilities is recorded on the balance sheet as a retirement benefit asset or obligation.

Defined benefit pension scheme assets are measured at fair value using bid price for assets with quoted prices. For scheme assets with no quoted price, the fair value is derived by using quotations from independent third parties or by using applicable valuation techniques at the end of each reporting period. Defined benefit pension scheme liabilities are measured at the balance sheet date by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability.

Service cost, representing the cost of employee service in the year, is included in operating costs. Net finance cost is calculated by applying the discount rate used for the scheme liabilities to the net obligation.

Changes in the retirement benefit obligation that arise from:

- differences between the return on scheme assets and interest income included in the income statement;
- actuarial gains and losses from experience adjustments; and
- changes in demographic or financial assumptions,

are classified as re-measurements, charged or credited to other comprehensive income and recorded in the statement of comprehensive income in the period in which they arise.

(ii) Defined contribution scheme

Contributions to defined contribution pension schemes are charged to the income statement in the period in which they fall due.

o) Provisions

Provisions are recognised where:

- there is a present obligation as a result of a past event;
- it is probable that there will be an outflow of economic benefits to settle this obligation; and
- a reliable estimate of this amount can be made.

Provisions are discounted to present value using a pre-tax discount rate that reflects the risks specific to the liability where the effect is material.

1. Accounting policies (continued)

p) Borrowings

Borrowings are initially recognised at fair value less issue costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest rate method whereby interest and issue costs are charged to the income statement and added to the carrying value of borrowings at a constant rate in proportion to the capital amount outstanding.

Index-linked debt is adjusted for changes in the relevant inflation index and changes in value are charged to finance costs.

q) Share based payment

The Company operates a number of equity-settled share based compensation plans for employees. The fair value of the employee services received in exchange for the grant is recognised as an expense over the vesting period of the grant.

The fair value of employee services is determined by reference to the fair value of the awards granted, calculated using an appropriate pricing model, excluding the impact of any non-market vesting conditions. The number of awards that are expected to vest takes into account non-market vesting conditions including, where appropriate, continuing employment by the Company. The charge is adjusted to reflect shares that do not vest as a result of failing to meet a non-market condition.

Share based compensation plans are satisfied in shares of the ultimate parent company.

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

2. Critical accounting judgments and key sources of estimation uncertainty

In the process of applying the Company's accounting policies, the Company is required to make certain judgments, estimates and assumptions that it believes are reasonable based on the information available. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from those estimates.

a) Critical accounting judgments

i) Classification of costs between operating expenditure and capital expenditure

Hafren Dyfrdwy's business involves significant construction and engineering projects. Assessing the classification of costs incurred on such projects between capital expenditure and operating expenditure requires judgments to be made. The judgments are made based on objective criteria that the Company has developed to facilitate the consistent application of its accounting policies.

Sources of estimation uncertainty

ii) Depreciation and carrying amounts of property, plant and equipment

Calculating the depreciation charge and hence the carrying value for property, plant and equipment requires estimates to be made of the useful lives of the assets. The estimates are based on engineering data and the Company's experience of similar assets (details are set out in note 1 g). A five year change in the average remaining useful lives of property, plant and equipment would result in a £1,030,000 change in the depreciation charge.

iii) Retirement benefit obligations

Determining the amount of the Company's retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made concerning long-term interest rates, inflation and longevity of current and future pensioners. Changes in these assumptions could significantly impact the amount of the obligations or the cost of providing such benefits. The Company makes assumptions concerning these matters with the assistance of advice from independent, qualified actuaries. Details of the assumptions made and associated sensitivities are set out in note 13 to the financial statements.

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

3. Revenue

The Company's activities are solely based in the UK.

	2020	2019
	£'000	'£000
Water and waste water services	**31,038**	30,280
Commission	**1,380**	1,703
Turnover	**32,418**	31,983

4. Operating costs

	2020	2019
	£'000	£'000
Wages and salaries	**4,659**	5,049
Social security costs	**463**	462
Pension costs	**477**	763
Total employee costs	**5,599**	6,274
Raw materials and consumables	**1,479**	1,447
Rates	**2,883**	2,511
Charge for bad and doubtful debts	**1,104**	1,355
Services charges	**915**	888
Depreciation of property, plant and equipment	**6,366**	6,003
Depreciation of right-of-use assets	**7**	–
Amortisation of intangible fixed assets	**965**	733
Hired and contracted services	**8,887**	7,986
Hire of plant and machinery	**287**	287
Infrastructure maintenance expenditure	**5,146**	4,152
Ofwat licence fees	**43**	76
Other operating costs	**9,817**	9,315
Other operating income	**(75)**	(236)
	43,423	40,791
Release from deferred credits	**(176)**	(199)
Own work capitalised	**(7,115)**	(6,021)
	36,132	34,571

Pension costs in 2019 includes £400,000 exceptional costs – see note 5.

During the year the following fees were charged by the auditor:

	2020	2019
	£'000	£'000
Fees payable to the Company's auditor for:		
- the audit of the Company's annual accounts	**49**	45
Total audit fees	**49**	45
Fees payable to the Company's auditor and its associates for other services:		
- other assurance services	**14**	26
Total non-audit fees	**14**	26

Other assurance services also include certain agreed upon procedures performed by Deloitte in connection with Hafren Dyfrwdy's regulatory reporting.

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

5. Exceptional items before tax

	2020 £'000	2019 (restated) £'000
GMP equalisation costs	–	400

In the prior year, on 25 October 2018, the High Court issued a judgment in relation to gender equality in Guaranteed Minimum Pension rights that had an impact on the Group's defined benefit pension liabilities. An exceptional charge of £400,000 was incurred for the provision following this judgment.

6. Employee numbers

The average monthly number of employees (including Executive Directors) during the year was:

	2020 Number	2019 Number
Direct staff	**135**	133

7. Directors' remuneration

	2020 £'000	2019 £'000
Non-executive director remuneration	**90**	90

The Executive Directors do not receive remuneration for their services within the Company. The emoluments of the Executive Directors are paid by other companies within the Severn Trent Group.

8. Finance income

	2020 £'000	2019 £'000
Interest income earned on:		
Bank deposits	**1**	–
Other financial income	**1**	–
Interest income on defined benefit scheme assets	**1,600**	1,700
Total finance income	**1,602**	1,700

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

9. Finance costs

	2020 £'000	2019 (restated) £'000
Interest charged on:		
Amounts payable to group undertakings	**–**	2,329
Lease obligations	**40**	18
Bank and other loans	**–**	120
Interest cost on defined benefit scheme assets (note 13)	**1,100**	1,200
Total finance costs	**1,140**	3,667

Borrowing costs of £1,574,000 (2019: £1,808,000) incurred funding eligible capital projects have been capitalised at an interest rate of 2.7% (2019: 4.0%). Tax relief of £299,000 (2019: £344,000) was claimed on these costs, which was credited to the income statement, offset by a related deferred tax charge of £299,000 (2019: £307,000).

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

10. Taxation

a) Analysis of tax charge/(credit) in the year

	2020	2019 (restated)
	£'000	£'000
Current tax at 19% (2019: 19%)		
Current year	**(1,855)**	(6,627)
Prior year	**–**	(145)
Prior year group relief	**177**	–
Total current tax credit	**(1,678)**	(6,772)
Deferred tax		
Origination and reversal of temporary differences:		
- current year	**1,301**	5,264
- prior year	**(31)**	(154)
Exceptional deferred tax arising on change of rate	**1,430**	–
Total deferred tax charge	**2,700**	5,110
	1,022	(1,662)

b) Factors affecting the tax charge/(credit) in the year

The tax assessed for the current year is higher (2019: lower) than the tax at the standard rate of corporation tax in the UK of 19% (2019: 19%).

The differences are explained below:

	2020	2019 (restated)
	£'000	£'000
Loss before taxation	**(3,252)**	(4,555)
Tax at the standard rate of corporation tax in the UK 19% (2019: 19%)	**(618)**	(865)
Tax effect of depreciation on non-qualifying assets	**63**	141
Other permanent differences	**1**	–
Adjustment in respect of prior years	**146**	(299)
Current year impact of lower rate for deferred tax	**–**	(639)
Exceptional deferred tax arising on rate change	**1,430**	–
Total tax charge/(credit)	**1,022**	(1,662)

Deferred tax is provided at the rate that is expected to apply when the asset or liability is expected to be settled. On 11 March 2020, the UK Government announced that it would reverse the previously planned reduction in the corporation tax rate that was due to take effect from 1 April 2020. This change was substantively enacted on 17 March 2020 and we have therefore remeasured our deferred tax assets and liabilities at 31 March 2020 at the new rate of 19%. This resulted in an exceptional deferred tax charge in the income statement of £1,430,000 and a credit to reserves amounting to £218,000.

c) Tax charged directly to equity

	2020	2019
	£'000	£'000
Deferred tax		
Tax on actuarial gains	**426**	68
Tax arising on rate change	**218**	–
	644	68

11. Other intangible assets

	Computer software
	£'000
Cost	
At 1 April 2018	4,587
Additions	4,957
At 1 April 2019	9,544
Additions	99
At 31 March 2020	**9,643**
Amortisation	
At 1 April 2018	(39)
Amortisation for the year	(733)
At 1 April 2019	(772)
Amortisation for the year	(965)
At 31 March 2020	**(1,737)**
Net book value	
At 31 March 2020	**7,906**
At 31 March 2019	8,772

12. Property, plant and equipment

	Land and buildings	Infrastructure assets	Fixed plant and equipment	Assets under construction	Total
	£'000	£'000	£'000	£'000	£'000
Cost					
At 1 April 2018	4,576	77,999	63,095	14,124	159,794
Additions	20,196	64,317	14,657	20,481	119,651
Disposals	(2,109)	(22,373)	(21,620)	(2,287)	(48,389)
At 31 March 2019	22,663	119,943	56,132	32,318	231,056
Additions	278	1,583	4,216	10,331	16,408
At 31 March 2020	**22,941**	**121,526**	**60,348**	**42,649**	**247,464**
Depreciation					
At 1 April 2018	(2,046)	(22,604)	(24,976)	–	(49,626)
Charge for the year	(597)	(1,112)	(4,294)	–	(6,003)
Disposals	1,258	7,078	8,606	–	16,942
At 31 March 2019	(1,385)	(16,638)	(20,664)	–	(38,687)
Charge for the year	(257)	(1,733)	(4,376)	–	(6,366)
At 31 March 2020	**(1,642)**	**(18,371)**	**(25,040)**	**–**	**(45,053)**
Net book value					
At 31 March 2020	**21,299**	**103,155**	**35,308**	**42,649**	**202,411**
At 31 March 2019	21,278	103,305	35,468	32,318	192,369

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

13. Retirement benefit schemes

a) Defined benefit pension scheme

(i) Background

The Company participates in the Water Companies Pension Scheme, a defined benefit pension scheme in the UK. This is a sectionalised scheme and the Company participates in the Dee Valley Water Limited section of the scheme. The scheme funds are administered by trustees and are independent of the Company's finances. Contributions are paid to the scheme in accordance with recommendations of an independent, qualified actuary. The section has a history of raising pensions in line with inflation, and these increases are reflected in the measurement of the obligation. The section is closed to new entrants.

The Trustees are required to act in the best interests of the schemes beneficiaries. A formal actuarial valuation of the scheme is carried out on behalf of the trustees at triennial intervals by an independent, professionally qualified actuary. Under the defined benefit pension scheme, members are entitled to retirement benefits calculated by reference to their pensionable service and pensionable salary history, with inflationary pension increases applying in line with the scheme rules.

The UK defined benefit pension scheme and the date of the last completed formal actuarial valuation as at the accounting date is as follows:

	Date of last formal actuarial valuation
Water Companies Pension Scheme – Dee Valley Water Limited Section (DVWS)	31 March 2017

(ii) Amount included in the balance sheet arising from the Company's obligations under the defined benefit pension scheme

	2020 £'000	2019 £'000
Fair value of assets	**65,145**	66,644
Present value of the defined benefit obligations	**(43,800)**	(48,000)
Net asset recognised in the balance sheet	**21,345**	18,644

	2020 £'000	2019 £'000
Fair value of scheme assets		
Liability-driven investment funds (LDI)	**32,700**	33,000
High-yield bonds	**28,201**	31,305
Cash	**4,244**	2,339
	65,145	66,644

The majority of the assets have quoted prices in active markets, but there are small proportions of the equity and LDI investments which are unquoted.

Movements in the fair value of the scheme assets were as follows:

	2020 £'000	2019 £'000
Fair value at 1 April	**66,644**	65,005
Interest income on scheme assets	**1,600**	1,700
Contributions from the sponsoring companies	**201**	339
Contributions from scheme members	**100**	100
Return on plan assets (excluding amounts included in finance income)	**100**	1,700
Scheme administration costs	**(200)**	(200)
Benefits paid	**(3,300)**	(2,000)
Fair value at 31 March	**65,145**	66,644

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

13. Retirement benefit schemes (continued)

Movements in the present value of the defined benefit obligations were as follows:

	2020	2019
	£'000	£'000
Present value at 1 April	**(48,000)**	(46,800)
Service cost	**(200)**	(200)
Exceptional past service cost	**–**	(400)
Interest cost	**(1,100)**	(1,200)
Contributions from scheme members	**(100)**	(100)
Actuarial (losses)/gains arising from changes in demographic assumptions	**(400)**	900
Actuarial gains/(losses arising from changes in financial assumptions	**2,500**	(2,200)
Actuarial gains arising from experience adjustments	**200**	–
Benefits paid	**3,300**	2,000
Present value at 31 March	**(43,800)**	(48,000)

(iii) Amounts recognised in comprehensive income in respect of defined benefit pension scheme

The amounts recognised in the income statement are as follows:

	2020	2019
	£'000	£'000
Current service cost	**(200)**	(200)
Exceptional past service cost	**–**	(400)
Scheme administration costs	**(200)**	(200)
Interest income on scheme assets	**1,600**	1,700
Interest cost	**(1,100)**	(1,200)
Total amount credited/(charged) to the income statement	**100**	(300)

The amounts recognised immediately in other comprehensive income are as follows:

	2020	2019
	£'000	£'000
Net actuarial gains/(losses) in the year due to:		
- Changes in financial assumptions	**2,500**	(2,200)
- Changes in demographic assumptions	**(400)**	900
- Experience adjustments on defined benefit obligations	**200**	–
- Actuarial gains on assets relative to interest on assets	**100**	1,700
Gain recognised in other comprehensive income	**2,400**	400

Actuarial gains and losses have been reported in the statement of comprehensive income.

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

13. Retirement benefit schemes (continued)

(iv) Actuarial risk factors
The scheme typically exposes the Company to actuarial risks such as investment risk, inflation risk and longevity risk.

Investment risk

The Company's contributions to the scheme are based on actuarial calculations which make assumptions about the returns expected from the scheme's investments. If the investments underperform against these assumptions in the long-term, then the Company might need to make additional contributions to the scheme in order to fund the payment of accrued benefits.

Each plan's investment strategy seeks to balance the level of investment return sought with the aim of reducing volatility and risk. In undertaking this approach reference is made to both the maturity of liabilities and the funding level of that plan. A number of further strategies are employed to manage underlying risks, including liability matching asset strategies, diversification of asset portfolios and interest rate hedging.

The Section does not invest directly in property occupied by the Company or in financial securities issued by the Company. The investment strategy is set by the Trustee of the Section. Currently the plan has a balanced approach, investing in lower risk assets (e.g. liability driven instruments, which respond to factors such as changes in interest rates) alongside higher risk assets (e.g. high-yield bonds).

Inflation risk

The benefits payable to members of the scheme are linked to inflation measured by the RPI or CPI, subject to caps. The Company's contributions to the scheme are based on assumptions about the future level of inflation. If inflation is higher than the levels assumed in the actuarial calculations then the Company may need to make additional contributions to the Scheme in order to fund the payment of accrued benefits.

The scheme uses Liability Driven Investment ("LDI") within the asset portfolio to hedge against the value of liabilities changing as a result of movements in long-term interest rate and inflation expectations. This structure allows the scheme to both hedge against these risks and retain capital investment in assets that are expected to generate higher returns.

Longevity risk

The Company's contributions to the scheme are based on assumptions about the life expectancy of scheme members after retirement. If scheme members live longer than assumed in the actuarial calculations then the Company may need to make additional contributions to the scheme in order to fund the payment of accrued benefits.

(v) Actuarial assumptions
The major financial assumptions used in the accounting valuation of the obligations for the Company were as follows.

	2020	2019
	% pa	% pa
Price inflation – RPI	**2.5**	3.2
Price inflation - CPI	**1.7**	2.2
Discount rate	**2.4**	2.5
Pension increases in payment	**2.5**	3.2

The assumption for price inflation is derived from the difference between the yields on longer-term fixed rate gilts and on index-linked gilts.

In setting our discount rate, we construct a yield curve. Short-dated yields are taken from market rates for AA corporate bonds. Long-dated yields for the curve are based on the average yield available on all long-dated AA corporate bonds. We project the expected cash flows of the schemes and adopt a single equivalent cash flow weighted discount rate based on this constructed yield curve.

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

13. Retirement benefit schemes (continued)

The mortality assumptions are based on those used in the latest triennial funding valuation. The mortality assumptions adopted at the year end for accounting purposes and the life expectancies at age 65 implied by the assumptions are as follows:

	2020		2019	
	Men	**Women**	Men	Women
Mortality table used	**S3PA_L**	**S3PA_M**	S2NMA	S2NFA
Mortality table compared with standard table	**112%**	**95%**	95%	99%
Mortality projections	**CMI 2019**	**CMI 2019**	CMI 2018	CMI 2018
Long-term rate of future improvement per annum	**1.0%**	**1.0%**	1.0%	1.0%
Remaining life expectancy for members currently aged 65 (years)	**22.2**	**23.9**	21.9	23.6
Remaining life expectancy at age 65 for members currently aged 45 (years)	**23.1**	**25.1**	22.9	24.8

The calculation of the scheme obligations is sensitive to the actuarial assumptions and in particular to the assumptions relating to discount rate, price inflation (capped, where relevant) and mortality. The following table summarises the estimated impact on the Company's obligations from changes to key actuarial assumptions whilst holding all other assumptions constant.

Assumption	Change in assumption	Impact on disclosed obligations
Discount rate[1]	Increase/decrease by 0.1% pa	Decrease/increase by £0.6 million
Price inflation[2]	Increase/decreased by 0.1% pa	Increase/decrease by £0.5 million
Mortality[3]	Increase in life expectancy by 1 year	Increase by £1.9 million

1 A change in discount rate is likely to occur as a result of changes in bond yield and as such would be expected to be offset to a significant degree by a change in the value of the bond assets held by the Scheme.

2 The projected impact resulting from a change in RPI reflects the underlying effect on pensions in payment, pensions in deferment and resultant increases in salary assumptions.

3 The change in assumption is based on triennial valuations and reflect the fact that life expectancy rates are expected to increase.

(vi) Effect on future cash flows

Contribution rates are set in consultation with the Trustees for the Section and each participating employer.

The average duration of the benefit obligation from the Section at the end of the year is 14 years (2019: 15 years).

b) Defined contribution pension schemes

The Company also operates a defined contribution scheme. The pension cost charge for the period represents contributions payable by the Company to the Scheme and amounts to £173,000 (2019: £163,000).

There were no outstanding or prepaid contributions either at the beginning or end of the financial year.

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

14. Trade and other receivables

	2020	2019
	£'000	£'000
Current assets		
Net trade receivables	**6,890**	6,348
Amounts receivable from group undertakings	**14,645**	17,229
Net other amounts receivable	**3,238**	2,773
Prepayments	**328**	275
Net accrued income	**4,203**	4,194
	29,304	30,819

The carrying values of trade and other receivables are reasonable approximations of their fair values.

Credit risk

Trade receivables, other amounts receivable and accrued income

The Company has a statutory obligation to provide water and waste water services to domestic customers within its region. Therefore there is no concentration of credit risk with respect to its trade receivables from these services and the credit quality of its customer base reflects the wealth and prosperity of all of the households and businesses within its region.

The Company applies the IFRS 9 simplified approach to measuring expected credit losses, which uses a lifetime expected credit loss allowance for all trade receivables, other amounts receivable and accrued income.

A collective provision is recorded for expected credit losses against assets for which no specific provision has been made. Expected credit losses for trade receivables are based on the historical credit losses experienced over the last nine years and reasonable supportable information on the future impact of the COVID-19 outbreak on unemployment levels and hence on the Company's collection of trade receivables.

Debts are written off when there is no realistic expectation of further collection and enforcement activity has ceased. There were no amounts outstanding on receivables written off and still subject to enforcement activity (2019: nil).

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

14. Trade and other receivables (continued)

Expected credit loss allowance

The expected credit loss at 31 March 2020 and 2019 was as set out below. The expected loss rate disclosed is calculated as the expected loss on the total amount originally billed for each age category.

2020	**Expected loss rate %**	**Gross carrying amount £'000**	**Loss allowance £'000**	**Net carrying amount £'000**
Not past due	6	8,880	(513)	8,367
Up to 1 year past due	29	4,100	(1,200)	2,900
1 – 2 years past due	46	2,581	(1,196)	1,385
2 – 3 years past due	28	1,189	(335)	854
3 – 4 years past due	40	677	(271)	406
4 – 5 years past due	52	374	(196)	178
5 – 6 years past due	29	341	(100)	241
6 – 7 years past due	100	15	(15)	–
7 – 8 years past due	100	10	(10)	–
8 – 9 years past due	100	1	(1)	–
More than 9 years past due	100	2	(2)	–
		18,170	**(3,839)**	**14,331**

2019	Expected loss rate %	Gross carrying amount £'000	Loss allowance £'000	Net carrying amount £'000
Not past due	10	7,139	(748)	6,391
Up to 1 year past due	6	4,163	(255)	3,908
1 – 2 years past due	34	3,365	(1,130)	2,235
2 – 3 years past due	40	691	(273)	418
3 – 4 years past due	45	373	(169)	204
4 – 5 years past due	59	314	(185)	129
5 – 6 years past due	86	222	(192)	30
6 – 7 years past due	100	18	(18)	–
7 – 8 years past due	100	10	(10)	–
8 – 9 years past due	100	5	(5)	–
More than 9 years past due	100	–	–	–
		16,300	(2,985)	13,315

Movements on the expected credit loss allowance were as follows:

2020	**Trade receivables £'000**	**Accrued income £'000**	**Other amounts receivable £'000**	**Total £'000**
At 1 April 2019	1,847	62	1,076	2,985
Charge for bad and doubtful debts	541	15	548	1,104
Amounts written off during the year	(127)	–	(123)	(250)
At 31 March 2020	**2,261**	**77**	**1,501**	**3,839**

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

14. Trade and other receivables (continued)

2019	Trade receivables	Accrued income	Other amounts receivable	Total
	£'000	£'000	£'000	£'000
At 1 April 2018	1,918	–	964	2,882
Charge for bad and doubtful debts	696	62	597	1,355
Amounts written off during the year	(767)	–	(485)	(1,252)
At 31 March 2019	1,847	62	1,076	2,985

15. Cash and cash equivalents

	2020	2019
	£'000	£'000
Cash at bank and in hand	**484**	328

16. Trade and other payables

	2020	2019
	£'000	£'000
Current liabilities		
Trade payables	**1,691**	668
Amounts owed to ultimate parent undertaking	**6**	84
Amounts owed to parent and fellow subsidiary undertakings	**11,615**	8,988
Social security and other taxes	**126**	118
Other payables	**6,310**	5,075
Deferred income	**1,141**	176
Accruals	**5,504**	2,885
	26,393	17,994
Non-current liabilities		
Other payables	**430**	–
Accruals	**29**	–
Deferred income	**10,800**	11,837
	11,259	11,837
	37,652	29,381

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

17. Borrowings

	2020	2019 (restated)
	£'000	£'000
Current		
Bank overdrafts	–	612
Non-current		
Other loans	**107**	107
Loans due to parent company	**60,762**	58,839
Lease liabilities	**12**	–
	60,881	58,946
	60,881	59,558

Loans due to parent company comprises of the following:

	2020	2019 (restated)
	£'000	£'000
Index-linked	**32,672**	32,649
Floating rate loan	**28,090**	26,190
	60,762	58,839

The loan principal on the index-linked loan is adjusted annually by changes in the Retail Prices Index. Interest on the loan is charged on the indexed principal at 3.635% per annum. The loan matures on 29 September 2032.

Interest on the floating rate loan is charged at LIBOR + 1.5%. The loan facility of £30 million matures on 8 March 2022. On 14 July 2020 the Company repaid £20 million of this loan from the proceeds of a fresh issue of shares – see note 21.

18. Deferred tax

An analysis of the movement in the deferred tax liabilities and assets recognised by the Company is set out below:

	Accelerated tax depreciation £'000	Retirement benefit surplus £'000	Other £'000	Total £'000
At 1 April 2018 as previously reported	11,236	3,095	128	14,459
Restatement	–	–	(5,626)	(5,626)
At 1 April 2018 restated	11,236	3,095	(5,498)	8,833
Charge to income restated	1,270	6	3,834	5,110
Charge to equity	–	68	–	68
As at 31 March 2019 restated	12,506	3,169	(1,664)	14,011
As at 31 March 2019 as previously reported	12,506	3,169	–	15,675
Restatement	–	–	(1,664)	(1,664)
As at 31 March 2019 restated	12,506	3,169	(1,664)	14,011
Charge to income	1,059	95	116	1,270
Charge/(credit) to income arising from rate change	1,471	155	(196)	1,430
Charge to equity	–	426	–	426
Charge to equity arising from rate change	–	218	–	218
As at 31 March 2020	**15,036**	**4,063**	**(1,744)**	**17,355**

Hafren Dyfrdwy Cyfyngedig
Notes to the financial statements (continued)

19. Share capital

	2020	2019
	£'000	£'000
Total issued and fully paid share capital		
133,051 ordinary shares of £1 each (2019: 133,051)	**133,051**	133,051

20. Capital commitments

At 31 March 2020 the Company had capital commitments as follows:

	2020	2019
	£'000	£'000
Contracted for but not provided in the financial statements	**6,710**	3,690

21. Post balance sheet events

On 10 July 2020 the Company approved the issue of 20 million ordinary shares of £1 each to its parent company, Severn Trent Water Limited in exchange for cash. The cash was applied to pay down £20 million of the floating rate loan (see note 17).

Also on 10 July 2020 the Company accepted the offer of a £30 million revolving credit facility from its ultimate parent company, Severn Trent Plc. Amounts drawn under the facility bear interest at 1.7% above LIBOR. The facility is committed until 1 July 2022.

22. Related party transactions

During the year £90,000 (2019: £90,000) was paid to non-executive directors of the Company. There have been no other transactions with the Directors of the Company.

In accordance with the exemption allowed by FRS 101, no disclosure is made of transactions with other wholly owned subsidiary companies which are consolidated into the Severn Trent Plc Group.

23. Ultimate parent undertaking

The immediate parent undertaking is Severn Trent Water Limited, which is the parent undertaking and controlling party of the smallest group to consolidate these financial statements. Financial statements for Severn Trent Water Limited can be obtained from The Company Secretary, Severn Trent Water Limited, P.O. Box 5309, Coventry, CV3 9FH.

The ultimate parent undertaking and controlling party is Severn Trent Plc, which is the parent undertaking and controlling party of the largest group to consolidate these financial statements. Copies of the Severn Trent Plc consolidated financial statements can be obtained from Severn Trent Plc's registrars at Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA.