Hafren Dyfrdwy Limited (formerly Dee Valley Water Limited)

Annual report and financial statements for the year ended 31 March 2018

Company number: 03527628

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Company information

Company number	03527628
Directors	JB Coghlan A J Duff J Bowling O R Garfield A Beynon S Jones-Evans M Mehmet
Secretary	V B Walton
Registered office	Packsaddle Wrexham Road Rhostyllen Wrexham Clwyd LL14 4EH
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Auditor	Deloitte LLP Statutory Auditor 4 BrindleyPlace Birmingham B1 2HZ

Hafren Dyfrdwy Limited (formerly Dee Valley Water Limited)

Strategic report

Principal Activity

The principal activity of the Company is the provision of water and waste water services to customers in North East Wales and Powys, for which Hafren Dyfrdwy Limited is the licensed water supply undertaker.

The Directors of Hafren Dyfrdwy Limited (previously Dee Valley Water Limited) 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 2018.

Business overview

In February 2017 Severn Trent Water Limited acquired the voting and non-voting ordinary share capital of the Company's former parent company, Dee Valley Group plc (now Dee Valley Group Limited). Severn Trent is one of the leading water companies in England and Wales, and is focused on enhancing the service offering for Hafren Dyfrdwy's customers. The Company now benefits from the application of an innovative totex approach, economies of scale, a lower cost of financing, procurement expertise and a 24 hour multi-channel customer service team in order to provide a better service for Hafren Dyfrdwy's customers.

On 23 March 2018, Ofwat announced the completion of a consultation under section 103 of the Water Industry Act 1991 on a proposed modification of the Severn Trent Water Limited and Dee Valley Water Limited licences to align the boundaries of the respective companies' operations to the national boundaries of Wales and England. The modifications came into effect from 1 July 2018, and the Company's Welsh business was rebranded as Hafren Dyfrdwy. Hafren Dyfrdwy is Welsh for 'Severn Dee' and represents the two major rivers in the Welsh region that we now proudly serve. We want to make our services as amazing as water itself so we've come together to create something which will ensure all our customers in Wales can enjoy wonderful water for generations to come.

As part of the above change, the licences of the two companies will be updated to reflect Ofwat updated licence conditions, including up-to-date financial and regulatory ring-fencing conditions.

This Strategic Report covers the year ending 31 March 2018. As such, we are reporting performance for the previous Dee Valley Water business which supplied 59 million litres of drinking water each day to around 128,000 customers in North East Wales, Cheshire and the surrounding areas.

Financial performance

Our financial performance continues to be satisfactory with revenue of £27.4 million (2017: £26.9 million) and profit before interest and tax (PBIT) of £5.9 million (2017: £3.6 million).

Revenue increased due to increases in tariff prices. PBIT also increased as the prior year included transaction costs of £2.4 million.

Our current tax charge was £1.6 million (2017: credit of £0.1 million), including a charge for prior year items of £1.3 million (2017: credit of £0.7 million).

Net finance costs decreased by £349,000, mainly as a result of an increase in the amount of costs capitalised in fixed assets.

During the year we continued to invest in our network and other assets, increasing our property, plant and equipment by £8.6 million. We also invested £4.5 million in implementing new integrated IT systems which has been capitalised as an intangible asset.

The Company has a strong financial position with net assets of £44.8 million. At 31 March the liquidity position was satisfactory with £0.9 million in cash and undrawn committed facilities amounting to £22.7 million.

Strong progress has been made against the Company's operational key performance indicators this year and this, alongside the financial certainty provided by the backing of Severn Trent Plc, ensures that the Company can progress confidently into the fourth year of AMP6.

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Our customers

We have delivered another strong year-on-year improvement in customer service, as measured by Ofwat's Service Incentive Mechanism. Improvements in our training and processes identified in previous years have helped continue this trend. Our real time feedback system, Rant & Rave, also continues to help us identify and resolve customer service issues, primarily complaints and unwanted contacts.

A survey was conducted in 2015/16 to assess satisfaction with our service and establish a baseline target of 80% for the 'value for money' component.

Customer satisfaction and trust measures within the survey this year scored highly and in line with other metrics produced by CCWater and Ofwat's Service Incentive Mechanism. Despite this, our performance against our baseline target for 'value for money' has declined for the second year running.

As we continue to integrate our processes with Severn Trent, and establish the new licensee since 1st July, we will continue to seek new opportunities to engage with our customers in relation to their bills. In particular we will consider:

- How the design of the bill can influence customers understanding of charges and their perception of value
- Which communication channels are most effective for the particular message we need to convey
- How our education programme influences our customers' perception of us.

Operational performance

We have continued our strong performance of improvement in the number of drinking water contacts we receive. This year our water quality teams have targeted areas of the network for ice-pigging to remove the build-up of silt and chemical residues from the network. Alongside this we have undertaken an intensive programme of high velocity flushing in over 160km of our network.

During the year the Legacy treatment works has also been taken out of supply. Whilst this occurred too late in the reporting year to have an impact on the number of contacts we have reported, we expect the number of contacts to reduce in future as we have removed a key source of manganese from the supply network. To complement this we are expecting to undertake 250km of high velocity flushing in the Legacy zone during 2018.

The strong improvement in greenhouse gas emissions achieved this year can be attributed partly to a change in the grid electricity conversion factor and partly to improvements in the efficiency of our operations, both in terms of electricity use and fuel/chemical use across our sites.

On supply interruptions, despite the difficult operating conditions experienced across the sector this year, and an increase in our burst numbers, we are reporting a significant improvement in the number of hours the average property was without supply.

One major change that has occurred this year is the integration and alignment of our network control function with that of Severn Trent Water. This has enabled a greater level of centralised control alongside knowledge sharing and increasing the resilience of our incident control functions.

But we firmly believe that prevention is better than the cure and have therefore ensured that all network shut downs and maintenance tasks that were planned for the year have been carried out. As part of this process a 'plan B' is always in place to ensure we minimise the impact on our customers at all times.

Alongside this we have a continual programme of education and training for our front-line operatives to ensure consistency of our response.

Our Mean Zonal Compliance is another strong area of performance, although compliance for the year has dipped slightly to 99.97% from the exceptional performance in the previous year.

Looking forward, completing our programme of inspection and improvements at our service reservoirs will improve our ability to manage water quality risks.

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Customers are now enjoying higher quality water, thanks to the completion of a complex scheme to close the Legacy treatment works and instead supply water from a more resilient and efficient facility.

Constructed in the 1920s, the works at Legacy on the outskirts of Wrexham was licensed to abstract water from nearby former lead mines. This water was then treated through a series of pressure filters and chlorination plants before being held in a 350,000 gallon tank. However, despite regular upgrades, the facility was nearing the end of its useful life and some customers were experiencing occasional discolouration problems.

In March 2018, following several years of hard work by the team at Dee Valley, a project to transfer the raw water to Llywn Onn was completed – including a new distribution water pipe – and the Legacy treatment works was finally closed.

This completes the obligation we agreed with Ofwat to remove the water quality issue in the Legacy water treatment zone.

Our commitment to deliver the outcomes of the service reservoir water quality risk management scheme requires the delivery of the outcomes of the service reservoir (SR) water quality risk management schemes by the end of 2019-20. The required work is the replacement of Llwyn Onn treated water tank, Sugn-y-Pwll service reservoir and Berwyn service reservoir. In addition we need to replace the roof membranes at eight service reservoirs. Whilst eight sites were named in our business plan, these can be substituted as our inspection programme identifies the most at risk reservoirs.

The Llwyn Onn treated water tank is being replaced by two new SRs on the same site. The first was completed in December 2017, allowing the decommissioning of the existing tank. Work has begun on the second, which is programmed to be complete by October 2018.

Construction at Sugn-y-Pwll will allow the existing tank to be disconnected and the new service reservoir to be commissioned well in advance of the 2020 completion date. Similarly, the Berwyn service reservoir at Llangollen, will be commissioned during 2019 ahead of the obligation date.

Our programme of roof inspections is also on track to complete this AMP which will ensure that all reservoirs have been tested within the last 10 years. Based on the findings we will install the new membranes at the eight sites required to meet the obligation.

We continue to promote the efficient use of water. Unfortunately we have seen a further deterioration this year despite our ongoing programme of activity to promote water efficiency.

We continue to offer meter installations as part of our free optant programme alongside a small programme of selective metering.

Our schools education programme continues to target our youngest and most receptive customers as we promote the efficient use of water. Integrating this activity with the Severn Trent approach is helping us learn lessons and identify best proactive approaches.

Despite missing the target on per capita consumption and water efficiency we are determined that our efforts to drive down per capita consumption will allow us to return to target by the end of the AMP.

Scope for improvement

Last year, we reported that leakage had deteriorated due to an increase in mains bursts and a major interruption on a strategic main in Wrexham. While the outturn position had remained within expected levels for the performance commitment, total leakage, as measured in million litres per day, was higher than assumed in the Water Resource Management Plan (11.31 Ml/d compared to 10.17 Ml/d).

We have reviewed the position and as a result, we believe the actuals reported for this performance commitment should be restated. Actual performance has been normalised using total properties whereas the target has used household properties only. Results for both 2015/16 and 2016/17 need to be restated. Critically, this means Hafren Dyfrdwy did not achieve its performance commitment last year and a £29,400 ODI penalty should be retrospectively applied. This is discussed in more detail in our 2018 Annual Performance Report.

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In terms of 2017/18 performance, we've had no significant bursts and have seen a commensurate improvement in our leakage performance. Operating conditions across the year were moderate which contributed to us being ahead of the curve over the winter period. This allowed us to absorb the impact of the 'Beast from the East' weather event which saw a noticeable increase in the level of leakage in March.

However, despite the improvement, we have not achieved the target and will incur an £8.5k ODI underperformance penalty.

We will continue to increase the number of permanent and temporary loggers to give us a better understanding of where and when water is being lost from our network. This investment should enable us to achieve our target leakage level in future.

For the second year running we have seen an increase in the number of bursts on our network. There are two key drivers of this increase:

- The freeze/thaw event in March 2018 lead to an increase in pipe bursts over a short period
- Removing the Legacy treatment works from the supply network led to a small number of localised pipe bursts as the new system was optimally configured.

Looking forward, our mains replacement programme accelerates over the next two years which should help prevent burst pipes.

Our people

This continued improvement in performance would not have been possible without the efforts of our people and teams. Acquired in 2017, Hafren Dyfrdwy has now been substantially integrated into the Severn Trent Group, and we've been busy sharing ideas between the businesses. One of the Hafren Dyfrdwy teams is currently leading the Severn Trent water quality improvement programme – a good example of how we're sharing best practice and learning from each other's experiences.

Future progress

As part of the alignment of the boundaries of Severn Trent and Hafren Dyfrdwy to the national boundaries of Wales and England, we have agreed with Ofwat how performance commitment levels and ODIs should be allocated between the two companies. Full details can be found in the final licence modification announcement on the Ofwat website. The approach has also been shared with the Customer Challenge Group.

The diagram below shows how customers have moved between the two companies and how performance will be reported next year:

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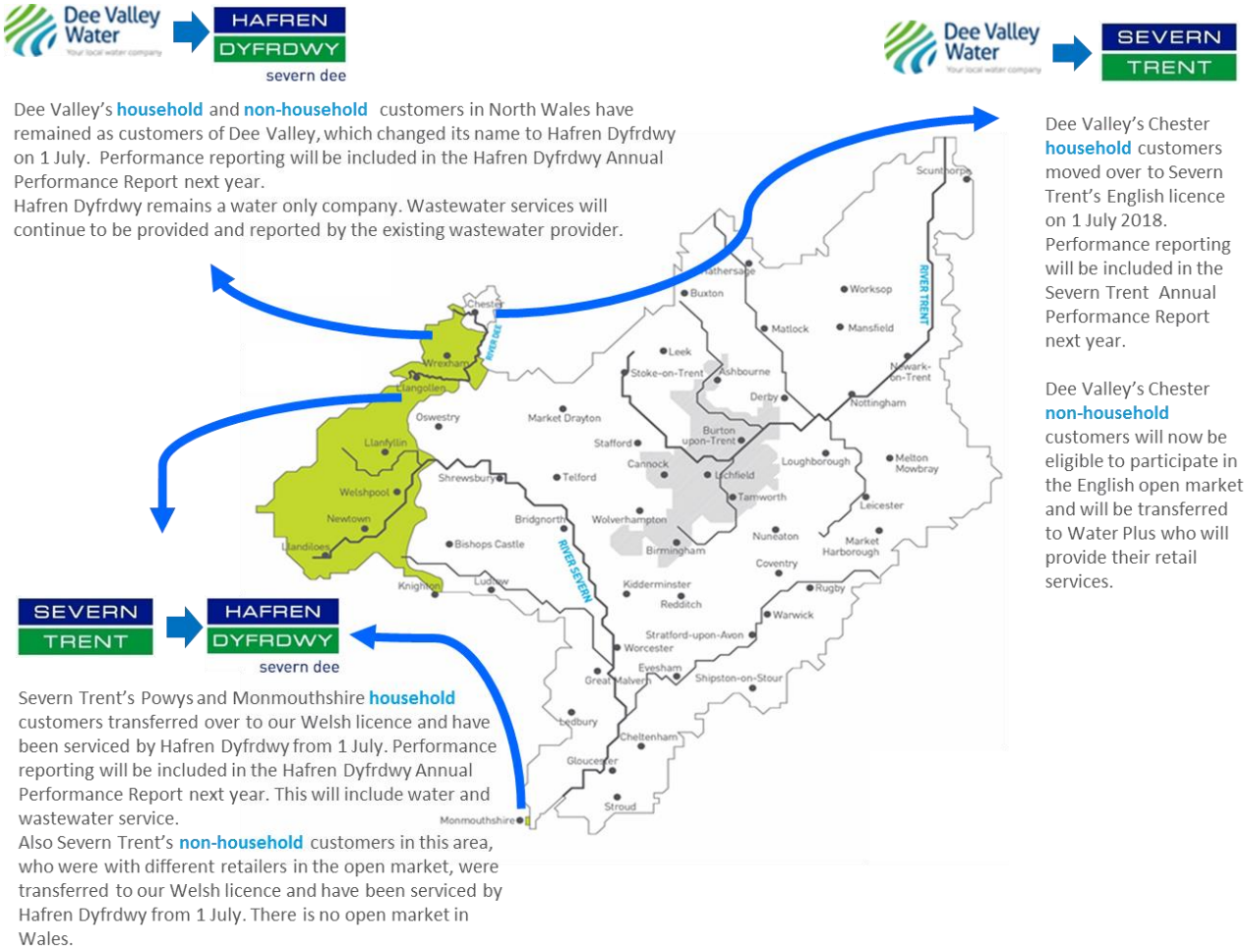

Hafren Dyfrdwy customers should expect all performance commitments to be achieved (or within target deadband) for the remaining two years of the regulatory period. The exception is discoloured water contacts where we expect to continue our current improvement trend. This is discussed in more detail below.

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Ofwat KPI Performance

The key performance indicators set by Ofwat for the Company are summarised in two high-level areas which provide a broad overview of performance.

Description	Unit	Actual performance (with target in brackets)		Outperformance Payment / (Underperformance penalty)
		2016/17	2017/18	
Discoloured Water Contacts	Number per 1,000 customers	1.07 (1.90)	0.91 (1.01)	£0.0025m
Mean zonal compliance	Percentage	99.99% (100%)	99.97% (100%)	Nil
Delivery of the outcome of the Legacy treatment works major scheme	Scheme completion	Pass (N/A)	Complete (Complete)	Nil
Delivery of the outcomes of the service reservoir water quality risk management scheme	Scheme completion	Pass (Nil)	Pass (Nil)	N/A
Supply interruptions	Hours/property /year	0.35 (0.24)	0.07 (0.20)	£0.0209m
Sustainable economic level of leakage	Litres /property /day	96.5 (90.8)	92.5 (90.8)	(£0.0090m)
Security of supply index	Percentage	100 (100)	100 (100)	N/A
Number of bursts	Number	209 (234)	243 (222)	Nil
Gross operational greenhouse gas emissions	Tonnes carbon dioxide or equivalent	8385 (9762)	7709 (9752)	N/A
Customers' perception based on market research	Percentage	77% (Improved)	73% (Improved)	N/A
Per capita consumption and water efficiency	Litres /person/day	135.21 (130.45)	136.57 (129.44)	Nil
Service incentive mechanism	Score	85.94 (80)	86.5 (80)	Ofwat methodology
Non-household service incentive mechanism	Score	90.43 (80)	94.0 (80)	Ofwat methodology

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FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

All of the Company's risks are identified and managed through a continuous corporate risk management process.

The process to adopt the well-established Severn Trent Plc Enterprise Risk Management (ERM) approach has commenced in order to strengthen the Company's processes to manage and mitigate risks. The Board has overall accountability for ensuring that risk is effectively managed across 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. Internal Audit supports the Audit Committee in evaluating the design and effectiveness of internal controls and risk mitigation strategies implemented by management.

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.

Within Hafren Dyfrdwy Limited, 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, as illustrated on pages 8 to 10. We aim to have a strong control framework in place to enable us to understand and manage these 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 and liquidity.

Where appropriate, the table below contains a summary of the principal risks and uncertainties of the Company:

Risk	**What Does It Mean**	**Mitigation**
Regulation and compliance		
Ongoing regulatory reform and the potential increase in policy divergence between the English and Welsh governments	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 increase costs of administration, reduce income and margin and lead to greater variability of returns.	As a Welsh company we are committed to working proactively with the Welsh Government to develop its water strategy for its people. With the alignment of the boundaries of Severn Trent and Dee Valley Water to the national boundaries of Wales and England, from 1st July 2018 onwards, the risk to the company of policy divergence between English and Welsh governments has been removed. Regulatory reform is mitigated through the maintenance of 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.
Failure to meet targets for regulatory performance and customer service	Ofwat has set the company some challenging operational performance targets for PR14, with financial penalties and loss of credibility if we fail to meet these. Ofwat's regulatory processes place customers at the heart of	Our review of processes, systems and equipment is ongoing and investments are being made to deliver significant improvements in the quality of product and service. We have a series of internal measures that enable us to proactively monitor performance and take prompt corrective action when and where necessary.

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Risk	What Does It Mean	Mitigation
	the business. Failure to meet these higher standards will lead to customer dissatisfaction and Service Incentive Mechanism (SIM) penalties imposed by Ofwat, all of which will damage the company's reputation.	During the year the Legacy alternative scheme was successfully delivered. Failure to complete the scheme in the agreed timescale could have led to significant penalties and increased scrutiny from Ofwat. We have delivered another strong year-on-year improvement in SIM. Improvements in our training and processes identified in previous years have helped continue this trend. Our real time feedback system, Rant & Rave, also continues to help us identify and resolve customer service issues, primarily complaints and unwanted contacts.
Operational		
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.	Assets are managed through condition monitoring and maintenance. When appropriate, risk-based asset investment planning identifies assets for replacement, which is a continuing process. 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. The Drinking Water Safety Plan addresses the management of water quality risks throughout the supply system from catchment to customer. This ensures there are adequate mitigations in place for all risks, including discolouration in the form of operational procedures, processes, maintenance, monitoring and appropriately trained staff. Risk-based investment planning plays an important part by ensuring equipment performs effectively and emerging risks are addressed.

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.	The cyber threat is constantly evolving – as are our efforts to counter it. As a vital utility we take the threat very seriously and receive support and guidance at Government level and from other support structures. Our review of our existing systems and controls is underway and our people are being trained to be more security aware. As a precaution, we have robust incident response, business continuity and disaster recovery procedures in place and regularly test our ability to recover from systems failure. We also maintain insurance cover for loss and liability.
Health & Safety		
The nature of the activities we undertake creates a potential to cause harm to our employees, contractors and the general public	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 procedure or the breakdown of an asset could lead to injury.	Alignment to the well-established Severn Trent Health, Safety and Wellbeing framework has continued during the year. The framework ensures all our operations and processes are conducted in compliance with Health and Safety legislation and in the interests of the safety of our people and contractors. Our Goal Zero initiative clearly establishes our target that no one should be injured or made unwell as a result of what we do. We recognise that the key to a safer organisation is the behaviour of staff. As such, we encourage near miss reporting across the organisation as we believe this ensures we review incidents to address the root causes of incidents. Our assets are subject to regular monitoring and maintenance though proactive and reactive programmes of work. Our reservoirs are independently inspected and then maintained by our staff to ensure that they remain safe.

Viability statement

Assessment of current position and long-term prospects

The directors' assessment of the Company's current financial position is set out in the Financial Review on page 2.

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 ensure that water companies are able to finance their appointed activities. Ofwat meets this obligation by setting price controls for five year Asset Management Periods (AMPs). This mechanism reduces the potential for variability in revenues from the regulated business. The current AMP runs until March 2020. Ofwat has published its Final Methodology for assessing companies' business plans and setting price controls for the AMP period 2020 – 2025 and the Company has made significant progress in developing its business plan, which is due to be submitted to Ofwat in September 2018.

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The Company has significant investment programmes that are largely funded through intra-group borrowing. The Company's strategic funding objectives reflect the long-term nature of its business and it seeks to obtain a balance of secure long-term funding at the best possible economic cost. The Severn Trent Group's Treasury Policy requires that it maintains sufficient liquidity to cover cash flow requirements for a rolling period of 18 months in order to mitigate the risk of restricted access to capital markets. The Company's refinancing requirements are managed within the overall Severn Trent Group Treasury Policy. The weighted average maturity of the Company's debt at the balance sheet date was 14 years.

The Company has established a process to assess its prospects. The Board undertakes an 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 plan assesses the Company's prospects and considers the potential impacts of the principal risks and uncertainties. Stress tests are performed to assess the potential impacts of combinations of those risks and uncertainties. The plan also considers the mitigating actions that might be taken to reduce the impact of such risks and uncertainties and the likely effectiveness of the mitigating actions.

Period of assessment

The directors considered a number of factors in determining the period to be covered by the assessment. The long-term nature of the Company's 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 the Company's financial projections. The Company has an established planning and forecasting process and the directors consider that the assessment of the Company's prospects is more reliable if it is based on an established process.

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

Bearing in mind the long term nature of the Company's business; the enduring demand for its services; the nature of the Company's established planning process and the changing nature of the regulation of the water industry in England and Wales, the directors have 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 the future prospects the Company has considered the potential effect of risks that could have a significant financial impact under severe but plausible scenarios. The risks considered were identified in the Company's ERM process, which is described on page 8, and from the key assumptions in the financial model. The scenarios tested are described below.

Scenario tested	Related principal risk
1. *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.	Risk 1: Ongoing regulatory reform
2. *Underperformance against performance commitments* The Company operates under a regulatory model which 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.	Risk 2: Failure to meet targets for regulatory performance and customer service
3. *Non-compliance with legislation resulting in a financial penalty* The Company operates in a regulatory and legal environment that is complex and changing. Failure to keep pace with changes in legislation could lead to non-compliance and result in financial penalty.	Risk 3: Failure to comply with regulatory requirements
4. *An increase in inflation for part of the period under consideration* Increasing inflation tends to lead to an increase in the pension deficit and bad debt which would adversely impact cash flows and gearing.	N/A – key assumption in financial model
5. *A reduction in inflation for part of the period under consideration* The Company's revenues are linked to inflation. Low or negative inflation tends to adversely impact profits and cash flows if increases in costs exceed revenue.	N/A – key assumption in financial model

6. *An increase in household consumer bad debt* An increase in customer bad debt would adversely impact profits and cash flows.	N/A – key assumption in financial model
7. *Debt refinancing above projections* The Company must ensure there is sufficient liquidity available to fund near term financial commitments. Significant increases in debt financing costs could impact liquidity and profits.	N/A – key assumption in financial model
8. *A severe climate event, operational failure or other exceptional event with a very significant financial impact* The Company's Enterprise Risk Management process has identified a number of risks including cyber security, failure of key assets and severe weather events that might have a significant impact on the Company's operational and financial performance.	Risk 4: Business interruption and/or data loss resulting from cyber threats Risk 5: Health and safety impact
9. *Over-collection of revenue resulting in financial penalty* The Regulatory framework has a mechanism to reduce the impact of deviations on customer bills arising from revenue forecasting deviations. Over-collection of revenues compared to forecast outside of a set threshold would lead to financial penalty.	Risk 3: Failure to comply with regulatory requirements
10. *A combination of scenarios comprising: unfunded costs; underperformance against performance commitments and non-compliance with legislation resulting in a financial penalty*	See above

The directors have identified actions, including reducing discretionary outflows of funds and working with providers of finance, including other Group companies, that would be available to the Company to mitigate the impact of adverse outcomes.

The Company has significant funding to fund the Company's capital programme. The Company's principal source of finance is the Severn Trent Group and therefore the Company has considered the outcome of the Severn Trent Group's assessment of viability in making its own assessment. Under all scenarios considered the Company would remain solvent and have access to sufficient funds in normal market conditions. The Severn Trent 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 Severn Trent 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, resulted in an impact to the Company's expected liquidity, solvency or debt covenants that could not be addressed by mitigating action and hence were not considered to be 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 the assessment of prospects and viability statement should be made. The Audit Committee supports the Board in performing this review.
This statement is subject to review by Deloitte, our external auditor. Their audit report is set out on page 23.

Assessment of viability
The directors have assessed the viability of the Company over a seven year period to March 2025, 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 2025.

By order of the board

James Bowling
Director
13 July 2018

Hafren Dyfrdwy Limited (formerly Dee Valley Water Limited)

Directors' report

The directors present their annual report and the audited financial statements of the company for the year ended 31 March 2018. Under Section 414C (11) of the Companies Act 2006 the directors have opted to disclose information regarding principal risks and uncertainties and future developments in the Strategic Report.

Matters included in the Strategic report

The following matters are included in the company's Strategic report on pages 2 to 12:

- Principal activity of the company
- Future developments in the business
- Principal risks and uncertainties

Directors and Directors' Interests

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

E FitzGerald	(resigned 15 December 2017)
P J Remnant	(resigned 1 April 2018)
A R E Strank	(resigned 1 April 2018)
D J N Reiniche	(resigned 1 April 2018)
K S Beeston	(resigned 1 April 2018)
J B Coghlan	
A J Duff	
J Bowling	
O R Garfield	
A Beynon	(appointed 1 April 2018)
S Jones-Evans	(appointed 1 April 2018)
M Mehmet	(appointed 1 April 2018)

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 within the accounts for the ultimate parent company Severn Trent Plc.

Dividends

There have been no dividends (2017: £1,945,511) paid in the year. The directors do not recommend the payment of a dividend (2017: nil)

Charitable contributions

During the year the Company did not make any contributions to charitable causes (2017: £6,126).

Post balance sheet events

On 29 June 2018 the Company changed its name to Hafren Dyfrdwy Limited.

On 1 July 2018 the terms of the Company's Instrument of Appointment as a water undertaker under the Water Act 1989 issued by the Secretary of State for Wales (the Licence) were amended. The Licence now includes those parts of Wales (mainly Powys) previously served by Severn Trent Water Limited and excludes those parts of England around Chester previously served by the Company. The Licence was also amended to enable the Company to act as a Water and Sewerage undertaker to its customers in Powys.

Going concern

These financial statements have been prepared on a going concern basis. The company has considerable financial resources together with a customer monopoly in its area of supply. Consequently, the Directors believe that the Company is well placed to manage its business risks successfully over the forthcoming twelve month period.

DIRECTORS' REPORT
For the year ended 31 March 2018

The Directors therefore have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future and consider that the going concern basis continues to be appropriate in the preparation of these financial statements.

Directors' indemnities

The company's Articles of Association provide that directors of the company shall be indemnified by the company against any costs incurred by them in carrying out their duties including defending any proceedings arising out of their positions as directors in which they are acquitted or judgement is given in their favour or relief from any liability is granted to them by the court. This indemnification has been in force throughout the year and up to the date of signing the financial statements.

Internal Controls
The Board is responsible for the Company's Internal Control systems and for reviewing their effectiveness. The Audit Committee of Severn Trent Plc 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 Code and the Guidance, and appropriate systems have been in place for the year ending 31 March 2018 and up to the date of the Annual Report. This is described in the Severn Trent Plc Audit Committee report on page 86 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.

Corporate Governance

The Board has had a diverse agenda during the year: from addressing the challenges of the upcoming Ofwat Price Review ("PR19") without losing focus on other key strategic and operational priorities; to ensuring that the Company is operating effectively as a standalone business within the Severn Trent Group. PR19 is a key strategic item for the business that has required a robust governance process to ensure the right level of debate and oversight without allowing this topic to dominate the strategic landscape. In summary, the Board's principal areas of focus have been:

- **PR19;**
- **Customer service;**
- **Water quality;**
- **Environmental performance; and**
- **Integration of the Company into the Severn Trent Group.**

Customers continue to be at the forefront of our attention. Customer Delivery, Water Quality and Environmental Performance have been the subject of regular "performance review" items on the agenda and financing has been addressed through the continuing important work of the Treasury Committee, through the Chief Financial Officer's regular reports to the Board and via specific finance related items on the agenda. The cost of debt methodology for PR19 has been a key consideration due to its wider impact for the business as a whole. (See Board activities on pages 17 to 18).

There is a great dynamic in the Board room but we are by no means complacent and recognise that there are still many challenges to tackle. We continue to foster a culture of ownership, stewardship and always doing the right thing, sharing the wider Severn Trent Group values: we put our customers first; we are passionate about what we do; we act with integrity; we protect our environment; and we are inspired to create an awesome company.

In respect of the Company's stakeholders, there has been oversight of a full range of engagement with shareholders, regulators, customers, communities and employees alike. There have been regular communications with shareholders and open lines of communication with Ofwat, CCW, Natural Resources Wales, the Environment Agency and the DWI. All the Board members have multiple formal and informal opportunities to engage with customers and employees and are constantly impressed at the quality of Hafren Dyfrdwy's people, wherever they work and whatever their role. Engagement scores from the annual employee engagement questionnaire are excellent and this is mirrored in the Board's communication with employees at and below management level.

DIRECTORS' REPORT
For the year ended 31 March 2018

We continue to strive for comprehensive talent development and succession planning at all levels of the business.

Looking forward, Hafren Dyfrdwy has a strong unified Board with the broad range of professional backgrounds, skills and perspectives needed to take the company into the next regulatory period.

UK Corporate Governance Code Compliance Statement

Hafren Dyfrdwy Limited is not a listed company, hence it is not required to comply with the UK Corporate Governance Code (the "Code").

However, the Board of Hafren Dyfrdwy Limited has chosen, where appropriate and reasonably practicable, to voluntarily comply with the Code to ensure that its high standards of governance also apply to it.

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

- The Board committees operate at the Severn Trent Plc level rather than the Company level. Whilst the Board committees are not duplicated at the Company level, their terms of reference state that their supervisory remit extends to all Severn Trent Group companies. In particular the Audit Committee's terms of reference include, but are not limited to, reviewing Hafren Dyfrdwy's:
    - Processes for producing regulatory submissions;
    - Statutory and regulatory accounts prior to their approval by the Hafren Dyfrdwy Limited Board;
    - Reviewing the effectiveness of the controls over the Company's financial reporting and
    - Processes for ensuring compliance with the requirements of the Scheme of Charges submitted to Ofwat and compliance with licence Condition E.
- The Board committees are all led by Independent Non-Executive Directors who comprise the majority of membership of each Committee. Details of the committees are reported publicly in the Severn Trent Plc Annual Report and Accounts. The Directors of Hafren Dyfrdwy Limited are invited to attend meetings of the Audit Committee of Severn Trent Plc when it is considering matters in relation to the Company.
- 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.

Severn Trent Plc and Hafren Dyfrdwy Limited operate as distinct legal entities. The Boards comply with the Severn Trent Plc Board governance framework and the respective Matters Reserved to the Board. They are assisted through the management of separate agendas, meetings and minutes by Company Secretariat and advised in their meetings by the Company Secretary, where appropriate. Subsidiary Company Boards are managed through designated governance processes. In particular, the relationships between Hafren Dyfrdwy Limited, Severn Trent Water Limited, and other Severn Trent Group businesses such as Severn Trent Business Services are monitored and controlled to ensure that regulatory requirements and obligations under competition law are complied with in respect of all transactions between them, or with third parties.

Governance framework

The Board is responsible to all stakeholders, including the Company's shareholders, for the approval and delivery of the Company's strategic objectives. It makes sure that the necessary financial, technical and human resources are in place for the Company to meet its objectives. The Board leads the Company within a framework of practical and effective controls which enable risk to be assessed and managed.

Responsibility for the development and implementation of the Company's strategy and overall commercial objectives is delegated to the Chief Executive who is supported by the Severn Trent Executive Committee ('STEC').

DIRECTORS' REPORT
For the year ended 31 March 2018

Charter of Expectations

The Severn Trent Charter of Expectations sets out clearly the defined roles of the Chairman, Chief Executive, Chief Financial Officer, Senior Independent Director and Non-Executive Directors, the operation of the Board and Severn Trent Plc Board Committees, and also reflects the Board's responsibility for setting the tone of the Group's culture, values and behaviour. In accordance with the Code, it sets out a clear division of responsibilities between the roles of Chairman and CEO.

The Charter of Expectations is reviewed annually, with the last review undertaken in March 2018. It's also used to assist in the ongoing assessment of the effectiveness of the Board and its Committees and that of individual Directors. It is available on the Severn Trent Group's corporate website (www.severntrent.com).

Matters Reserved to the Plc Board

The Schedule of Matters Reserved to the Plc Board sets out the processes in place regarding the Plc Board's tasks and activities and the matters specifically reserved for the Board's decision making. A copy is available on the Severn Trent Group's corporate website (www.severntrent.com).

The Board has reserved the following matters, amongst others, for its own consideration:

- the Group's strategic and operating plans
- financial reporting and controls
- major acquisitions and disposals
- key Group policies
- Group Authorisation Arrangements ("GAA")

Conflicts

The Board formally considers any actual or potential conflicts of interest at every meeting, and reviews the authorisation of any potential conflicts of interest every six months.

Group Authorisation Arrangements

The GAA is the framework through which the Severn Trent Plc Board authorises the right people, at the right level, to take important decisions to effectively control and manage legal, financial and administrative decisions throughout the Group. These arrangements are reviewed annually, with the last review undertaken in April 2018.

The flow of authority is from the Severn Trent Plc Board to the Chief Executive and the Severn Trent Executive Committee. In respect of certain decisions, the delegated authority is subject to an obligation to work with specialist business service areas (such as Tax, Treasury, Group Finance, Group Commercial and General Counsel), which provides additional expertise and a Group-wide perspective.

'Doing the Right Thing – the Severn Trent Way'

In addition to the Charter of Expectations and Terms of Reference for the Board, and the company-wide GAA, Severn Trent also sets out the cultural tone expected of its workforce through clearly defined values and standards of behaviour that are expected from everyone who works for the Severn Trent Group. Its Code of Conduct 'Doing the Right Thing – the Severn Trent Way' has been rolled out across the Group in the form of all-employee training programme, is integral to the induction process and is continuously re-enforced by management to make sure that all of our people embody the Severn Trent Group's values:

- **we put our customers first**
- **we are passionate about what we do**
- **we act with integrity**
- **we protect our environment**
- **we are inspired to create an awesome company**

Our Code of Conduct is key to helping us achieve our vision of being the most trusted water company by 2020.

We know that the right culture must be set from the top. An annual review has been conducted of the key metrics which indicate what kind of culture exists across the Severn Trent Group.

DIRECTORS' REPORT
For the year ended 31 March 2018

Policies, Standards and Procedures

In addition to our Code of Conduct, Severn Trent has an additional twelve policies which apply to everyone who works for the Severn Trent Group. These policies have been designed to help employees and contractors understand their role within the company and their responsibility to the Severn Trent Group. They also, in turn, outline the Group's responsibility to the individual. These policies are the strategic link between the Severn Trent vision and how we manage our day to day business, and are underpinned by specific company standards and procedures.

Board activities

The table below sets out the main matters considered by the Board in 2017/18 at its scheduled Board meetings. The Board's agenda is ordinarily structured as follows:

- procedural matters
- performance review (including health and safety, operational, customer and financial matters)
- strategic items
- items for approval/noting (including the Company Secretary's Update on governance and regulatory issues)

This structure has been agreed to ensure that Matters Reserved to the Board are addressed appropriately and that the Board's time is spent effectively. Strategic items are regularly presented to the Board by senior managers within the business.

Summary Board Activities 2017/18

Overview

All Board meetings consist of: Procedural matters; Performance Reviews; Strategy; Items for approval/noting. Further details are provided below:

Board Focus

Topic & Actions

Procedural matters

Agreeing minutes of last meeting, reviewing progress against specific actions.

Performance Reviews

Reviews are received from the CEO and CFO at every meeting which include a strong focus on Production and Customer Delivery during the year. The financial reviews have included operational performance, in addition to budget approval.

Strategy

Whilst the following is not an exhaustive list of all the matters the Board have considered during the financial year, it does indicate the key areas of activity and hopefully provide insight into the strategic workings of the Board:

Water Resources Management Plan: The Board have challenged the prescribed methodology and drilled down in terms of the assumptions, variances and scenarios in addition to simply testing alternative methodologies, applying the expertise of those board members who have the skills set for such matters.

Board Composition: Further to consultation with Ofwat, the Board in consultation with the Nominations Committee of Severn Trent Plc considered the make-up of the Board, appointed the Chairman of this Board and sourced candidates for three new independent Non-Executive Directors.

Customer Service: As well as receiving updates on performance at every meeting the Board met with CCW for Wales to listen to its perspective on Customers' views on performance.

PR19: This price review is a particularly challenging area this year and the Board has therefore spent a commensurate amount of time on it to enable progressive scrutiny.

Enterprise Risk Management ("ERM") Update: The Board receives six monthly updates on ERM risks

Health, Safety and Wellbeing Strategy: The Board received an update and noted pleasing progress with the achievement of certain important milestones during the year but acknowledge there are still further issues to improve upon and the cultural challenge continues.

Re-nationalisation Debate: The Board has been closely following topical debate around the proposal by the Labour Party in its May 2017 election manifesto to re-nationalise utilities, including the water sector.

Water Quality: The Board met with the DWI and invited them to give feedback on the Company's water quality performance, both in terms of current performance and challenges for the next AMP.

Cyber Security: Given the Cyber Security landscape continues to evolve with an increasing level of activity and a number of high profile incidents for other companies and government departments, the Board has received an update on the company's Cyber Security Roadmap during the year. It noted the scrutiny by the National Cyber Security Centre, its risk based approach and investment priorities, and increased in-house support and positive reviews by Defra and PwC.

GDPR: The Board recognises that the implementation of GDPR is challenging but through a considered update during the year was reassured about what had to be done by management in order to prepare for it. It has scheduled future updates to review progress.

Innovation Investment Review: The Board reviewed the work of the innovation team and the progress that has been made to accelerate the pace of application in deploying value-generating technology.

Items for approval/ noting

This is a standing item on the agenda to meet the requirements of the business in terms of approving matters such as leases and land disposals, the alignment of water licences (particularly in light of re-defining the English/Welsh boundaries), and setting tariff charges. This item always includes the Company Secretary's Update to address regular reviews of governance matters (by way of example see annual reviews shown below), to keep directors abreast of regulatory changes and obtain board approvals for specific matters reserved to the Board.

Annual Governance Reviews:

- Directors' conflicts of interest
- Gifts and Hospitality Register
- Board Diversity Policy
- Charter of Expectations
- Matters Reserved to the Board
- Group Authorisation Arrangements

Training and continuing professional development

As well as Board agenda items, training sessions in relation to specific topics of interest that were presented to Directors during the year are set out above.

The aim of the training sessions is to continually refresh and expand the Board's knowledge and skills to enable them to fulfil their roles effectively on the Board and its Committees and contribute to discussions on technical and regulatory matters. The sessions also serve as an opportunity for the Board to discuss strategy and risks with management below Executive Committee level and gain further insight into our businesses and management capability.

Directors' resources

An online resource library and Continuing Professional Development ('CPD') repository is available for use by the Directors, which is constantly reviewed and updated. The library includes a Corporate Governance Manual and details of Board training sessions. It also contains a further reading section which covers updates and guidance on changes to legislation and corporate governance best practice. The Directors also have access to professional development provided by external bodies and our advisers.

Induction programme

Three new Independent Non-Executive Directors were appointed to the Board of Hafren Dyfrdwy Limited with effect from 1 April 2018. Each new Director received an appropriate induction facilitated by the Company Secretary covering the following topics, as well as a tour of a key operational site to understand our water treatment and distribution processes, and the customer journey, in a live environment, as follows:

- Ofwat pre-appointment process
- Company structure including regulatory overview and performance
- Company strategy

DIRECTORS' REPORT
For the year ended 31 March 2018

- Key stakeholder relations including customers, suppliers, regulators and service providers
- Key operations and processes including operational areas and key sites
- Financial performance
- Our people – including health, safety and wellbeing, talent and succession, trade unions and an overview of our remuneration policy
- Group risk profile and our approach to risk
- Governance framework
- Board calendar, effectiveness reviews and action plans
- Minutes of previous meetings
- Insight into key areas of focus for any specific appointment

We will continue to enhance the Board's induction process, particularly bearing in mind feedback from new appointees.

DIRECTORS' REPORT
For the year ended 31 March 2018

Directors' Remuneration Report

Remuneration details

The Executive Directors of Hafren Dyfrdwy Limited mirror those of Severn Trent Plc. Their remuneration is determined by the Remuneration Committee of Severn Trent Plc, and a recharge is made to the Company in respect of a proportion of their time for duties carried out by the Executive Directors on behalf of the Company. No emoluments were paid directly to any Director by the Company during the year ended 31 March 2018.

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 at https://www.severntrent.com/investors/annual-reports/2018-annual-report/) sets out the Remuneration Policy for Executive Directors and other senior executive managers, and the total remuneration paid to those directors. Remuneration for Executive Directors comprises the following elements:

- base salary and benefits;
- annual bonus;
- long term incentive plan; and
- pension arrangements.

The table below sets out the total remuneration received by the Executive Directors for 2017/18 (or for performance periods ending in 2017/18 in respect of the long term incentives).

						Year ended 31 March 2018
Director	**Salary and Fees[1] (£000)**	**Benefits[2] (£000)**	**Annual Bonus[3] (£000)**	**LTIP[4] (£000)**	**Pension[5] (£000)**	**Total (£000)**
Liv Garfield	687.2	17.7	501.0	706.6	171.8	**2,084.3**
James Bowling	414.2	18.7	301.9	278.3	103.5	**1,116.6**
Emma FitzGerald[6]	302.4	13.1	209.8	271.3	75.6	**872.2**

(1) Salaries are shown before the deductions of benefits purchased through Severn Trent Plc's salary sacrifice scheme, such as pension contributions via salary sacrifice.

(2) Benefits include a car allowance of £15,000 p.a., family level private medical insurance, life assurance worth six times salary and participation in an incapacity benefits scheme.

(3) The annual bonus is paid 50% in cash and 50% in shares with the portion deferred into shares subject to an additional holding period of three years with no further performance conditions attached.

(4) This relates to the vesting of the 2015 LTIP which is based on RoRE performance over the three year period to 31 March 2018. The value of the shares has been estimated using the average share price for the period from 1 January 2018 to 31 March 2018 of £18.69.

(5) The Executive Directors' pension provision is equal to 25% of salary. No Executive Directors accrued benefits under any defined contribution pension plans during the year or have participated in a defined benefits scheme while an Executive Director.

(6) Stepped down from the Board on 31 December 2017. Amounts for Emma FitzGerald are pro-rated for the period in which she was an Executive Director, with one exception of the vesting of the 2015 LTIP award.

Summary of Remuneration Policy, proposed amendments and implementation in 2018/19

Shareholders of Severn Trent Plc approved the Remuneration Policy at the AGM in 2015 (97.99% voted in favour). As such, Severn Trent Plc is required to seek approval for the new Policy at the 2018 AGM. The table below sets out an overview of the key areas of the Policy and summarises how the Committee is proposing to implement the Policy in 2018/19. Full details of the proposed Policy can be found on pages 120 to 128 of the Severn Trent Plc Annual Report and Accounts. The Remuneration Committee believes that the fundamental architecture of the Executive Directors' remuneration package is appropriate but has made a number of evolutionary changes to the previous Remuneration Policy to reflect the development of the Company, the Executive Directors and the latest corporate governance best practice:

- Pension contributions for any new Executive Directors will be capped at 15% of salary in line with other employees;
- A 2 year holding period will apply following the vesting of LTIP awards for the Executive Directors (this holding period will continue post cessation of employment);
- The minimum shareholding guidelines will be increased to 300% of salary for the CEO and 200% of salary for other Executive Directors, reflecting best practice; and

- The maximum LTIP award opportunity will be increased to 200% of salary. The increase in maximum award opportunity will be reflected in the level of challenge in the targets, and the Remuneration Committee has introduced a stretch target for delivery of upper quartile performance as independently assessed by OFWAT based on its calculation of RoRE performance.

Annual Bonus 2018/19
In summary, the annual bonus performance measures and weightings for 2018/19 financial year will be as follows:

- Regulated Water and Waste Water[1] Profit Before Interest & Tax – 47%
- STW Customer Outcome Delivery Incentives – 20%
- Business Services Profit Before Interest & Tax – 10%
- Customer Experience – 8%
- Health and Safety (Lost Time Incidents) – 8%
- Personal Objectives – 7%

The Remuneration 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 Severn Trent Plc Remuneration Report.

Chairman and Non-Executive Directors' fees

From 1 April 2018, Non-Executive Director fees for Sally Jones-Evans, Ann Beynon and Mohammed Mehmet were set at £30,000 per annum.

John Coghlan and Andrew Duff are remunerated as directors of Severn Trent Plc, and receive no additional remuneration in respect of their roles as directors of the Company. Their remuneration for the year is discussed on page 107 of the 2018 Severn Trent Plc Annual Report.

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. However, continuation of their reappointment is conditional on satisfactory performance and recommendation by the Nominations Committee of Severn Trent Plc.

[1] The Regulated Water and Waste Water business of Severn Trent Plc includes the wholesale and household retail activities of Hafren Dyfrdwy and Severn Trent Water.

DIRECTORS' REPORT
For the year ended 31 March 2018

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 judgements 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.

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.

By order of the board

James Bowling
Director
13 July 2018

Independent auditor's report to the members of Hafren Dyfrdwy Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements:

- **give a true and fair view of the state of the company's affairs as at 31 March 2018 and of its profit for the year then ended;**
- **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 of Hafren Dyfrdwy Limited (formally Dee Valley Water Limited) (the 'company') which comprise:

- the income statement;
- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity; and
- the related notes 1 to 21.

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

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 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.

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 obligations; and • Classification and valuation of capital expenditure.
Materiality	The materiality that we used in the current year was £547,000, which was determined on the basis 2%of revenue.
Scoping	Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement on page 13 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 confirm that we have nothing material to report, add or draw attention to in respect of these matters.

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 8 to 10 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 8 that they 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; or
- the directors' explanation on page 12 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.

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

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.

Valuation of the provision for trade and other receivables	
Key audit matter description	A proportion of the Company's water customers do not or cannot pay their bills, which results in the need for provisions to be made for non-payment of the customer balance. The Company also invoices sewerage charges on behalf of another water company and is subject to credit risk under the terms of that agreement. Management makes estimates regarding future cash collection when calculating the bad debt provision. The value of the provision for trade and other receivables at 31 March 2018 is £3,739,000 (2017: £2,875,000) as disclosed in Note 14. Provisions are made against the Company's trade and other receivables based on historical experience of levels of recovery from accounts in particular ageing categories. The key audit matter has been focused on the determination of the ageing of trade receivables balances as this determines the level of provisioning to be recorded and the historical cash collection rates applied to the aged debt. Due to the high level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance.
How the scope of our audit responded to the key audit matter	We challenged and tested the information used to determine the bad debt provision. Specifically, we have: • evaluated the design and implementation of key management review controls over the bad debt provision for water and sewerage; • audited the information used in calculating the bad debt provision to verify the ageing of debt used within the bad debt model; • assessed the rationale for rates used based on current and expected cash collection performance for water; • assessed the provision for amounts due in relation to sewerage invoices by comparing to historical cash collection rates and benchmarking to Severn Trent Water Limited; and • analysed the level of exposure to the debtor balance to support the appropriateness of the valuation of the bad debt provision.
Key observations	We are satisfied that the assumptions applied in assessing the impairment of trade and other receivables and the calculation of the ageing of trade receivables are appropriate and no additional provision was identified from the audit work performed.

Valuation of the retirement benefit surplus	
Key audit matter description	This 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 and pension increases, along with investment returns 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. The company's retirement benefit surplus at 31 March 2018 is £18.2 million (31 March 2017 £9.85 million) per Note 13.

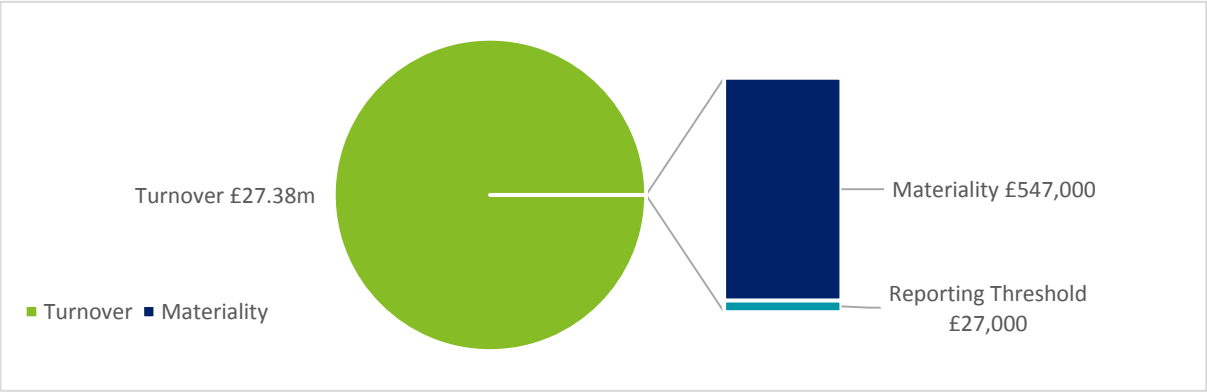
How the scope of our audit responded to the key audit matter	We have challenged the assumptions applied by performing the following procedures: • evaluated the design and implementation of key controls; • with support from the pension specialists within our audit team, we challenged the assumptions used in the calculation of the pension scheme deficit, specifically challenging the discount rate with reference to comparable market and other third party data; and • assessed whether there had been any changes in the methodology to determine the assumptions since the prior year.
Key observations	We are satisfied that management's assumptions in the valuation of the retirement benefit obligation, including discount rates, are appropriate and within a reasonable range.
Classification and valuation of capital expenditure	
Key audit matter description	Hafren Dyfrdwy Limited 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. As disclosed in Note 12, Property, plant and equipment ("PPE") additions in the year were £14,042,000 (2017 £8,960,000). Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure. Capital projects may contain a combination of enhancement and maintenance activity which are not distinct and therefore there is a key audit matter that PPE is valued incorrectly as a result of items of operating expenditure being misclassified. Due to the level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance.
How the scope of our audit responded to the key audit matter	We performed the following procedures to respond to the key audit matter: • we assessed the capitalisation policy to determine compliance with relevant accounting standards; • we evaluated the design and implementation of controls over the application of the policy to expenditure incurred on projects within the company's capital programme during the year; • for a sample of capital projects, we assessed the application of the capitalisation policy to the costs incurred by understanding the initial business case for the project and ensuring that it had been approved by the relevant capital programme board; and • we agreed a sample of costs to third party invoices and assessed whether the split between capital and operating expenditure was aligned to the original approved business plan.
Key observations	We are satisfied that the valuation and classification of assets capitalised in the year is appropriate.

Our application of 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	£547,000
Basis for determining materiality	Materiality has been calculated based on 2% of revenue for the year.
Rationale for the benchmark applied	Revenue has been used as the benchmark as it is a key driver of financial performance.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £27,000, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

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

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.

We have nothing to report in respect of these matters.

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.

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.

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 Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements

Opinion 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 its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

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 by the company, 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.

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.

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.

Kate Hadley, ACA (Statutory auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
Birmingham, United Kingdom
13 July 2018

Hafren Dyfrdwy Limited

Income statement

For the year ended 31 March 2018

	Note	2018 £000	2017 £000
Turnover	3	**27,352**	26,910
Operating costs		**(21,410)**	(23,316)
Profit before interest and tax	4	**5,942**	3,594
Finance income	7	**300**	347
Finance costs	8	**(3,020)**	(3,369)
Net finance costs		**(2,720)**	(3,022)
Profit on ordinary activities before taxation		**3,222**	572
Current tax	9	**(1,617)**	100
Deferred tax	9	**650**	(399)
Taxation on profit on ordinary activities		**(967)**	(299)
Profit for the year		**2,255**	273

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

Statement of comprehensive income

For the year ended 31 March 2018

	Note	**2018**	2017
		£'000	£'000
Profit for the year		**2,255**	273
Other comprehensive income/(loss) for the year			
Items that will not be reclassified to the income statement:			
Net actuarial gains/(losses)	13	**8,100**	(485)
Tax on net actuarial gains/losses		**(1,385)**	82
Effect of rate change on deferred tax on accumulated actuarial gains		**–**	97
		6,715	(306)
Total comprehensive income/(loss) for the year		**8,970**	(33)

Hafren Dyfrdwy Limited

Balance sheet

At 31 March 2018

	Note	2018 £'000	2017 £'000
Non-current assets			
Other intangible assets	11	**4,548**	–
Property, plant and equipment	12	**110,168**	101,530
Retirement benefit surplus	13	**18,205**	9,845
		132,921	111,375
Current assets			
Inventory		**434**	372
Trade and other receivables	14	**23,080**	18,455
Cash and cash equivalents		**908**	50
		24,422	18,877
Current liabilitiess			
Borrowings	15	**(478)**	–
Trade and other payables	16	**(23,213)**	(15,077)
Current tax payable		**(877)**	(12)
		(24,568)	(15,089)
Net current (liabilities)/assets		**(146)**	3,788
Non-current liabilities			
Borrowings	15	**(62,482)**	(55,307)
Trade and other payables	16	**(11,162)**	(10,430)
Deferred tax	17	**(14,296)**	(13,561)
		(87,940)	(79,298)
Net assets		**44,835**	35,865
Equity			
Called up share capital	18	**240**	240
Other reserves		**614**	614
Fair value reserve		**11,685**	11,685
Retained earnings		**32,296**	23,326
Equity attributable to owners of the company		**44,835**	35,865

The financial statements were approved by the board of directors on 13 July 2018. They were signed on its behalf by:

James Bowling
Director
13 July 2018
Company Number: 03527628

Hafren Dyfrdwy Limited

Statement of changes in equity

For the year ended 31 March 2018

	Equity attributable to owners of the company				
	Share capital	Other reserves	Fair value reserve	Retained earnings	Total
	£000	£000	£000	£000	£000
At 1 April 2016	240	614	11,685	25,305	37,844
Profit for the year	–	–	–	273	273
Net actuarial losses	–	–	–	(485)	(485)
Tax on net actuarial losses	–	–	–	82	82
Effect of change of deferred tax rate on accumulated actuarial gains	–	–	–	97	97
Total comprehensive loss for the year	–	–	–	(33)	(33)
Dividends paid	–	–	–	(1,946)	(1,946)
At 1 April 2017	240	614	11,685	23,326	35,865
Profit for the year	–	–	–	2,255	2,255
Net actuarial gains	–	–	–	8,100	8,100
Tax on net actuarial gains	–	–	–	(1,385)	(1,385)
Total comprehensive income for the year	–	–	–	8,970	8,970
At 31 March 2018	**240**	**614**	**11,685**	**32,296**	**44,835**

Other reserves represent reserves arising from previous Schemes of Arrangement accounted for under the principles of merger accounting.

The fair value reserve arose on the revaluation of infrastructure assets to fair value on transition to FRS 101.

Notes to the financial statements

1. Accounting policies

a) Accounting convention

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

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

b) Basis of preparation

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. The group financial statements of Severn Trent Plc are available to the public and can be obtained as set out in note 21.

c) Revenue

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.

Turnover 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.

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

d) 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. Taxable profit differs from net profit as reported in the income statement because it excludes items of income and expenses that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

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.

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.

1. Accounting policies (continued)

d) Taxation (continued)

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

e) Borrowings

All 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.

f) Foreign currency

Foreign currency transactions arising during the year are translated into sterling at the rate of exchange ruling on the date of the transaction. All profits and losses on exchange arising during the year are dealt with through the income statement.

g) Other intangible and non-current assets

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

	Years
Software	3 - 10
Other assets	2 - 20

Amortisation charged on 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 i) below).

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 cost can be measured reliably.

Research expenditure is expensed when it is incurred.

h) Property, plant and equipment

Property, plant and equipment is held at cost (or at deemed cost for infrastructure assets on transition to IFRS/FRS 101) 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.

1. Accounting policies (continued)

h) Property, plant and equipment (continued)

Where items of property, plant and equipment are transferred to the group 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
Freehold land and buildings	Buildings and service reservoirs	30 – 80 years
Infrastructure assets	Impounding reservoirs	250 years
	Raw water aqueducts	250 years
	Water mains	80 – 150 years
Fixed plant and equipment	Fixed plant	20 – 40 years
	Equipment	20 – 40 years
	Water meters	15 years
	Mobile plant and vehicles	2 – 15 years

i) Impairment of non-current assets

At each balance sheet date, the company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). 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. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of the future cash flows have not been adjusted.

If the recoverable amount of the asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount.

An impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

j) Inventory

Inventory and work in progress is stated at the lower of cost and net realisable value. Cost includes labour, materials, transport and attributable overheads.

1. Accounting policies (continued)

k) Trade and other receivables

Trade receivables, 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.

Trade receivables that are assessed not to be impaired individually are assessed collectively for impairment by reference to the group's historical collection experience for receivables of similar age or characteristics.

l) 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.

The 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. The 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 period, 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.

2. Significant accounting judgements and key sources of estimation uncertainty

Critical accounting judgements

i) Classification of costs between operating expenditure and capital expenditure

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

Sources of estimation uncertainty

i) 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. A five year change in the average remaining useful lives of property, plant and equipment would result in a £934,000 change in the depreciation charge.

ii) Retirement benefit obligations

Determining the amount of the group'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.

3. Revenue

	2018	2017
	£'000	£'000
Water and waste water services	**27,350**	26,910
Other services	**2**	–
Turnover	**27,352**	26,910
Finance income	**300**	347
	27,652	27,257

Revenue for 2017 includes commission income of £2,477,000 that was disclosed as other operating income in the prior year financial statements.

4. Profit before interest and tax

	2018	2017
	£'000	£'000
Profit before interest and tax is stated after charging/(crediting):		
Depreciation – infrastructure assets	**477**	1,340
Depreciation – non-infrastructure assets	**4,927**	3,611
Amortisation of intangible assets	**39**	–
Profit on disposal of property, plant and equipment	**(204)**	(44)
Staff costs (see note 5)	**7,344**	7,548

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

	2018	2017
	£'000	£'000
Fees payable to the company's auditor for:		
- the audit of the company's annual accounts	**51**	33
Total audit fees	**51**	33
Fees payable to the company's auditor and their associates for other services to the group:		
- other assurance services	**20**	9
Total non-audit fees	**20**	9

No other fees were payable to the auditor (2017: nil).

5. Employee numbers and costs

The average number of persons employed by the company (including Directors) during the year was as follows:

	2018	2017
Direct staff	**137**	172

The aggregate payroll costs of these persons was as follows:

	2018 £'000	2017 £'000
Wages and salaries	**6,180**	6,291
Social security costs	**468**	665
Pension costs – defined benefit plans	**488**	365
Pension costs – defined contribution plans	**208**	227
Total staff costs	**7,344**	7,548

6. Directors' remuneration

The following table shows the remuneration due to directors for their services to the company during the year:

	2018 £'000	2017 £'000
Emoluments for qualifying services	–	660

As at 31 March 2018, there were no retirement benefits accruing to directors (2017: none) under a defined benefit scheme. The company made no contributions of into a defined contribution scheme in respect of the Directors (2017: £21,000).

Emoluments disclosed above include the following amounts paid to the highest paid Director:

	2018 £'000	2017 £'000
Emoluments for qualifying services	–	313

Amounts paid to past directors in respect of loss of office was £137,612 (2017: £nil).

7. Finance income

	2018 £'000	2017 £'000
Interest income earned on:		
Other financial income - bank interest	**–**	2
Net interest income on defined benefit scheme assets (note 13)	**300**	345
Total interest receivable	**300**	347

8. Finance costs

	2018 £'000	2017 £'000
Interest charged on:		
Amounts payable to other group companies	**2,960**	–
Bank and other loans	**60**	3,369
Total interest expense	**3,020**	3,369

Borrowing costs of £1,056,000 (2017: nil) incurred funding eligible capital projects have been capitalised at an interest rate of 6.0%. Tax relief of £201,000 was claimed on these costs, which was credited to the income statement, offset by a related deferred tax charge of £180,000.

9. Taxation

a) Analysis of tax charge in the year

	2018 £'000	2017 £'000
Current UK corporation tax at 19% (2017: 20%)		
Current year	**288**	610
Prior year adjustment	**1,329**	(710)
Total current tax	**1,617**	(100)
Deferred tax		
Origination and reversal of temporary differences:		
- current year	**333**	(96)
- prior year adjustment	**(983)**	1,191
Change arising from rate change	**–**	(696)
Total deferred tax	**(650)**	399
	967	299

The company earns profits primarily in the UK. Therefore, the tax on profit on ordinary activities is the standard rate for UK corporation tax.

b) Factors affecting the tax charge in the year

The tax assessed for the current year is higher (2017: higher) than the standard rate of corporation tax in the UK of 19% (2017: 20%).

The differences are explained below:

	2018 £'000	2017 £'000
Profit on ordinary activities before tax	**3,222**	572
Tax at the standard rate of corporation tax in the UK 19% (2017: 20%)	**612**	114
Tax effect of depreciation on non-qualifying assets	**46**	–
Non-deductible expenses	**2**	514
Adjustments in respect of prior years	**346**	481
Change arising from rate change	**–**	(696)
Other tax adjustments – utilisation of unprovided tax losses	**–**	(97)
Current year impact of rate change	**(39)**	(17)
Total tax charge	**967**	299

c) Tax (credited)/charged charged directly to equity

In addition to the amount charged to the income statement, the following amounts have been credited/(charged) directly to equity:

	2018 £'000	2017 £'000
Deferred tax		
Tax on actuarial gains/losses	**(1,385)**	179

10. Dividends

Amounts recognised as distributions to equity holders in the period is as follows:

	2018 £'000	2017 £'000
Final dividend for the year ended 31 March 2018 of nil (2017: 809p) per ordinary share	**–**	1,946
	–	1,946

11. Other intangible assets

	Computer software £000
Cost	
At 1 April 2017	–
Additions	4,587
At 31 March 2018	**4,587**
Amortisation	
At 1 April 2017	–
Amortisation for the year	(39)
At 31 March 2018	**(39)**
Net book value	
At 31 March 2018	**4,548**
At 31 March 2017	–

12. Property, plant and equipment

	Land and buildings £'000	Infrastructure assets £'000	Fixed plant and equipment £'000	Assets under construction £'000	Total £'000
Cost					
At 1 April 2016	69,899	64,406	19,960	–	154,265
Additions	4,178	4,338	444	–	8,960
Disposals	–	–	(500)	–	(500)
At 1 April 2017	74,077	68,744	19,904	–	162,725
Additions	–	–	–	14,042	14,042
Disposals	(9,273)	–	(7,700)	–	(16,973)
Reclassifications	(60,228)	9,255	50,891	82	–
At 31 March 2018	**4,576**	**77,999**	**63,095**	**14,124**	**159,794**
Depreciation					
At 1 April 2016	(25,148)	(18,058)	(13,538)	–	(56,744)
Charge for the year	(2,202)	(1,340)	(1,409)	–	(4,951)
Disposals	–	–	500	–	500
At 1 April 2017	(27,350)	(19,398)	(14,447)	–	(61,195)
Charge for the year	(89)	(477)	(4,838)	–	(5,404)
Disposals	9,273	–	7,700	–	16,973
Reclassifications	16,120	(2,729)	(13,391)	–	–
At 31 March 2018	**(2,046)**	**(22,604)**	**(24,976)**	**–**	**(49,626)**
Net book value					
At 31 March 2018	**2,530**	**55,395**	**38,119**	**14,124**	**110,168**
At 31 March 2017	46,727	49,346	5,457	–	101,530

In previous years fixed plant was included in the same category as land and buildings. These assets have been reclassified in the current year to align with the categories used by the Severn Trent group.

13. Retirement benefit schemes

a) Defined benefit pension scheme

(i) Background

The company participates in 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 actuarial advisor. 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

	2018	2017
	£'000	£'000
Fair value of assets	**65,005**	70,854
Present value of the defined benefit obligations	**(46,800)**	(61,009)
Net asset recognised in the balance sheet	**18,205**	9,845

	2018	2017
DVWS	**£'000**	£'000
Fair value of scheme assets		
Equities	**10,005**	16,296
Diversified growth funds	**5,300**	4,960
Liability driven investment funds (LDI)	**42,400**	42,512
Emerging markets multi-assets funds	**3,900**	3,543
High-yield bonds	**3,400**	3,543
	65,005	70,854

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

13. Retirement benefit schemes (continued)

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

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

	2018 £'000	2017 £'000
Fair value at 1 April	**70,854**	60,168
Interest income on scheme assets	**1,700**	2,029
Contributions from the sponsoring companies	**597**	799
Contributions from scheme members	**203**	125
Return on plan assets (excluding amounts included in finance income)	**(400)**	9,774
Benefits paid	**(7,800)**	(1,903)
Expenses paid	**(149)**	(138)
Fair value at 31 March	**65,005**	70,854

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

	2018 £'000	2017 £'000
Present value at 1 April	**(61,009)**	(50,479)
Service cost	**(488)**	(365)
Interest cost	**(1,400)**	(1,684)
Contributions from scheme members	**(203)**	(125)
Actuarial gains arising from changes in demographic assumptions	**4,000**	–
Actuarial gains/(losses) arising from changes in financial assumptions	**4,700**	(10,593)
Actuarial gains arising from experience adjustments	**(200)**	334
Benefits paid	**7,800**	1,903
Present value at 31 March	**(46,800)**	(61,009)

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

The amounts recognised in the income statement are as follows:

	2018 £'000	2017 £'000
Service cost	**(488)**	(365)
Interest income on scheme assets	**1,700**	2,029
Interest cost	**(1,400)**	(1,684)
Net amount recognised in the income statement	**(188)**	(20)

13. Retirement benefit schemes (continued)

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

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

	2018	2017
	£'000	£'000
Net actuarial gains/(losses) in the year due to:		
- Changes in financial assumptions	**4,700**	(10,593)
- Changes in demographic assumptions	**4,000**	–
- Experience adjustments on benefit obligations	**(200)**	334
Actuarial losses/(gain) on assets relative to interest on assets	**(400)**	9,774
(Gain)/loss to recognise in other comprehensive income	**8,100**	(485)

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

(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.

The funding target is for the Section to hold assets equal to the value of accrued benefits allowing for future increases in those benefits. If there is a shortfall against this target, the company and the trustees will agree on deficit contributions to meet this deficit over a period. There is a risk that adverse experience could lead to a requirement for the company to make additional contributions to recover any deficit that arises.

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. The current strategy is to invest in a combination of lower risk assets (e.g. liability driven investments, which respond to factors such as changes in interest rates) and return-seeking assets (e.g. equities and other diversified assets) with the allocation to lower risk assets gradually increased so that by March 2035, all of the Scheme's assets are invested in lower risk assets.

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 portfolios 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 is 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 group 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.

	2018	2017
	% pa	% pa
Price inflation – RPI	**3.1**	3.4
Price inflation - CPI	**2.1**	2.4
Discount rate	**2.7**	2.5
Pension increases in payment	**3.1**	2.5

13. Retirement benefit schemes (continued)

(v) Actuarial assumptions (continued)

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.

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:

	2018		2017	
	Men	**Women**	Men	Women
Mortality table used	**S2NMA**	**S2NFA**	S2NMA	S2NFA
Mortality table compared with standard table	**95%**	**99%**	95%	99%
Mortality projections	**CMI 2017**	**CMI 2017**	CMI 2016	CMI 2016
Future improvement per annum (pa)	**1.0%**	**1.0%**	1.0%	1.0%
Remaining life expectancy for members currently aged 65 (years)	**22.4**	**24.1**	22.5	24.1
Remaining life expectancy at age 65 for members currently aged 45 (years)	**23.4**	**25.3**	23.6	25.3

The calculation of the Section obligations is sensitive to the actuarial assumptions and in particular 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 by 0.1% Decrease by 0.1%	Decrease £0.7m Increase by £0.8m
Price inflation[2]	Increase by 0.1% Decrease by 0.1%	Increase by £0.7m Decrease by £0.6m
Mortality[3]	Increase in life expectancy by 1 year	Increase by £1.9m

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

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 assumpions.

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

(vi) Effect on future cash flows

Following the actuarial valuation as at 31 March 2017, the additional deficit contributions ceased in March 2018. This will be reviewed in October 2018. From 1 April 2018 employer contributions are 32.3% for open scale members and 36.7% for closed scale members. Employee contributions remain at 8%.Contribution rates are set in consultation with the trustees for the Section.

The weighted average duration of the expected benefit obligation from the Section at the end of the year is 16 years (2017: 17 years).

(b) Defined contribution pension scheme

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 £208,000 (2017: £227,000).

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

14. Trade and other receivables

	2018 £000	2017 £000
Current assets		
Trade receivables	**5,038**	5,334
Bad debt provision	**(2,882)**	(2,875)
Net trade receivables	**2,156**	2,459
Amounts receivable from fellow subsidiary undertakings	**9,850**	9,746
Other amounts receivable	**7,514**	2,781
Prepayments and accrued income	**3,560**	3,469
	23,080	18,455

Other amounts receivable are net of provisions of £857,000 (2017: £nil). All of the provision relates to amounts less than one year old.

Doubtful debt provision

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

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

Movements on the doubtful debts provision were as follows:

	2018 £000	2017 £000
At 1 April	**2,875**	2,658
Charge for bad and doubtful debts	**644**	364
Provision against other amounts receivable	**857**	–
Amounts written off during the year	**(637)**	(147)
At 31 March	**3,739**	2,875
Comprising:		
Provision against trade receivables	**2,882**	2,875
Provision against other amounts receivable	**857**	–
At 31 March	**3,739**	2,875

A collective provision is recognised against assets which are past due but for which no specific provision has been made. This is calculated based on historical experience of levels of recovery.

The aged analysis of trade receivables that are specifically provided for is as follows:

	2018 £000	2017 £000
Up to 1 year	**998**	481
1 - 2 years	**859**	741
2 - 3 years	**510**	717
More than 3 years	**515**	936
	2,882	2,875

15. Borrowings

	2018 £'000	2017 £'000
Current liabilities		
Bank overdrafts	**478**	–
Non-current liabilities		
Other loans	**108**	114
Loans due to parent and fellow subsidiary undertakings	**62,374**	55,193
	62,482	55,307

At 31 March 2018, loans due to parent and fellow subsidiary undertakings comprised an index-linked loan and a revolving credit facility, both owed to the parent company, Severn Trent Water Limited. The loan principal 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. At 31 March 2018 the company had drawn down £7,290,000 (2017: £2,000,000) on the revolving credit facility, and interest is payable at 6m LIBOR + 1.5%. The revolving credit facility is for a maximum principal of £30,000,000 and matures on 8 March 2021.

16. Trade and other payables

	2018 £'000	2017 £'000
Current liabilities		
Trade payables	**369**	13,103
Amounts owed to ultimate parent	**4,258**	–
Amounts owed to fellow subsidiary undertakings	**1,032**	–
Social security and other taxes	**341**	241
Other payables	**15,528**	144
Deferred income	**194**	204
Accruals	**1,491**	1,385
	23,213	15,077
Non-current liabilities		
Deferred income	**11,162**	10,430

17. Deferred tax

	Accelerated tax depreciation £'000	Retirement benefit obligation £'000	Other £'000	Total £'000
At 1 April 2016	(11,598)	(1,744)	–	(13,342)
(Charge)/credit to income	(315)	(109)	26	(398)
Credit to equity	–	179	–	179
At 1 April 2017	(11,913)	(1,674)	26	(13,561)
Credit / (Charge) to income	677	(36)	9	650
Credit / (Charge) to equity	–	(1,385)	–	(1,385)
At 31 March 2018	**(11,236)**	**(3,095)**	**35**	**(14,296)**

18. Share capital

	2018	2017
	£'000	£'000
Total issued and fully paid share capital		
240,404 ordinary shares of £1 each (2017: 240,404)	**240**	240

19. Capital commitments

At 31 March 2018 the Company had capital commitments as follows:

	2018	2017
	£000	£000
Contracted for but not provided in the financial statements	**3,156**	–

20. Related party transactions

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.

There were no other related party transactions.

21. Ultimate parent undertaking

The immediate parent undertaking is Dee Valley Water (Holdings) Ltd, a company registered in England and Wales.

Severn Trent Water Limited is the parent undertaking 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 Directors regard Severn Trent Plc, a company registered in England and Wales, as being the company's ultimate holding company and controlling party. Severn Trent Plc is the parent company of the largest group for which group accounts are drawn up and of which the company is a member. Financial statements for Severn Trent Plc can be obtained from Severn Trent Plc's registrars at Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA.