



Dŵr Cymru
Welsh Water

Business Plan 2010 – 2015
Part A The Company Strategy
Executive Summary

FOREWORD

Glas Cymru

Welsh Water delivers safe and reliable drinking water and sanitation services to its customers, protecting the environment and, crucially, looking after the water industry in Wales - and the essential public service it provides - for future generations. Ever since Glas Cymru, a “not for profit” company limited by guarantee, took over the ownership of Welsh Water back in 2001 on behalf of Welsh Water’s customers, this has been our only consideration – we have no competing objectives.

Our Sustainable Future

This Business Plan sets out what we want to achieve over the coming five years. It makes good progress towards the goals included in “Our Sustainable Future”, a document we published in 2007 which sets out our long term vision for the water industry in our region. Our objective has been to make sure, as far as possible, that what we do in the coming years comprises the best possible package of outcomes and delivers a public service our customers would accept as being good value for money.

Legitimacy

A good understanding and acceptance of what Welsh Water plans to do and proposes to charge for the public service it provides is of enormous importance. With the legitimacy that comes from this, we can carry out our day to day responsibilities more efficiently, we can retain and attract talented and committed people into this industry and, by reducing regulatory and political risk in particular, we can keep the cost of financing Welsh Water’s assets as low as possible – all of which means better value for money, both for today’s customers and for future generations.

Planning in uncertain times

In our Draft Business Plan, published in August 2008, we gave our view at that time of the priorities for the next five years, comprising an affordable first step towards the goals in “Our Sustainable Future”. Neither our long-term strategy nor our view of the immediate priorities has changed significantly since then.

However, we have had to draw up this Final Business Plan in the context of a most challenging and uncertain economic environment, with risks to the business that we cannot control but which we must be able to react to. As a consequence, we have subjected our plans to renewed internal challenge to ensure that they deliver the best possible value for money to our customers – our Board and the Members of Glas Cymru have been fully involved in this governance process. It is important that we do not over-promise in terms of what we can safely deliver in this period and that we retain flexibility to adapt our plans if circumstances change. Our overriding concern will be to ensure that we do not create additional pressure on our customers’ budgets at a time when they will already be under great strain.

Customer bills and investment

In deciding what needs to be done in the years ahead, a balance has to be struck between affordability on one hand and the quality and reliability of service on the other. The water industry everywhere is very capital intensive and Welsh Water employs a network of reservoirs, treatment works, pumping stations, and mains and sewers which has a replacement value of some £25 billion – around £20,000 per household. Much of what we do day to day to deliver a high quality and reliable public service involves operating and maintaining this enormous network of often very long life assets. Network performance is therefore key to the service we give our customers as well as our ability to protect our environment from pollution. It follows that the key trade-off is between affordability and investment in our network of assets. This is why much of this Business Plan is concerned with how much we propose to invest over the next regulatory period 2010-2015 (AMP5) and the benefits that this investment will deliver for our customers and the environment.

Affordability

Welsh Water's average household bill is still higher than average – only because Welsh Water, with its long coastline, employs more wastewater treatment assets per customer than most other companies. Moreover, average household incomes are lower in our region than elsewhere. We have been able to mitigate this serious disadvantage through our growing 'customer dividend' – which this year is £22 per customer – but keeping our bills affordable in the years ahead, especially for our least well-off customers, remains a key consideration in our plans.

Water quality and public health

Nothing is more important than safe drinking water. While the overall quality and reliability of drinking water supplied by Welsh Water has never been higher, we need to extend and upgrade our water treatment facilities if we are to maintain these high standards. In particular, we must deal with changes in our environment that have led to some deterioration in the quality of raw water we abstract for public water supply and respond to the emergence of new threats to the safety and quality of our drinking water. Just as important as a reliable asset network are the skills and capabilities of our people in operating and managing the network so that the safety of drinking water is always assured, and sustaining this is another of our key objectives.

Asset renewal and maintenance

A further feature of our Business Plan is the development of a forward looking, risk-based approach to planning asset renewal and maintenance. The aim here is to act more proactively and do what is required to keep our key assets operating reliably before breakdown and failure. Not only does this avoid service shortfalls and other problems like pollution, it is more cost efficient. But even with this greater emphasis on asset renewal and maintenance, our £25 billion network of assets will continue to get older. We are continuing to develop our asset management capabilities, as reflected in our recent successful certification under PAS55:2008, making us the only water company to achieve the most up-to-date BSi asset management specification.

Environmental programme

Our Business Plan will deliver a number of important statutory environmental improvements and environmental impact investigations, additional resilience against the risk of flooding and investment in new sludge treatment processes which will both improve our long term operating cost efficiency and cut our "carbon footprint". The Business Plan also includes provision for tackling further serious sewer flooding risks, the worst kind of customer service failure, both through specific investment schemes and the beginning of a long term strategy to reduce the amount of surface water entering our sewerage network (SUDS).

Affordable bills and a £1,356m investment programme

By setting rigorous targets for further efficiency savings in future, and by continuing to finance the capital investment programme efficiently as a result of our unique "not for profit" ownership model, we believe we can deliver this capital investment programme and the benefits it would give for customers and the environment without the need for the average household bill to be any higher in real terms in 2015 than it is today – with an average household bill of £376 (rebased to 2007-08 RPI), or just over £1 per day.

Risks and uncertainties

The very uncertain economic climate will have a significant adverse impact on our business; for example reduced demand especially from business customers, higher levels of bad debts and increased funding costs. In addition, draft proposals from government could lead to a substantial increase in our costs base; the initial proposal to increase our business rates bill alone could add some £10 a year to every household's bill. Other decisions to be taken by government and regulators could have a dramatic impact on the longer term cost to customers, such as the decisions that will be taken by the Welsh Assembly Government as to the timing and method of the adoption of private sewers by Welsh Water. Of particular significance is the proposal by the Environment Agency for major reductions to the level of water abstractions from designated rivers in South Wales, which could result in the need for some £180 million of capital investment. We will make every effort to find ways to achieve our common environmental objectives in a manner which is truly sustainable and remains affordable for our customers.

Final Business Plan

We believe our Business Plan represents a reasonable and sustainable package that balances affordability and service - both for today's customers and for future generations.

It follows an exhaustive and detailed analysis of what really needs to be done plus extensive consultation and discussion with key stakeholders in our region. The priorities in the Plan have been derived from the results of the detailed customer research exercises that we have carried out.

Given the current extremely difficult economic environment, we may need to keep these plans under review, to ensure that they remain affordable and financeable. That said, the Board of Welsh Water believe that this is a Business Plan that can be supported by customers and endorsed by other stakeholders, which will in turn mean that it can be delivered and financed efficiently.

Nigel Annett

Managing Director

This document summarises Welsh Water's Business Plan for the next five year regulatory period, which runs from April 2010 to March 2015 (AMP5).

Publication of this Business Plan follows on from the publication of 'Our Sustainable Future' in November 2007, which set out our objectives and strategies for the next 25 years, and the publication of our draft Business Plan in August 2008. This Business Plan published in April 2009 will be followed by Ofwat setting new price limits for all regulated water companies in England and Wales in November 2009 (the Final Determination).

Glas Cymru

Since 2001, Welsh Water has been owned by Glas Cymru, a "company limited by guarantee". Glas Cymru is a single purpose company formed to own, finance and manage Welsh Water. Because it has no shareholders, any financial surpluses are retained for the benefit of Welsh Water's customers.

Under Glas Cymru's ownership, Welsh Water's assets and capital investment are financed by bonds and retained financial surpluses. Most day-to-day activities are carried out by specialist contract partners employed by Welsh Water following a competitive procurement process. The Glas Cymru business model aims to reduce Welsh Water's asset financing cost, the water industry's single biggest cost, and improve service delivery by employing the best contract partners for each distinct activity in the business.

Financing efficiency savings to date have largely been used to build up Welsh Water's reserves, which are essential to ensure that the business can sustain itself through periods of economic difficulty, such as the current serious recession. These savings have also funded some additional discretionary investment in service improvements and the annual 'customer dividend', which will have totalled some £150 million by March 2010.

Welsh Water

Welsh Water is the sixth largest of the ten regulated water and sewerage companies in England and Wales.

We provide an essential public service to over 3 million people living in Wales and some adjoining parts of England. Our overall ambition is to be recognised by our customers as the best water company in the UK.

The water industry everywhere is capital intensive and we employ a huge and complex network of often very long life assets – with a gross replacement cost of some £25 billion – to deliver water and sewerage services to our customers. Our primary responsibility is to operate, maintain and efficiently upgrade this large network of assets so as to ensure a safe and reliable supply of drinking water for customers and then carry away wastewater and deal with it so as to protect the natural environment. Since 1989, we have invested over £5 billion (2007-08 prices) on maintaining and upgrading our assets to improve water quality, environmental quality and customer service – a rate of investment that is around three times higher than in the years prior to privatisation in 1989.



Current performance

Our performance has improved significantly in recent years:

- ▶ overall compliance with drinking water quality standards is 99.9%;
- ▶ Wales has some of the best rivers in England and Wales, with 95.4% classified as having 'good' or 'very good' chemical quality;
- ▶ the beaches and marinas in Wales secured 47 Blue Flag awards in 2008, around a third of the UK total;
- ▶ in Ofwat's industry league table for 'overall performance assessment' we have been consistently above average in the last 7 years, with one of our best ever scores expected in 2008-09;
- ▶ regular customer opinion research shows customer satisfaction at over 70%;
- ▶ customer dividends¹ of nearly £125 million paid to date. The customer dividend was introduced in 2003 and has grown to £22 per customer in 2009-10 – we remain the only company in the sector to make such a dividend;
- ▶ through rigorous attention to cost efficiencies, we have much the best record amongst all of the water and sewerage companies in the period since 2001 for reducing operating costs;
- ▶ investment of over £2 billion has been delivered since 2001 – equivalent to nearly £2,000 for every customer we serve; and
- ▶ the business has been placed on a secure financial footing for the long-term, as reflected in improved credit ratings and reduced gearing levels.

Customer bills have risen to help finance the increase in investment after 1989, but big improvements in our cost efficiency have helped to keep down the burden on customers. The average household bill in 2009-10 will be £376, which compares with £381 in 1999-2000 (all rebased to 2007-08 RPI).

The table below summarises Welsh Water's current performance against the targets set in the current Monitoring Plan and identifies our targets for 2015.

Performance measures	Units	Outturn 2007-08	The Monitoring Plan Target for 2010	BP Target 2015
Water Service				
DG2 properties at risk of receiving low pressure	%	0.02	0.02	0.01
DG3 overall performance score (interruption to supply)	%	0.54	0.08	0.03
Restrictions to water supply	No.	0	0	0
Water quality mean zonal compliance	%	99.93	-	99.95
Iron compliance 'at the tap'	%	99.4	99.3	99.8
Leakage	MI/d	204	195	184
Sewerage Service				
Properties internally flooded due to overloaded sewers	No.	78	67	86
Properties internally flooded due to other causes	No.	182	120	100
Properties at risk of flooding (1 year in 10 + 2 in 10)	No.	365	36*	196
Combined sewer overflows (CSOs) satisfactory	%	94	94	100
Percentage population equivalent served by compliant works (WRA consent LUT)	%	99.8	100	99.9
Bathing waters – compliance with guideline/good standards	%	86	Stable	92.5
Customer Service				
DG6 billing contacts responded to within 5 days	%	99.99	100	100
DG7 written complaints responded to within 10 days	%	99.2	99.9	99.9
DG8 bills based on company or customer meter readings	%	99.9	99.9	99.5

* During AMP4 the flooding registers were rebased. We estimate that there will be 219 properties on the ARR at the end of AMP4. Of these 99 will be mitigated, 94 will be additions to the register between 2008 and 2010 which we have yet to investigate, and 18 will be non cost beneficial schemes which we are unable to mitigate. The remaining eight properties will be addressed in AMP5.

Welsh Water's sustainable strategy

To achieve our strategic objective of being recognised by our customers as the best water company in the UK, we require a sustainable strategy to deliver the best possible value for money to our customers. We want customers to be assured that they will receive a safe and reliable service which meets all their expectations at a price which is affordable and below that charged by other equivalent water companies. Within our 25 year strategy document entitled 'Our Sustainable Future', we stated that a truly sustainable strategy had to encompass eight key dimensions:

- ▶ **Protecting public health.** Customers can have complete confidence in the safety of their drinking water.
- ▶ **Safeguarding the environment.** In providing services for our customers, we will protect the environment within which we all live – taking a holistic view of environmental impact at a local, river basin and global level.
- ▶ **Responding to climate change.** We will adapt our activities to deal with the potential consequences of climate change, while substantially reducing our own 'carbon footprint' as an effective contribution to the wider effort within Wales.
- ▶ **Meeting customers' expectations.** We provide an essential public service crucial for public health and safeguarding the environment. We will meet customers' increasing expectations, ensuring they can rely completely on our service.
- ▶ **Looking after our assets.** Our long-term asset planning will ensure the continuation of enhanced standards for the benefit of future generations, at the lowest 'whole life' asset cost.
- ▶ **Financing the business.** We will minimise the burden of financing costs on our customers for years to come by offering a high credit quality to long-term investors.
- ▶ **Employer of choice.** The best people will be proud to work for us because of the quality of service we provide, the opportunities we offer and the safe environment within which we work.
- ▶ **Affordability and value for money.** Our customers will regard the services we provide as affordable and good value for money, with a range of help targeting customers who struggle to pay.



How the sustainable strategy links to our AMP5 outputs

Although there remains a substantial need for further investment to maintain assets and deliver improvements, to do everything by 2015 would be unrealistic and would cause customer bills to rise sharply. Therefore, some hard decisions have been made on what does and what does not get done in the period to 2015. Innovation and continuous improvement will be crucial in striving to achieve improved standards and will be a key theme in helping to deliver best value for our customers. Our Business Plan has taken account of the Social and Environmental Guidance issued by Welsh Assembly Government in late 2008 and comprises a package of proposals which we believe customers and stakeholders will support.

The Strategic Policy Position Statement on Water, made by Jane Davidson in March 2009, provides helpful clarification of the Welsh Assembly Government's position on a variety of important water and wastewater related policy issues. Amongst the core principles are ensuring access to safe drinking water and maintaining water and sewerage services at an affordable price.

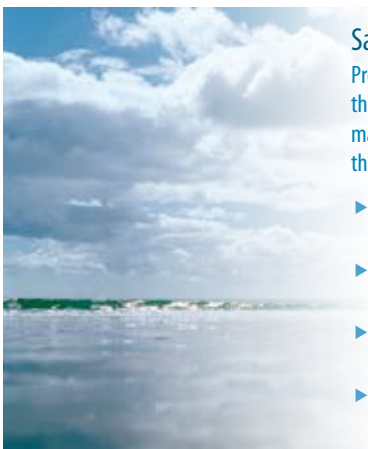
The main elements of our proposed AMP5 programme are described over the page, within the context of our long term sustainable strategy.



Protecting public health

Our biggest responsibility is to provide a safe and reliable drinking water supply to our customers at all times. We will undertake significant work at 23 water treatment works including the installation of enhanced treatment to deal with raw water deterioration and identified emerging risks, protecting water quality to some 215,000 customers at a cost of £101 million.

- ▶ Implementation of Drinking Water Safety Plans which are subject to ongoing review, generating further major investment at 18 water treatment works serving some 330,000 customers, at a cost of almost £90 million.
- ▶ Enhancing our capabilities to ensure the reliability and safety of drinking water.
- ▶ Undertaking 410 km of mains renovation to improve the acceptability of water to customers.
- ▶ Reducing contacts from customers regarding water quality.



Safeguarding the environment

Promoting long term, low carbon solutions to improve the quality of the local environment. We will achieve this through an integrated approach, including Sustainable Urban Drainage Solutions (SUDS) and catchment management schemes. We will continue to promote water efficiency in a cost beneficial manner, for example, through the 'Be Waterwise' initiative.

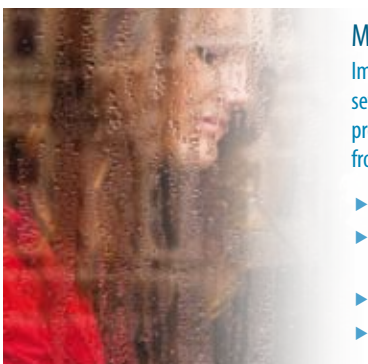
- ▶ Targeting zero serious pollution incidents and a significant reduction in minor incidents from the sewerage network to some 100 a year by 2015.
- ▶ Undertaking 29 investigations to evaluate the requirements of the Water Framework Directive (WFD) and other legislation to find the optimal solutions in terms of environmental impact.
- ▶ Further enhancing the already high standard of bathing and shellfish waters through investment at 14 sites, so that the number of Blue Flag beaches and marinas along our coastline remains high.
- ▶ Enhancing treatment at 45 wastewater treatment works which will deliver a range of benefits, for example, reducing the level of phosphates in the river Dee.



Responding to climate change

Improving energy efficiency and carbon reduction measures, particularly through investment in full advanced sewage sludge digestion at 3 sites and working towards this at one extra site, making use of the methane gas produced to generate power and reduce our "carbon footprint". We will also adopt measures to adapt to the impacts of climate change on our business.

- ▶ Expanding the use of low carbon wastewater treatment methods and catchment management solutions.
- ▶ Seeking methods to achieve reductions of 25% in our "carbon footprint" by 2015.
- ▶ Assessing 113 priority catchments and delivering 4 pilot schemes for SUDS thereby reducing the risk of flooding from overloaded sewers.
- ▶ Developing greater asset resilience to extreme weather conditions at 15 key water treatment works and pumping station sites, protecting those key assets which could be affected by flooding events or coastal erosion.



Meeting customers' expectations

Improving the performance of the water and sewerage networks. We will reduce the risk of customers suffering sewer flooding incidents caused by overloaded sewers, solving some 461 known and forecast hydraulic flooding problems, and reduce the number of properties flooded each year due to blockage, collapse or equipment failure from 120 per year to 100 per year through strategically targeted investment.

- ▶ Preserving the reliability of essential services, with very low instances of water interruptions or low pressure problems.
- ▶ Using the latest technology to anticipate and prevent service failures and to improve our customer relationship management by focusing on first time resolution of complaints.
- ▶ Maintaining at least a minimum of a 1 in 20 hosepipe ban standard.
- ▶ Meeting economic leakage targets and encouraging customers to use water wisely.



Looking after our assets

Delivering process improvements across the business by developing our 25 year programme using our Strategic Investment Planning System (SIPS). SIPS meets the requirements of the asset management Common Framework and will help us make more informed, long term asset planning decisions. It will tailor our capital maintenance and investment expenditure to obtain the best possible value for customers into the future.

- ▶ Implementing our long-term asset strategies and processes, which have recently been awarded the PAS55:2008 BSi asset management specification.
- ▶ Supporting economic development in our area through investment in our assets.
- ▶ Undertaking major refurbishment at 4 of our largest wastewater treatment works at a cost of £28 million.
- ▶ Addressing the environmental problems caused by unsatisfactory intermittent discharges at 15 sites.
- ▶ Undertaking 129km of sewer rehabilitation to reduce service failures associated with poor condition sewers.



Financing the business

We will continue to pursue benefits from our business model and internal cost efficiencies for the benefit of our customers, whilst efficiently delivering our £1,356 million capital programme during AMP5. We have now reduced our operating expenditure by some 10% since 2000-01 in real terms.

- ▶ Targeting gearing at around 70% and an 'A grade' corporate credit rating.
- ▶ Focusing on value for money for customers through the efficient delivery of services and investments - achieving operating efficiencies of a further £21 million by 2015.
- ▶ Undertaking innovative financial strategies to keep down the cost of borrowing for the benefit of our customers.
- ▶ Maintaining flexibility in our investment delivery plans to respond to adverse developments in the economic climate, without compromising essential customer and environmental services.



Employer of choice

Supporting our people through a major process change, with some £73 million to be invested during the second phase of our IT Enabled Change (ITEC) programme. This will allow us to further develop our core business processes with a view to achieving and maintaining improved efficiency and high quality customer service.

- ▶ Maintaining a highly skilled workforce to manage key assets and the business infrastructure, committed to delivering high quality customer service.
- ▶ Improving the technical skill base of the workforce through targeted development programmes.
- ▶ Providing a safe working environment having obtained OHSAS 18001 (2007) accreditation.
- ▶ Continuing to develop our unique business model by working with 'best in class' partners so that we are able to share best practice in the way we deal with our customers and drive efficiency.



Affordability and value for money

Affordability will always be a top priority for us. Average household customer bills in 2015 will be no higher than they are today, having allowed for changes in the RPI. With environmental quality, service and reliability improving at the same time, customer value for money will improve significantly. We will also seek to develop innovative 'win win' tariffs that will benefit some of our more disadvantaged customers whilst helping to keep our cash collection costs down.

- ▶ Working with Government to ensure that they fully understand the impact on our customers' bills of legislative and policy changes, such as the adoption of private sewers, the implementation of the Traffic Management Act and possible major increases in the level of business rates.
- ▶ Rigorously pursuing internal cost savings to deliver efficiencies across our operations.
- ▶ Working with others to develop new and innovative ways to assist customers with payment difficulties, reflecting the prevailing economic climate.
- ▶ Measuring domestic and business customer satisfaction with value for money through regular customer research.

Summary of AMP5 capital investment

The adjacent table sets out the capital investment programme required to deliver the Business Plan and compares this with AMP4. To achieve our objectives for customers will mean investment of some £1,356 million during AMP5, which is some £73 million lower than our current level of investment in AMP4. This plan has been rigorously reviewed and challenged to balance affordability with the need for investment.

A targeted increase in the planned level of maintenance expenditure in AMP5 reflects the need to maintain our now larger asset base so as to preserve current high levels of service, in particular water quality and environmental protection, and to reduce whole life asset operating costs.

Highlights of our AMP5 investment programme include:

- ▶ improved treatment at 23 sites to address risks to the quality of drinking water (£101 million);
- ▶ investment at 14 sites to further enhance the high standards of bathing and shellfish waters (£33 million);
- ▶ full advanced sludge digestion at 3 sites to reduce energy costs and reduce our carbon footprint plus working towards this at 1 extra site (£88 million);
- ▶ replacement of 529km of water main causing repeated interruptions of supply to worst served customers (£18 million);
- ▶ an initial programme to start to remove surface water from our sewers - SUDS (£15 million);
- ▶ ongoing investment to reduce the incidents of sewer flooding (£34 million);
- ▶ phase 2 of our IT Enabled Change (ITEC) programme to improve efficiency and customer service (£73 million); and
- ▶ significant investment to supply new housing and enable economic development (£70 million).

For the first time, our Business Plan has been developed through a long-term asset planning process, which has achieved successful certification under PAS55:2008 standard, making us the only water company to achieve the most up-to-date BSi asset management specification. We can now operate a rolling 5-year investment plan, avoiding the inefficiencies associated with the more rigid 5-yearly investment cycles of the past.

Since the submission of our draft Business Plan in August 2008, we have continued the development of our Strategic Investment Planning System (SIPS) system and have re-optimised our AMP5 investment plan. The overall plan has been reduced from £1,503 million at the DBP stage to £1,356 million, but the proposed service targets remain largely the same.

In 2007-08 prices	AMP4 2005-10	AMP5 2010-15
Water Supply	£m	£m
Maintenance of impounding reservoirs	7	12
Maintenance of trunk mains	21	15
Maintenance of water treatment works	53	153
Maintenance of water supply network	131	199
Quality programme to refurbish water mains	225	16
Leakage control	36	36
Improvements to water treatment works	72	96
Security and Emergency Measures Directive	17	11
Option meters (and their maintenance)	31	35
Catchment and habitat studies	0	15
Flood resilience	0	6
Water resource enhancement	19	1
New development and growth	31	28
Business support	53	66
Total	696	689
Sewerage and Wastewater Treatment		
Maintenance of wastewater network	78	142
Maintenance to sewer overflows	0	10
Drainage area plans	7	16
Maintenance of treatment works	107	125
Maintenance of sludge treatment works	14	14
Dealing with sewer flooding problems	67	34
Dealing with odour problems	14	9
Dealing with surface water (SUDS)	0	15
New capacity for economic development	48	42
Improvements to sewer overflows	226	41
Improvements to treatment works	103	75
Improvements to sludge treatment works	0	3
Advanced sludge digestion	0	88
S101a first time sewerage	6	5
Private sewers transfer	0	0
Business support	63	48
Total	733	667
Total AMP5	1,429	1,356

Impact on price limits and customers' bills

Under the industry's regulatory regime, the revenues raised from our customers do not fully meet the cash needs of the business to deliver on-going investment. The shortfall, often up to £100 million a year, is met by raising funds from investors via the capital markets. The cost of servicing this debt, which has grown steadily to around a quarter of our annual expenditure, is met by customers through their water and sewerage bills.

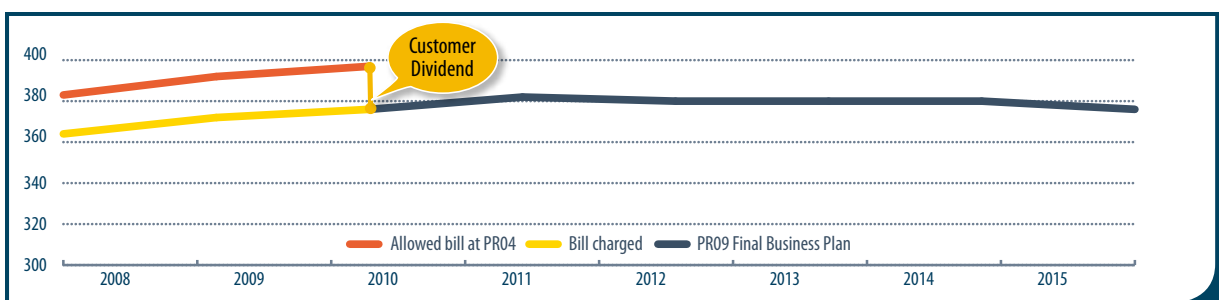
Our financial assessment, using the published Ofwat methodology and Ofwat's Reservoir financial model, shows that household customers' bills should move broadly in line with inflation (RPI) over the AMP5 period. At this stage, we believe that a real, post tax cost of capital of 4.9% is appropriate, in line with a recent published study by NERA, and that this will deliver a cash profile that is broadly 'financeable'. However, both of these assumptions will need to be kept under review during the remainder of the periodic review process, in light of the current very considerable uncertainty in the capital markets. The main drivers affecting customers' bills are shown below:

	£ per year
Average household bill in 2010	376
▶ efficiency improvements	-20
▶ maintaining existing services	+3
▶ future service enhancements	+17
Average household bill in 2015	376

(Rebased to 2007-08 RPI, as required by Ofwat for comparability purposes).

As can be seen, customers' bills will be marginally higher in real terms in the early years of AMP5 due, in particular, to the effects of the expected serious economic recession in that period. However, by 2015, customers' bills will have returned to the 2010 level, in real terms.

Customer bills



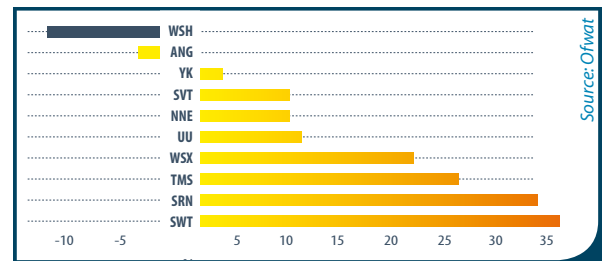
This positive result is only possible because of the exacting future efficiency targets and efficient financing assumptions that are built into our Business Plan.

Affordability is a top priority for us. Proposing that average household customer bills in 2015 will be no higher than they are today, having allowed for changes in the RPI, is a positive outcome for our customers. We will also continue to develop new tariffs (such as Water Direct, Water Collect and Welsh Water Assist) to help some of our most disadvantaged customers, who already struggle to pay their bills, whilst helping us to keep our cash collection costs down, for the benefit of customers as a whole.

Delivering further real efficiency improvements across our business is the key to financing continued high investment without resulting in increases in customer bills. The graph below shows the success to date of our competitive outsourcing strategy and other initiatives in driving efficiencies through our operating business since 2001. During this period and measured against other water and sewerage companies we have achieved the biggest reduction in both water and sewerage operating expenditure in real terms.

Exacting efficiency targets will reduce operating costs by a further £21 million by 2015, partially offset by the impact of certain higher input costs, notably higher energy prices, pension contributions and bad debt charge.

Operating costs since 2001 (% increase/decrease)



AMP5 risks and uncertainties

There could be further upward pressure on customer bills beyond 2010 from economic factors outside our control, including energy prices, uncertainty in the financial markets and the size of the impact of recession on the levels of demand and bad debts. In addition, there are significant risks that government action could lead to substantial increases in our costs base, for example the initial proposal from the Valuation Office was to increase our valuation for business rates in 2010 by some 75%, which would imply an increase in our annual rates bill of some £13 million a year in AMP5 – equivalent to a £10 a year increase to every household's water bill. We do not believe that any such dramatic increase in the burden of rating on water customers can be justified, especially in light of current economic conditions, and so we are continuing to resist such proposals strenuously and have not accepted them in our Business Plan.

Other decisions to be taken by government and regulators could also have a dramatic impact on the longer term cost to customers. In our Business Plan document, we have proposed a phased and prioritised process for the adoption of private sewers by Welsh Water, which we believe would minimise the cost of this change to water customers in general, whilst maximising the benefits to those households worst affected. Such an approach would be consistent with the position of the Welsh Assembly Government as set out in their Strategic Policy Position Statement on Water. It is important that the details of this process are finalised in time for the resulting additional operating costs and investment to be allowed for in Ofwat's Final Determination later this year.

There are also additional environmental requirements which could be imposed on us during the period covered by this Business Plan. In particular, the Environment Agency have made proposals to reduce dramatically the volume of water we are allowed to abstract from designated rivers in South Wales, in order to meet its precautionary assessment of the requirements of the Habitats Directive. To offset this reduction could require significant investment in new water resources, currently estimated at some £180 million implying significant price increases for water customers, of the order of £15 a year for every household. At this stage, we have not included this investment in our Business Plan, but have included the cost of environmental investigation schemes, which we believe would enable a more informed view of the actual environmental impact of our water abstractions in these catchments, and of the costs and benefits of any remedial investment that might need to be contemplated. We believe that it is also premature to consider costly investment before we know the impact on these catchments of a possible Severn Barrage project, which is under separate consideration by Government.

Following the conclusion of a European Court case later this year, there may be implications for our wastewater treatment works in North Wales, if the North-East Irish Sea is designated as a "sensitive area" under the Urban Wastewater Treatment Directive, which could again cost some £150 million in the long-term – or some £10 per household.

We will make every effort to work with Government and regulators to find ways to achieve our common environmental objectives in a manner which is truly sustainable and remains affordable for our customers. There remains a great deal of uncertainty as to the extent and timing of such developments but, in the event that they were to come into effect during the AMP5 period, then we expect that the AMP5 Change Protocol procedure and possibly Interim Determinations would be needed to reflect the costs of any additional obligations, ultimately resulting in higher customer bills.

We support competition where it delivers better outcomes for our customers as a whole, through lower prices or improved services. However, we are concerned that options for the large-scale restructuring of the water sector, as promoted by Ofwat for example, would bring little benefit to customers in practice and could result in materially higher customer bills, if they were to undermine long-term investor confidence in the sector and push up the cost of capital.

Post-AMP5

Our Business Plan enables us to continue to progress towards delivery of the objectives contained within our 25 year sustainable strategy. Despite our achievements thus far, and the plans contained within this Business Plan, further investment will be required in future AMP periods to continue this journey. As a result of this sustained approach, our long-term vision is that customers should be able to look forward to:

- ▶ reliably high quality standards – for drinking water, customer service and the protection of the environment;
- ▶ delivering the lowest possible customer bills in future – lower than those of other equivalent UK water companies;
- ▶ ongoing investment in the latest technology, effective asset maintenance and well trained people, to ensure that the business is sustained for the long-term; and
- ▶ reducing greenhouse gas emissions significantly from current levels, with reductions of 50% by 2035, which will necessitate even greater innovation and revised treatment processes.

PAS55:2008 certificate



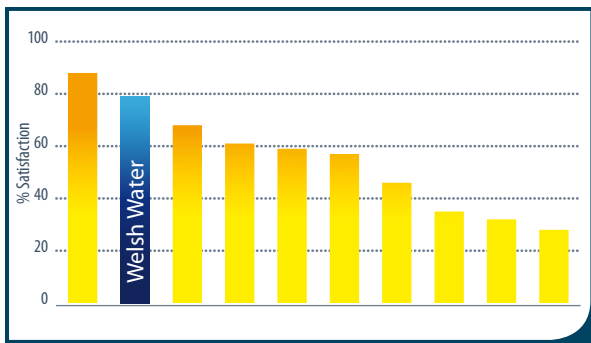
Customer priorities and stakeholder engagement

It is essential that our plans for the years ahead reflect, as far as possible, what our customers want from us and, in particular, meet the high standards for drinking water quality, environmental quality and service delivery they expect to see, at a price they are willing to pay.

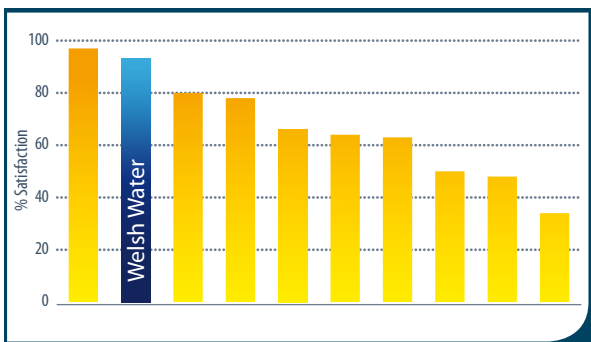
We have undertaken significant customer research including willingness to pay research, which involved face to face interviews with 1,000 household customers across our area and in depth telephone interviews with 300 business customers. The outputs from the research helped identify customer priorities and contributed to the cost benefit analysis.

Research carried out by Ofwat and seven other regulators across England and Wales in late 2008 has demonstrated a very positive endorsement by Welsh Water's customers of our draft Business Plan. For that reason, we have sought as much as possible to preserve the overall direction and balance of that plan in the face of the increasing economic challenges that have since arisen.

Value for money



Acceptability



Source: Ofwat and other stakeholders – PR09 quantitative research into customers' priorities – overall report January 2009

In conclusion

Our approach for the AMP5 period has been developed within the context of our 25 year vision contained in "Our Sustainable Future". This provides the long-term framework for the development and achievement of our short-term goals. We recognise the risks and uncertainties that exist and consider our robust approach to the delivery of efficiency, through innovation and continuous improvement, will be crucial to the success of our plan.

The uncertainties associated with the deepening economic recession mean that there is a greater need for flexibility in framing and then delivering the Final Determination.

Our Business Plan to 2015 will ensure that:

- ▶ current generally high standards of service are maintained and known risks to quality standards are addressed;
- ▶ areas for improvement reflect, as far as possible, customer priorities, willingness to pay and are cost beneficial; and
- ▶ the 'package' of improvements to drinking water quality and environmental quality, represents good value for money for our customers, with average household bills in 2015 being no higher in real terms than they are today.

The protection of drinking water, the level of environmental quality and service reliability will all improve in AMP5 and we believe that this, when combined with our proposed bill profile, will be a very positive outcome for our customers.