

# WATER AND SEWERAGE CORPORATIONS 2011-12

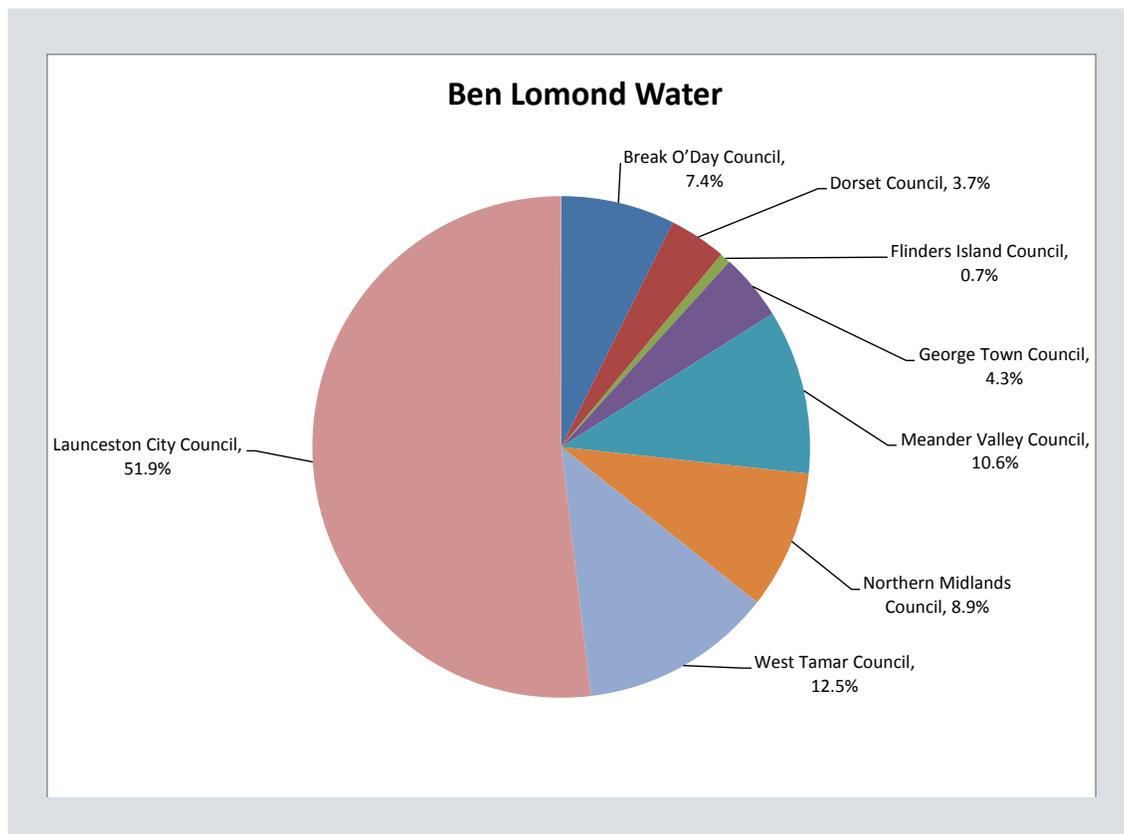
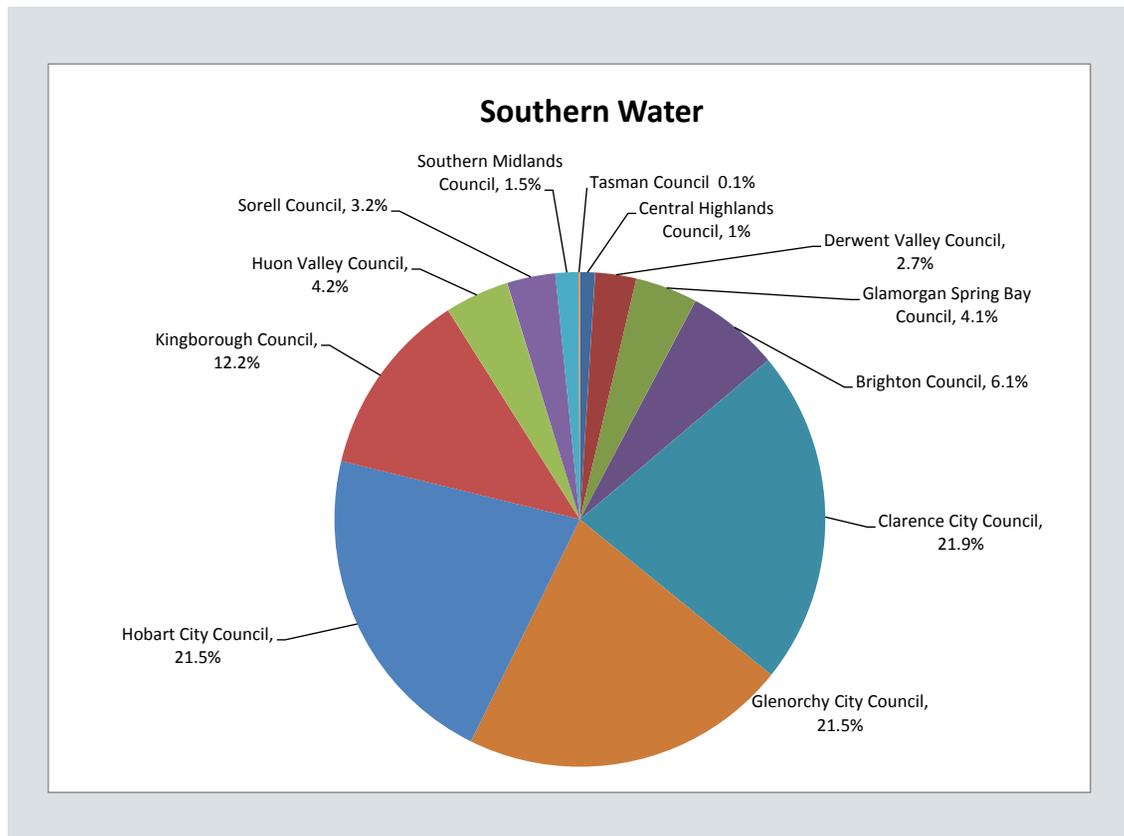
## INTRODUCTION

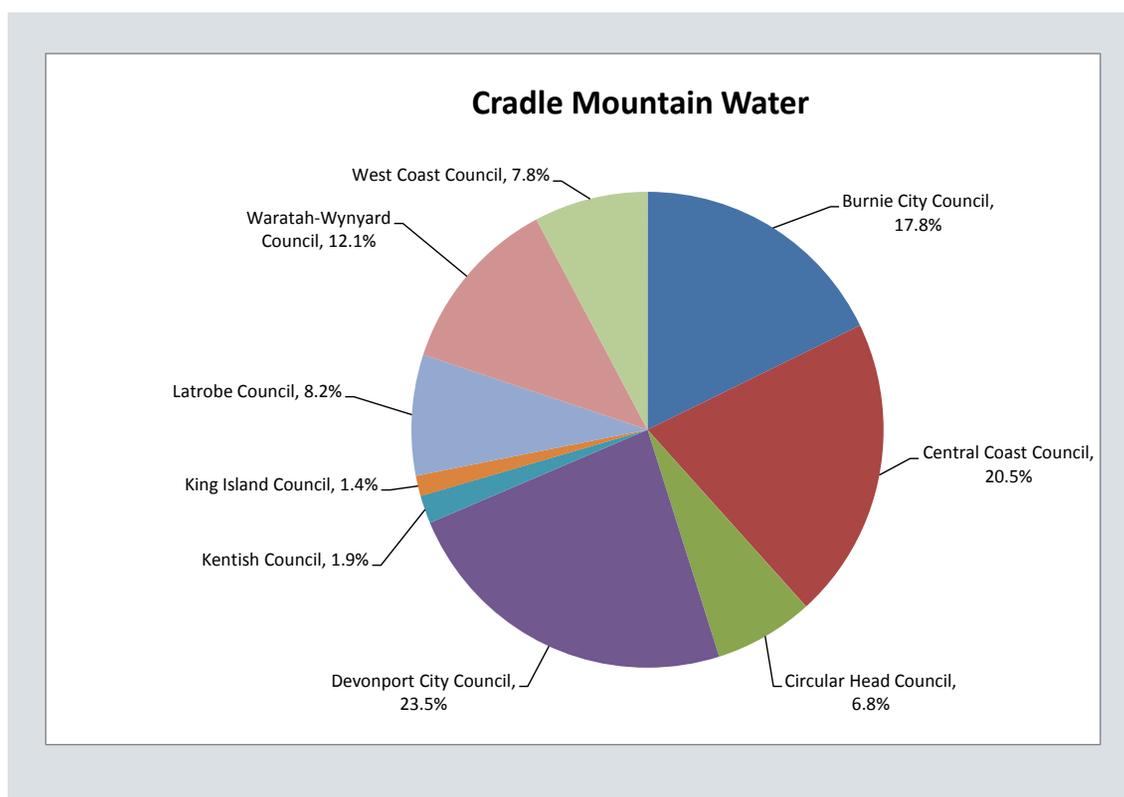
Tasmania's three regional water and sewerage corporations (the Regional Water Corporations) were established in 2008 under the *Water and Sewerage Corporations Act 2008* (the Act). The Corporations are separate legal entities each responsible for its own financial performance. The information provided in this Chapter is to enable comparison of the relative performance of each Regional Water Corporation with the comparative tables including a combined column for illustrative purposes only. Details for each Regional Water Corporation are provided in individual Chapters later in this Report.

The Regional Water Corporations are owned by councils in their respective regions:



The following charts show relative residual share percentages as per the *Treasure's Allocation Order for Water and Sewerage Returns* at February 2011.





The Regional Water Corporations provide bulk, distribution and retail water and sewerage services. A fourth Common Services Corporation (Onstream), in which the Regional Water Corporations have ownership interests, was established to provide a range of shared services aimed at supporting their operations. These include centralised payroll, human resources, finance, information and communications technology and billing services.

The Regional Water Corporations share distributions from Onstream based on their use of the services provided, which was approximately: Southern Water 50%, Ben Lomond Water 25% and Cradle Mountain Water 25%.

The Corporations' and the Common Services Corporation's, trading names and incorporation dates were:

- Tasmanian Water and Sewerage Corporation (Southern Region) Pty Ltd – trading as Southern Water (SW): 13 November 2008
- Tasmanian Water and Sewerage Corporation (Northern Region) Pty Ltd – trading as Ben Lomond Water (BLW): 13 November 2008
- Tasmanian Water and Sewerage Corporation (North-Western Region) Pty Ltd – trading as Cradle Mountain Water (CMW): 13 November 2008
- Tasmanian Water and Sewerage Corporation (Common Services) Pty Ltd – trading as Onstream (Onstream): 9 December 2008.

All Corporations commenced full operations on 1 July 2009.

The Regional Water Corporations have a common Chairman and a different common Chair of their Audit and Risk Committees and other Board Committees. Each Board has six directors, some of whom are common to the other Corporations. Cradle Mountain Water had one vacant position on its Board.

The Board of Onstream comprised six directors, the Chair who was common with the three Regional Water Corporations, their respective CEOs and two additional directors.

## KEY FINDINGS

### Asset valuations

At the end of each reporting period, the Regional Water Corporations review their assets for possible impairment by applying a cash generating unit test to determine recoverable amount represented by value in use. The value in use represents the discounted present value of future net cash flows expected to be generated from the assets. The discount rate used is based on a real pre-tax weighted average cost of capital (WACC). The calculation of value in use is dependent on a range of assumptions and estimates, such as the growth rate, inflation rate, operating expenditure growth rate, risk free rate etc. Last year, we recommended that variables impacting on the calculation of value in use be considered by Audit and Risk Committees and approved by the Boards of each Regional Water Corporation prior to the end of each reporting period. This recommendation was fully adopted and followed in the preparation of the 2011-12 financial statements.

The risk free rate is a key input when calculating WACC. Generally, the risk free rate is derived from Commonwealth government bond rates on the day of the valuation or an averaging period of around 20 days. During the current year, yields on 10-year Commonwealth government bonds declined significantly from 5.21% to 3.04%, reflecting sovereign debt apprehensions in Europe, global economic concerns and demand for the Australian dollar. This year, the Regional Water Corporations applied a risk free rate based on an average rate of the 10-year Commonwealth government bond rates over the last ten years. We concurred with this decision.

The change to the recoverable amount of assets was not material to warrant adjusting carrying amounts at 30 June 2012.

## KEY DEVELOPMENTS

### Bill to establish a single water corporation

Legislation to establish a single, statewide water and sewerage entity was tabled in Parliament on 23 October 2012. The target date for the new single water corporation is 1 July 2013. The assets, liabilities and employees of the existing Regional Water Corporations and Onstream would be transferred to the new Corporation assuming the bill proceeds as drafted.

The following events pre-dated the development and introduction of the proposed legislation.

### House of Assembly Select Committee inquiry into the Tasmanian Water and Sewerage Corporations

In late 2010, the House of Assembly established a Select Committee to inquire into the governance and operating structure, and financial performance, of the Regional Water Corporations and Onstream (the corporations). The Committee also inquired into the impact of future prices and strategies to achieve an equitable pricing structure. In its interim report, released in April 2011, the Committee urged the Regional Water Corporations, their owner councils and the State Government to mitigate the price shock expected after the price cap is removed on 1 July 2012.

In its final report, the Committee made the following five recommendations:

1. the existing four corporations model for the provision of water and sewerage services in the State be collapsed into a single state-wide corporation
2. local government councils, as owners of the corporations, should proactively lead the restructuring process and be involved with the development of any legislative changes, with every assistance provided by the government

3. the existing governance arrangements be reviewed as part of the legislation development process and that the views of local government be fully considered and addressed as part of the review
4. the water and sewerage corporations be compelled to take into account the broader economic, social and environmental benefits flowing from development proposals and there should be a process established at an early point in the development process for the facilitation of medium to large development proposals with a water or sewerage component and the potential to deliver broader economic benefits
5. discussions be held with the Tenants' Union of Tasmania and representatives of property owners, as part of the review of the *Residential Tenancy Act 1997*, regarding the metering of strata titled and multi-tenanted properties and the billing of water and sewerage charges.

## Local Government Association of Tasmania

The Local Government Association of Tasmania, at a special meeting on 5 June 2012, resolved to support the formation of a single water and sewerage corporation in Tasmania.

## Price Cap

As part of the transition to the new water and sewerage arrangements, the State Government capped price increases for water and sewerage at 5% for three years until 2011-12. The Government also agreed to provide compensation payments to the Regional Water Corporations in recognition of lost revenues and other costs associated with this decision. In June 2011, the State Government announced changes to the water and sewerage arrangements as part of its 2011-12 Budget saving strategies, including lifting the price cap to 10% or \$50 per service, whichever is greater and indexing concession payments. The following table summarises the amount of price cap rebates, other support and concessions received by the Regional Water Corporations since the introduction of the Price Cap:

Government Subsidies	Combined			SW		
	2011-12	2010-11	2009-10	2011-12	2010-11	2009-10
	\$'000s	\$'000s	\$'000s	\$'000s	\$'000s	\$'000s
Price cap rebate	4 000	12 923	5 554	1 925	6 089	2 556
Other government support *	925	0	0	0	0	0
Other concessions **	6 696	5 873	5 551	3 081	2 719	2 614
<b>Total Government Subsidies</b>	<b>11 621</b>	<b>18 796</b>	<b>11 105</b>	<b>5 006</b>	<b>8 808</b>	<b>5 170</b>

	BLW			CMW		
	2011-12	2010-11	2009-10	2011-12	2010-11	2009-10
	\$'000s	\$'000s	\$'000s	\$'000s	\$'000s	\$'000s
Price cap rebate	1 306	4 392	1 972	769	2 442	1 026
Other government support	0	0	0	925	0	0
Other concessions	1 930	1 712	1 553	1 685	1 442	1 384
<b>Total Government Subsidies</b>	<b>3 236</b>	<b>6 104</b>	<b>3 525</b>	<b>3 379</b>	<b>3 884</b>	<b>2 410</b>

\*The government agreed to provide additional support to assist the on-going viability of Cradle Mountain Water and agreed to pay \$4.225m over three years (\$0.925m in 2011-12, \$1.400m in 2012-13 and \$1.900m in 2013-14).

\*\*Other concessions, mainly to eligible pensioners and low income earners, increased in line with price rises in water and sewerage charges.

Evident from the table is the combined reduction in the price cap rebate in 2011–12 of \$8.923m which, as noted later in this Chapter, reduced significantly the profitability of each Regional Water Corporation this year.

## New Pricing Structure

Water and sewerage services are regulated services under the *Water and Sewerage Industry Act 2008*. Providers of regulated water and sewerage services are required to be licensed. The licence then binds the water and sewerage providers to comply with a number of regulatory obligations, including service standard obligations set out in the Water and Sewerage Customer Service Code, adoption of appropriate management practices in relation to, for example, asset management and compliance with prices set by the Regulator. The Regional Water Corporations are licensed regulated entities under the *Water and Sewerage Industry Act 2008*.

When the Regional Water Corporations started operations, prices were set by the Treasurer in the Interim Price Orders. This was a temporary measure and from 1 July 2012 water and sewerage prices are set independently by the Regulator through Price Determinations valid for the first regulatory period from 1 July 2012 to 30 June 2015.

In setting the prices, the Regulator acknowledged in its final report<sup>1</sup> that the Regional Water Corporations are currently not financially sustainable into the future at current revenue levels and set out a number of reform priorities for the first regulatory period, including ensuring the viability of the Regional Water Corporations, commencing the transition of revenues to achieve financial sustainability and introduction of a rational price structure, including two-part pricing of water. The Regulator also highlighted the need for managing the impact of price changes on customers and for this reason movements in annual prices will be regulated by applying caps on annual price movements.

Starting 1 July 2012, the Regional Water Corporations introduced universal postage stamp based two-part pricing for water charges: a fixed Water Service Charge and a variable Water Usage Charge. A fixed Sewerage Service Charge continues to apply for customers with a sewerage connection. The Water Usage Charge is based on the amount of water used, while Service Charges are levied annually per connection. All charges are billed quarterly.

The target tariffs proposed by the Regional Water Corporations were approved by the Regulator for each year of the regulatory period which will begin to move customers towards the real cost of providing the services. However, where current charges are less than the target tariffs, annual increases will be capped to 10% or \$50 per standard domestic service, whichever is the larger. A standard domestic sewerage service is classed as one equivalent tenement and a standard domestic water service is classed as a 20mm connection.

## Billing Arrangements

Onstream is responsible for providing billing services to the Regional Water Corporations. After the transition to the new water and sewerage arrangements, Onstream, during 2009–10, used a contracted billing arrangement with a number of councils. For part of 2010–11 Onstream used an interim billing system, which did not allow for an automated reminder notice of a customer's total debt being generated in circumstances where payment hadn't occurred by the due date, although instalment reminder notices were issued each quarter showing the outstanding balance of service charges. This caused delays in collecting outstanding charges.

A new billing system has been in place since January 2011 and each Regional Water Corporation started to implement strategies to recover outstanding charges, including the use of a debt collection agency.

<sup>1</sup>2012 Price Determination Investigation – Regulated Water and Sewerage Services in Tasmania – Final Report.

The following table provides details of the dollar value and % of receivables past due more than 90 days:

	SW		BLW		CMW	
	2012	2011	2012	2011	2012	2011
Receivables past due > 90 days (\$'000)	9 304	7 806	3 737	3 676	2 988	4 140
% of total receivables	27.0%	26.3%	21.5%	27.3%	48.6%	53.1%

While it may be understandable why the high levels of overdue Receivables has occurred, these delays must be impacting negatively on the cash flows of all three Regional Water Corporations.

## Restructure of Onstream

In October 2011, Onstream restructured its operations and co-located within premises occupied by the Regional Water Corporations. The scope of services provided by Onstream to the Regional Water Corporations was reduced to allow Onstream to focus on the provision of core services in the areas of IT, billing, payroll, finance and procurement. On the other hand, the Regional Water Corporations provide Onstream with support in the areas of company secretariat, risk management, human resources and safety support. Onstream is managed by two Joint General Managers. These roles are fulfilled by Onstream's Chief Financial Officer and Onstream's Chief Information Officer. This new model aims to reduce costs and improve efficiencies. In the event that the Bill before Parliament is passed, the activities of Onstream will be taken over by the new entity.

## FINANCIAL RESULTS

The financial information detailed below compares the results of the Regional Water Corporations in their third full year of operation ended 30 June 2012 and their financial position at that date.

Onstream's results are included in the results of the Regional Water Corporations.

### Profitability

The Regional Water Corporations generated a combined Net operating profit before net finance costs, tax, contributions and other transactions of \$22.188m in 2011-12, compared to \$30.156m reported last year. The decrease reflected the Government's decision to reduce the price-cap rebate to \$4.000m in 2011-12, a reduction of \$8.923m.

On a net profit after tax basis, the combined result was \$19.557m, which was \$2.425m less than last year. Net profit after tax was boosted by contributions received from customers and developers, which increased in 2011-12 by \$7.204m.

The decline in profit was reflected in lower average returns on assets of 1.1% (2010-11, 1.5%) and on equity of 0.9% (1.1%) and remained well below commercial returns. These levels of return will make it difficult to generate sufficient income to fully maintain the Regional Water Corporations' assets, to achieve their asset replacement programs and satisfy dividend expectations.

### Asset management

From an asset management perspective, the Asset renewal ratios for Ben Lomond Water and Cradle Mountain Water exceeded our benchmark this year, indicating increased spending on upgrading

existing infrastructure. Southern Water, on the other hand, invested the majority of its capital expenditure on significant new infrastructure projects, which caused the Asset renewal ratio below the benchmark. The Investment ratio was also high as the Regional Water Corporations continued to invest heavily in new and existing infrastructure assets. Consumption ratios indicate that infrastructure assets are, on average, at moderate level of financial sustainability risk.

## **Water inventory**

From 2011-12, Ben Lomond Water and Southern Water no longer recognise water as inventory, unless the value is material. This change in approach resulted in a reduction in water inventory balances by Southern Water, \$0.616m, and Ben Lomond Water, \$0.088m. Cradle Mountain Water did not recognise water inventory in the past.

## **Paying dividends**

In the current year, the Boards of the Regional Water Corporations adopted a dividend policy which excludes customer and developer contributions from profit for the purpose of determining ordinary dividends to council owners, a decision we support.

## **Compliance with accounting standards**

In all cases our audits concluded that the three Regional Water Corporations and Onstream completed their financial statements in accordance with Australian Accounting Standards. However, in our analysis of each of the three Regional Water Corporations' financial performance we have, in some cases, reallocated certain revenue or expenditure items to better assist readers to interpret financial performance.

In the remainder of this Chapter we compare the results of the three Regional Water Corporations in 2011-12.

## STATEMENT OF COMPREHENSIVE INCOME

	<b>Combined</b>	<b>SW</b>	<b>BLW</b>	<b>CMW</b>
	\$'000s	\$'000s	\$'000s	\$'000s
Sales revenue	221 656	111 398	58 950	51 308
Other operating revenue excluding contributions from customers and developers	2 355	1 228	322	805
<b>Total Revenue</b>	<b>224 011</b>	<b>112 626</b>	<b>59 272</b>	<b>52 113</b>
Depreciation	57 570	30 243	14 629	12 698
Employee benefits	59 284	30 093	15 409	13 782
Other operating expenses	84 969	40 954	24 079	19 936
<b>Total Expenses</b>	<b>201 823</b>	<b>101 290</b>	<b>54 117</b>	<b>46 416</b>
<b>Net Operating Profit before finance cost, tax, contributions and other transactions</b>	<b>22 188</b>	<b>11 336</b>	<b>5 155</b>	<b>5 697</b>
Finance costs	15 696	7 618	1 844	6 234
Interest cost on defined benefit superannuation plan	1 143	501	585	57
<b>Net operating profit before tax, contributions and other transactions</b>	<b>5 349</b>	<b>3 217</b>	<b>2 726</b>	<b>(594)</b>
Customer and developer contributions	22 555	14 117	7 204	1 234
Share of profit of associate	52	25	13	14
<b>Net profit before tax</b>	<b>27 956</b>	<b>17 359</b>	<b>9 943</b>	<b>654</b>
Income tax equivalents expense	(8 399)	(5 224)	(2 983)	(192)
<b>Net Profit</b>	<b>19 557</b>	<b>12 135</b>	<b>6 960</b>	<b>462</b>
Superannuation actuarial loss	(4 123)	(2 017)	(2 019)	( 87)
Share of other comprehensive loss of associate	( 189)	( 90)	( 48)	( 51)
Income tax benefit on above items	1 236	604	606	26
<b>Total other comprehensive income (expense)</b>	<b>(3 076)</b>	<b>(1 503)</b>	<b>(1 461)</b>	<b>(112)</b>
<b>Total Comprehensive Profit</b>	<b>16 481</b>	<b>10 632</b>	<b>5 499</b>	<b>350</b>

## Comment

The Regional Water Corporations generated a combined Net operating profit before net financing costs, tax, contributions and other transactions of \$22.188m (2010-11, \$30.156m) of which Southern Water contributed 51.1% (45.4%), Ben Lomond Water 23.2% (50.6%) and Cradle Mountain Water 25.7% (4.0%). The decrease of \$7.968m was directly attributed to lower government subsidies, \$7.175m, discussed previously. Revenue from the provision of water and sewerage services and operating costs both increased by 6.0%. In dollar term, the increases were \$11.632m and \$11.419m respectively.

Finance costs grew by \$1.737m or 12.4% due to higher borrowings, which increased by 25.8%.

The Regional Water Corporations receive contributions from customers and developers. These contributions represent payments for the cost of new connections or expansion of water and sewerage infrastructure as well as, in the case of new subdivisions, the value of infrastructure assets provided by developers. The combined contributions, \$22.555m, led to the Regional Water Corporations reporting a combined Net profit after tax of \$19.557m (\$21.982m), representing a decrease of \$2.425m or 11.0% on last year's combined result.

## STATEMENT OF FINANCIAL POSITION

	<b>Combined</b>	<b>SW</b>	<b>BLW</b>	<b>CMW</b>
	\$'000s	\$'000s	\$'000s	\$'000s
Cash	4 683	1 324	1 032	2 327
Receivables and prepayments	70 903	32 708	23 096	15 099
Inventories	6 976	4 774	1 247	955
Current tax asset	603	603	0	0
<b>Total Current Assets</b>	<b>83 165</b>	<b>39 409</b>	<b>25 375</b>	<b>18 381</b>
Payables	25 846	12 007	7 275	6 564
Borrowings	81 746	49 404	6 729	25 613
Employee benefits (incl. superannuation)	13 539	6 444	3 741	3 354
Unearned Income	1 146	670	223	253
Current tax liability	1 378	0	1 339	39
Restoration provision	325	325	0	0
<b>Total Current Liabilities</b>	<b>123 980</b>	<b>68 850</b>	<b>19 307</b>	<b>35 823</b>
<b>Working Capital</b>	<b>(40 815)</b>	<b>(29 441)</b>	<b>6 068</b>	<b>(17 442)</b>
Property, plant and equipment	2 061 920	1 109 918	533 112	418 890
Intangibles	3 939	1 201	812	1 926
Investment in associate	11	8	2	1
<b>Total Non-Current Assets</b>	<b>2 065 870</b>	<b>1 111 127</b>	<b>533 926</b>	<b>420 817</b>
Borrowings	194 601	97 171	26 780	70 650
Superannuation liability	13 939	7 229	5 776	934
Employee benefits	1 602	1 005	412	185
Unearned income	38 997	31 609	3 817	3 571
Deferred tax liabilities	27 081	18 456	7 279	1 346
Restoration provision	<b>3 078</b>	<b>3 078</b>	<b>0</b>	<b>0</b>
<b>Total Non-Current Liabilities</b>	<b>279 298</b>	<b>158 548</b>	<b>44 064</b>	<b>76 686</b>
<b>Net Assets</b>	<b>1 745 757</b>	<b>923 138</b>	<b>495 930</b>	<b>326 689</b>
Reserves	1 718 758	909 547	484 103	325 108
Retained earnings	26 999	13 591	11 827	1 581
<b>Total Equity</b>	<b>1 745 757</b>	<b>923 138</b>	<b>495 930</b>	<b>326 689</b>

### Comment

Total Equity mainly represented transfers from owner councils and accumulated Net profits offset by dividend distributions.

Working capital for Ben Lomond Water was positive indicating it was well placed to meet short-term commitments. Southern Water's and Cradle Mountain Water's working capital continued to be negative and deteriorated again compared to last year (2011, SW: (\$13.936m), CMW: (\$2.861m)). The higher working capital deficits at Southern Water and Cradle Mountain Water was connected to higher current borrowings, which increased by \$18.949m and \$14.673m respectively. We acknowledge that current borrowings are likely to be re-financed being within existing borrowing facilities. However, Cradle Mountain Water's capacity to borrow is becoming limited in particular because at 30 June 2012, it was only \$3.737m short of reaching the \$100.000m loan facility limit set by Tascorp. An additional temporary line of credit for \$10.000m was obtained by

Cradle Mountain Water in 2011-12 to cover potential cash shortfalls. This situation needs close monitoring by respective Boards.

Combined Receivables grew at twice the rate of the increase in water and sewerage charges, 12.0%, and were \$70.903m at 30 June 2012 (2011, \$63.319m and 2010, \$52.278m). The disparity between the growth in Receivables and revenue from provision of water and sewerage services is indicative of the continued delays in billing and the delay in the implementation of debt recovery initiatives. The higher receivables balance at year end also reflects the introduction of progressive billing whereby bill delivery is smoothed over the quarter rather than issued at the start of the quarter. The above noted trend is also evident by the high number of days it takes to collect payments from customers as shown in the Financial Analysis Section of this Chapter.

An increase in combined Property, plant and equipment, \$74.621m (2011, \$50.680m), comprised mainly the additions less depreciation. The Regional Water Corporations were in the process of undertaking significant capital works.

Borrowings for the Regional Water Corporations totalled \$276.347m (\$219.629m). Southern Water's proportion of the borrowings was 53.1% (53.4%), Ben Lomond Water 12.1% (8.5%) and Cradle Mountain Water 34.8% (38.1%). The increase in borrowings was necessary to fund the extensive capital programs.

Total combined Unearned income increased by \$12.308m, predominantly due to \$10.000m in funding provided by the Australian Government for the installation of water meters across the State to properties which are currently un-metered and where the existing meters do not meet minimum standards. The meters are essential to the implementation of the two-part pricing system. The funding was provided under the *National Water Security Plan for Cities and Towns*. The allocation of the funding was Southern Water, \$5.000m, and Ben Lomond Water and Cradle Mountain Water, \$2.500m each. The total cost of the water meters roll-out is estimated at \$50.000m, with \$45.278m having been spent by 30 June 2012.

## STATEMENT OF CASH FLOWS

	<b>Combined</b>	<b>SW</b>	<b>BLW</b>	<b>CMW</b>
	\$'000s	\$'000s	\$'000s	\$'000s
Receipts from customers and other sources	234 549	118 703	62 324	53 522
Payments to suppliers and employees	(159 068)	(80 115)	(43 720)	(35 233)
Interest received	292	166	45	81
Finance costs	(12 936)	(6 162)	(1 448)	(5 326)
Income tax paid	(9 299)	(4 889)	(2 763)	(1 647)
Guarantee fees paid	(2 108)	(1 077)	( 171)	( 860)
<b>Cash from operations</b>	<b>51 430</b>	<b>26 626</b>	<b>14 267</b>	<b>10 537</b>
Payments for property, plant and equipment	(110 018)	(58 494)	(28 989)	(22 535)
Capitalised costs	(13 581)	(8 342)	(1 732)	(3 507)
Proceeds from sale of property, plant and equipment	927	214	379	334
<b>Cash (used in) investing activities</b>	<b>(122 672)</b>	<b>(66 622)</b>	<b>(30 342)</b>	<b>(25 708)</b>
Proceeds from borrowings	158 825	74 713	66 371	17 741
Repayment of borrowings	(102 105)	(45 416)	(51 543)	(5 146)
Dividends paid	(11 178)	(8 612)	(2 566)	0
Customer and development contributions*	7 703	6 386	1 040	277
Grant funds received	12 084	8 084	2 050	1 950
<b>Cash from financing activities</b>	<b>65 329</b>	<b>35 155</b>	<b>15 352</b>	<b>14 822</b>
<b>Net increase (decrease) in cash</b>	<b>(5 913)</b>	<b>(4 841)</b>	<b>(723)</b>	<b>(349)</b>
Cash at the beginning of the year	10 596	6 165	1 755	2 676
<b>Cash at end of the year</b>	<b>4 683</b>	<b>1 324</b>	<b>1 032</b>	<b>2 327</b>

### Comment

Combined Cash at the end of the year decreased by \$5.913m to \$4.683m as at 30 June 2012. All three Regional Water Corporations reported a Net decrease in cash, which primarily resulted from higher spending on capital projects, \$40.151m. In 2011-12, investment in property, plant and equipment, including capitalised costs, totalled \$123.599m (2010-11, \$86.325m). Investing activities were funded by a combination of cash from operations, additional borrowings, government grants, contributions from customers and developers and cash from previous years.

In the case of Southern Water, the reduction in cash balance was also attributed to its strategy to utilise excess funds to repay overnight borrowings thus minimising finance costs. As mentioned previously, each Regional Water Corporation had to fund their capital expenditure by additional borrowings as they did not generate sufficient Cash from operations or other sources, for example government grants, while at the same time returned \$11.178m (\$9.976m) in dividends.

Combined borrowings increased by \$56.718m (\$16.012m), with Southern Water borrowing an additional \$29.296m (\$9.251m), Ben Lomond Water, \$14.828m (\$1.647m), and Cradle Mountain Water, \$12.594m (\$5.114m).

## FINANCIAL ANALYSIS

	<b>Bench Mark</b>	<b>SW</b>	<b>BLW</b>	<b>CMW</b>
<b>Financial Performance</b>				
Net profit (\$'000s)		12 135	6 960	462
Modified EBIT (\$'000s)*		11 336	5 155	5 697
Operating margin*	>1	1.11	1.10	1.12
Return on assets*		1.0%	0.9%	1.3%
Return on equity		1.3%	1.4%	0.1%
<b>Financial Management</b>				
Indebtedness ratio		140.8%	74.3%	147.2%
Debt to equity		15.9%	6.8%	29.5%
Debt to total assets		12.7%	6.0%	21.9%
Interest cover	>2	1.5	2.8	0.9
Current ratio	>1	0.6	1.3	0.5
Cost of debt		5.2%	7.1%	6.9%
Debt collection	30 days	93	101	96
Creditor turnover	30 days	13	24	13
<b>Asset Management</b>				
Asset investment ratio	>100%	221.0%	210.0%	205.1%
Asset renewal ratio	>100%	31.9%	106.8%	113.8%
Consumption ratio	>40%	52.8%	62.5%	50.2%
<b>Returns to Owners</b>				
Dividends paid (\$'000s)		8 612	2 566	0
Guarantee fee paid (\$'000s)		1 103	171	860
Income tax paid (\$'000s)		4 897	2 763	1 647
Total return to Owners		14 612	5 500	2 507
Dividends paid or payable (\$'000s)		8 006	1 249	0
Dividend payout ratio	50%	66.0%	17.9%	0.0%
Dividend to equity ratio		0.9%	0.3%	0.0%
<b>Other Information</b>				
Average staff numbers (FTEs)		360	185	168
Average staff costs (\$'000s)		94	88	96
Average leave balance per FTE (\$'000s)		17	22	20
* Contributions from customers and developers were excluded from Modified EBIT, Operating margin and Return of assets calculations.				

### Comment

All three Regional Water Corporations reported profits and their Operating margins were above one. However, returns on assets and equity continued to be below what would be regarded as commercial rates of return of 6% and may not be sufficient to assure long-term sustainability including asset management. This was also noted in the Regulator's final report in that the Regulator concluded that the Regional Water Corporations are currently not financially sustainable

into the future at current revenue levels. It is expected that this unfavourable position will continue over the first regulatory period.

However, we acknowledge that pricing principles in the *Water and Sewerage Industry Act 2008*, which are used as the basis for setting regulated prices, require the use of a lower percentage return on assets transferred to the Regional Water Corporation by previous owners before 1 July 2011. This pre-tax rate of return, not taking into account inflation, is set at 3% on the equity component. A commercial rate of return is applied to remaining assets and the debt component of the transferred assets.

Financial Management ratios reflected the Regional Water Corporations' higher levels of debt utilised to fund capital investment. Cradle Mountain Water's debt levels remained high relative to its revenue and assets base and compared to Southern Water and especially Ben Lomond Water.

The level of outstanding debtors remained high and was caused by delays in collecting outstanding charges as discussed previously in this Chapter.

Asset investment ratios (which measure capital investment in both new and existing assets compared to the total annual depreciation charge) exceeded benchmarks as the Regional Water Corporations continued to invest significantly in their infrastructure. In 2011-12, the combined capital investment totalled \$123.599m compared to \$86.325m invested last year. In addition to the roll-out of water meters, \$45.278m, the Regional Water Corporations invested in upgrades to existing, or construction of new, water and sewerage infrastructure throughout the State.

However, the Asset renewal ratios (which measure capital investment only on existing assets compared to the annual depreciation charge) reflected the differences in priorities between regions, with:

- Ben Lomond Water and Cradle Mountain Water focusing on upgrading existing infrastructure in addition to investing in new assets resulting in both benchmarks being achieved, whereas
- Southern Water invested the majority of its capital expenditure on significant new infrastructure projects, including the Berriedale to Elwick and Bowen Bridge pipeline, construction of the Huon Valley Regional Water Scheme and installation of water meters in areas which were previously unmetered.

We have computed the Consumption ratios by comparing accumulated depreciation to deemed cost (based on depreciated replacement costs) of infrastructure assets. On this basis, the Consumption ratios indicate, that on average, the Regional Water Corporations had used (consumed) 44.8% of the service potential of their water and sewerage infrastructure assets meaning that their remaining service potential was 55.2%. At this level, these assets are at moderate level of financial sustainability risk. Ben Lomond Water's infrastructure assets have the highest remaining service potential at 62.5% and at this level are at low level of financial sustainability risk.

The three asset management ratios are useful measures for assessing management of long-lived assets. However, they need to be considered over lengthier timeframes than only one year and also need to take into account on-going maintenance programs and long-term asset management plans.

The Regional Water Corporations provided returns of \$22.619m (2010-11, \$22.113) to their owner councils. These returns represented final dividends for 2010-11, interim dividends, where declared, for 2011-12, income tax equivalent and guarantee fee payments. Dividends paid or payable showed dividends in relation to current year's results. Cradle Mountain Water proposed that no dividend be paid in relation to its 2010-11 and 2011-12 results.

Of the average 713 FTEs employed by the Regional Corporations, 50.5% were employed by Southern Water, followed by Ben Lomond Water, 25.9% and Cradle Mountain Water, 23.6%. Last year, the Regional Water Corporations finalised their respective Enterprise Bargaining Agreements, which harmonised industrial relations within each individual Corporation and across the sector. Staff numbers do not include employees of Onstream.