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Preliminary 2019 Severn Trent PLC Earnings Call

EVENT DATE/TIME: MAY 21, 2019 / 8:30AM GMT



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PRESENTATION

Operator

Thank you for standing by, and welcome to the Severn Trent Full Year 2019 Conference Call. Your speakers for today are Liv Garfield, CEO; and James Bowling, CFO. (Operator Instructions) The presentation will begin momentarily.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Good morning, everyone, and welcome to the Severn Trent's '18/'19 full year results. I'm Mrs. Garfield, Chief Executive, and I'm joined on stage by James Bowling, and we've got all the members of the executive team who are eager to answer questions later.

This year has been a pivotal year for Severn Trent. It's been jampacked full of customer-focused delivery as well as preparation for the next regulatory period. We feel as though we've made some really good progress. First of all, the coveted Fast-Track status, which is fantastic to land, and that locks in, most importantly, 5 more years of the lowest bill in the land for our customers.

As well as that, we've made some significant operational improvements with a really strong second half of the year on our water business. And we've delivered our highest capital spend in a decade with GBP 769 million worth of capital investment.

But we've also been strongly preparing for the future. I'm pleased today to share guidance that we expect to carry over at least GBP 177 million worth of revenue from customer ODIs into the next regulatory period. And we've also made some really good progress with appointing contract partners for GBP 1.5 billion worth contract spend in AMP7.

And this is a year that we've been named as the most trusted company in our sector for water in England, which is great, something we set out on our journey to do. We want to go further, and that's why today we're announcing our triple pledge on carbon and also we're referencing again the fact that we pioneered and founded the new World Water Innovation Fund, which is the idea of bringing together some of the greatest water companies across the globe to solve some of the greatest challenges that collectively we're experiencing.

So I look forward to taking you through more details on a whole range of topics in a bit. But first, I'm going to hand it to James to take you through the financials.

James Bowling *Severn Trent Plc - CFO & Executive Director*

Thank you, Liv, and good morning, everyone. I'm pleased to report a strong set of financial results today. So let's now turn to the highlights.



With group turnover up 4%, we've delivered PBIT growth of over 6% to GBP 574 million. And thanks to good underlying cost control and a strong contribution from Business Services, we were able to deliver this increase in profit after absorbing the GBP 22 million cost of managing and subsequently recovering from a hot, dry summer.

On financing, our effective interest rate has fallen 60 basis points year-on-year to 3.9% as we've been successful in locking in a diverse range of low-cost, fixed-rate debt and benefiting from this year's lower inflation. This performance has helped to increase our underlying earnings per share by 21%, providing good cover for our full year dividend, which is up almost 8% on last year, in line with our policy of RPI plus 4% growth.

And finally, we've seen another good performance in RoRE. While this year's return was partly held back by reaching the Waste ODI cap, our strong financing performance helped us to an AMP6 cumulative RoRE of 9.1%, putting us among the very best in the sector.

As we've previously announced, we're now managing and reporting by resources and property development activity within our Business Services division. But to help you navigate this transition, I'll be sharing comparatives on the old segmental basis with a bridge to the new basis of reporting.

So let's first turn to Regulated Water and Waste Water. Our Regulated Water and Waste Water turnover grew by 4%, mainly driven by GBP 56 million of RPI-linked tariff increases across both Severn Trent Water and Hafren Dyfrdwy. The amount of customer ODI rewards taken into revenue was around GBP 10 million lower than last year as we chose to defer GBP 33 million into AMP7.

And this year's WRFIM overbilling adjustment was GBP 14 million more favorable than last year. And other minor differences, including the small revenue uplift from summer water consumption, brought the total increase for the year to GBP 63 million.

And as I mentioned, the slide includes a bridge to our new basis of reporting showing the transfer of revenue out of Regulated Water and Waste Water to Bioresources, which is now managed in our Business Services division.

Let's now turn to PBIT. We were pleased to see the efficiencies made in the year, including a GBP 7.4 million reduction in net labor costs and a GBP 7.1 million lower material and other cost, helped to offset the forecasted increase in power pass-through charges and EA license fees and much of the costs experienced from the hot, dry summer.

And as I explained at the half year, the hot weather meant around GBP 10 million of extra costs to meet increased demand from our customers and a further GBP 12 million in the second half on the subsequent operational recovery, particularly on leakage find and fix.

We saw a small improvement to our bad debt charge and depreciation was up 4.5% as new AMP6 capital assets come into service and after processing a small year-on-year increase in abandonment charges for retiring assets. Combined with the increase in turnover just discussed, our underlying Regulated Water and Waste Water PBIT grew by 5.7% or GBP 29 million.

So turning now to our Business Services division, where we've increased both turnover and PBIT from last year and have laid the foundations for an exciting period of opportunity and growth, our Property Development team delivered nearly GBP 20 million of PBIT this past year, in line with our guidance. We are progressing well with the coming year's program and remain on track for GBP 100 million by 2027 PBIT commitment.

We've made good progress on our Renewable Energy business with the acquisition of Agrivert, further broadening our portfolio of green energy assets. We're on track to not only deliver but to exceed our 50% self-generation target in the coming year and see further opportunities to grow generation in the future.

Turning now to cash flow and net debt. We generated cash from operations of GBP 826 million, that's up GBP 53 million on last year. We reinvested much of this in our largest capital investment program in a decade. The GBP 760 million we spent on projects this year is up nearly GBP 180 million on last year and includes the Birmingham Resilience Programme, upgrades to many of our waste treatment works as part of the Water Framework Directive and a large-scale network upgrade in Newark on Trent.



We also completed the acquisition of Agrivert this year, which increased net debt by GBP 114 million. And after accounting for tax, interest, dividends and other items, overall net debt increased by GBP 478 million over the period.

Let's now turn to our financing performance where we've had another strong year. Our effective interest rate was down 60 basis points to 3.9%, taking the total reduction delivered since the start of AMP6 to 150 basis points. The amount of cash interest we pay each year has also been in steady decline over the AMP, down nearly GBP 50 million since 2015. And with lower RPI rolling up on our index-linked debt, overall net finance cost decreased by GBP 25 million compared to last year.

You'll remember that at the start of AMP6, we rebalanced our debt portfolio towards more floating rate debt and rapidly reduced our finance costs in the lower-for-longer interest rate environment. We believe the current low, flat sterling yield curve is offering less upside for floating rate exposure, and so we've been issuing our recent debt at longer maturities and competitive fixed rates.

Overall, we've significantly improved our financing performance from the start of AMP6 and are in a strong position to start the next. And this year, we've raised over GBP 520 million of new debt at competitive rates, giving us liquidity until autumn 2021.

Earlier this month, we converted and extended one of our RPI loans into new GBP 125 million CPI equivalent, meaning around 1/4 of our index-linked debt is now CPI based, helping to further align our debt with the AMP7 model.

Our net pension deficit continued to reduce to GBP 453 million. We're now in the process of agreeing our 2019 triennial valuation with our trustees and I'll be updating you on that in November.

As I just mentioned, we started to reduce our floating rate exposure, and at March 31, the proportion of our gross debt at floating rates was 22%, that's down from 27% at half year. And since the year-end, we've repositioned our swaps portfolio to further reduce our floating rate exposure to around 15% of gross debt, helping to lock in much of our embedded debt around 7 at attractive long-term fixed rates.

Our regulatory gearing was 62.3% at the end of the year, up from last year's 60.8%, following this year's extensive capital investment program. Overall, the actions we've taken are helping to build a stable, low-cost financing position from which to start AMP7.

So turning now to our regulated -- return on regulated equity. The profile of our RoRE has been different in every year of the AMP so far. And this year, our outperformance was driven by financing as ODIs were impacted by hitting the cumulative Waste cap. And totex was held flat from the reinvestment of some of the GBP 220 million of totex savings made earlier in the AMP that we've previously guided you to.

Next year, we expect outperformance on both financing and ODIs, thanks to the increased Waste cap with the balance of the planned reinvestment program, meaning totex will be around 1% negative next year. On a cumulative AMP6 RoRE basis, we expect to continue to show good outperformance across all 3 levers.

Finally, let's turn to our technical guidance for '19/'20, where I'd like to point out a few highlights. In Regulated Water and Waste Water, turnover will be higher year-on-year, reflecting RPI-based price increases. And keep in mind that we chose to defer GBP 79 million of customer ODI rewards into AMP7 from year 3 rather than taking them as revenue in year 5, which will slightly offset this increase.

Operating costs are expected to rise as we see further pressure on energy pass-through costs, licenses and materials, which will offset further planned efficiencies. On customer ODIs, the uncapping of our Waste ODIs agreed with Ofwat in December brings back into play some of our well-advanced end-of-AMP performance measures, meaning we expect a net reward of at least GBP 25 million across water and wastewater.

In Business Services, we're expecting another year of PBIT growth as we benefit from our full year of Agrivert and our Derby food waste plant, and improved efficiency and power generation in our Bioresources business. Our Property Development team are forecasting

profits of between GBP 5 million and GBP 10 million for the year, reflecting the expected timing of current land sell opportunities.

Group interest expense will be higher year-on-year due to the increase in total debt from our capital program and the acquisition of Agrivert in the second half of '18/'19. We expect our total tax rate to be around 19% and our underlying current tax rate to be between 10% and 12%, taking into account allowances driven by our capital program. And group CapEx will be between GBP 700 million and GBP 800 million, with the upper end of the range reflecting the potential for an early start to some of our AMP7 projects.

And finally, our dividend will grow in line with our policy to just over GBP 1 a share. And as a reminder, we expect to announce our new AMP7 dividend policy in January following the final determination announcement in December.

And with that, I'll hand over to Liv.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Thank you very much, James. So throughout this 5-year period, we've sought just to keep customers right at the heart of everything we do. And as such, I thought it might be quite nice to start with a bit of a reflection on what it is the customers receive from us as well as, of course, the lowest bills in the land.

So firstly, by the end of next year, we will have invested the equivalent of GBP 1,300 per individual household across our patch, and that's focused on improving resilience and making sure that future generations can enjoy the great quality service that customers enjoy today.

We're conscious though that however small our bill is, nonetheless, there are customers each year that will struggle to pay that amount. And we're proud to be able to support at least 50,000 customers each and every year who are going through financial hardship at that particular time.

It's part of this track record that have led to us receiving the accolade of the most trusted water company in England and also consistently seen and acknowledged as upper quartile in the U.K. customer service index.

Now we work tirelessly each and every day, whether it's trying to fix a service issue or whether it's working out for the best in our communities. And that can be reflected in some of the statistics there, whether it's a 62% improvement over the last 4 years in external sewer flooding instance, the worst thing that can happen to a customer; or there's the 15% reduction in water quality complaints; or even perhaps in the over 670,000 customers that have been assisted and educated as to how they can change their water habits for the good of the environment. Whether that's local customers or schoolchildren, it's a real passion for us to educate our generation for the future.

Now as we've done those, there's absolutely more we can do and we'll start by talking about our ambitions in Waste. It's been a strong year for us operationally in the Waste part of our business, and that's led to a net reward of GBP 7 million on an ODI prospective basis.

And the reason for that is because the first 9 months of last year, we were capped. And for the last 3 months of last year, we have got significantly tougher targets as well as much lower incentives as part of the uncapping regime going forward. On a like-for-like basis, we actually would have earned GBP 103 million, and had our best year on ODI rewards.

Now looking forward, we're confident we can continue to still deliver on our Waste measures at the same time as being able to really do well on the end-of-AMP environmental measures that James mentioned earlier. And it's the combination of those that has helped us give our new guidance today of outperformance to the tune of at least GBP 25 million across the water and waste measures during the final year of the AMP.

Now you would have seen in the IAP assessment in January that both Severn Trent and Hafren Dyfrdwy were both actually acknowledged as being the leading companies on cost efficiency for waste, and we're excited about the next 5 years to continue to be efficient and to drive consecutive frontier performance for the future.

We're also pleased, though, to seeing some real progress made on water during the last 6 months of the year. It's been a big year for us

in terms of landing some significant water year-on-year improvements. And against -- I guess, you could almost say there's been a tale of 2 halves, to be honest, on many measures. We had that challenging long, hot summer to deal with and then we've ended with a very strong positive momentum as we come out at the tail end of the year, and you can see this from these 4 measures.

So starting with supply interruptions. We've talked to you before about our strategy, which is around prevent and then repair and then restore. And that's aimed at improving our supply interruptions performance, which has seen a 60% improvement year-on-year. And actually, if you take February and March, it's been our individual best February and Marches in our history, which is exciting as well.

If you look at low pressure, we saw that significant spike up in the summer. And then the teams worked fully across the organization with fantastic collaboration to not only hit the target but actually beat the target by 32%. And water quality complaints, I mean, this is the measure that really counts for this AMP and for next. And we've talked to you a lot of this measure and our improvements against it. So from the last year's 12% improvement, it was pleasing to see a further 6% improvement year-on-year.

And leakage, it's great to be back on track. We've hit the MLE target to 7 of the last 8 years. And this year, it was particularly stretching based on the weather conditions of last summer. But we've worked really hard and tirelessly. We've hired additional gangs in to find and fix. We've worked hard to understand our data in detail. We've made sure that we've taken new innovations and fast-tracked understanding and using those innovations as quickly as possible.

And all of that together as well as the [acquisitive] local investment that we talked about last year, has really pulled together to land that 4% year-on-year improvement. So we feel momentum that we're building up in water will stand us in good stead for the year ahead and, of course, the trajectory for the increased measures and performance targets in AMP7.

And lastly, I want to talk about environmental measures now. So we typically tend to talk about the in-year measures, and yet actually, we've got some really important end-of-AMP measures in particular in the environmental space. And we've been working hard on these for the last 4 years.

So let me take to the first one, it's catchment management. So you might have heard us talk about the relationships we've been building up with farmers in our patch. We've been trying to engage with them to educate them and incentivize them to change their working practices for the good of the company, the communities and customers. And it's landed towards the triple whammy this year: we've now been able to mitigate millions of pounds worth of capital investments, we've been able to land an GBP 11 million ODI reward and also significantly improve water quality through that relationship with those farmers.

If we move to talk about the Water Framework Directive, we are committed to spending hundreds of millions of pounds over this 5-year regulatory period to really improve our contribution, our working practices as to how we contribute to the environment. And having successfully been on track to deliver that, this is the last idea, we're now on track for significant ODI returns, which will be great for all of that work as well as making a massive contribution to biodiversity in our region.

Now we're proud of the fact that we're doing well against regulatory guidelines and against regulatory measures. But actually, we don't want to just be seen as someone who performs well against those regulatory standards, we want to get further. We are genuinely passionate in the organization about the environment and about how bold we can be. And that's why we're excited about announcing our commitment, one of only a handful of U.K. companies to do so, on the triple carbon pledge.

And by that, we're committed to using 100% electric vehicles, to using 100% renewable energy sources and to net zero carbon emissions by 2030. And we look forward to updating you on our progress on that over the course of the next few years.

So it's been a year when we've been working hard and we've made sure that we've not wasted 1 second of that Fast-Track status. So you gain time. That's what Fast-Track status gives you is time. And first of all, we've done literally an executive-led review of every performance commitment to AMP7. We've looked to understand what the actual measure means to educate our people and take them on the journey. We've looked to make sure that we know what plan is needed to deliver these new targets.



And we've also then, perhaps better than ever before, we've understood the interrelationship between how one particular driver root cause here can actually affect a whole suite of performance metrics if we really get it right.

Now the context of our preparation is against possibly the toughest Ofwat price review, I think, in the course of time. And if you look at it, you've got this kind of -- this never increasing situation of decreasing bills, increasing efficiencies being expected and, of course, rising customer expectations for what further standard is needed.

The reason we feel confident going into AMP7 is we think culture has a huge part of that. And what we've learned in AMP6 is if you didn't take your people on that journey, on ODIs and on efficiencies, if you can really get the whole organization seeing together and moving together to achieve something that will make a significant difference towards success and a fast start, in particular, at the start of AMP7.

Now on capital. We're absolutely in our top gear, I think it's fair to say, after our largest capital spend in a decade. But it's not just we feel as though that we're in top gear, we feel really good about the efficiency with which we're spending that capital. And one example, I guess Birmingham Resilience scheme, our largest project this AMP and we're on track to deliver that to time and to budget.

But it's not just about strongly closing at AMP6 and delivering all those commitments we've promised, it's about making sure we've got a firm lens on a fast start in AMP7. And that's why, simultaneously, we've been working hard to really appoint those contractors to get ourselves in a strong position on GBP 1.5 billion worth of contract spend. And also to get ourselves ready for where we think our outperformance will come, our [USP], which is in the design function.

And you'll see them stand here today, because obviously you're going to chat with the team about it. We're genuinely excited about having the design function in-house, the chance for us to make sure that we have a Severn Trent customer-centric design which will be operator-friendly and we think will yield ongoing efficiencies for us in the future.

So I could spend literally ages talking about each and every single one of these particular boxes on this chart, and you know that as well as delivering operational improvements, we're passionate and proud that we continue to make Severn Trent an even more awesome place to work.

Now we know that 4 years ago, we had this lovely culture, we had people that were desperately keen to work really hard for our customers and the company, they're passionate about the job that they do. And what we've been trying to do during the course of the last year is to build on that fantastic foundation, is to really make the vision and the purpose even clearer and to really get even more embedded in the communities in which we serve.

I'm not going to take you through each and every box on the slide, what I'm going to do is just pick off a couple of my favorites. So the first one is Glassdoor. We think Glassdoor gives a really good, independent insight into the culture of the business, gives you the chance to understand what current and past employees generally think and are saying about the company.

And the reason we think it's important is, in the war for talent, we constantly want to take sure that as people are beginning to be curious and maybe thinking about joining Severn Trent, they can get a really good independent assessment of what it would feel like, what would it be like to be named in the top 50 Glassdoor companies in the U.K. with our culture really shining through.

And then topically, since last week was Mental Health Awareness Week, I thought we'd touch on that particular mental health topic. Now we know that our responsibility as leaders is not only look after the physical safety of our workforce, but actually look after the mental well-being with just as much effort and gusto. And that's why over 70% of our leaders, including the entire senior team, were all mental health awareness trained to make sure that we can look after the whole person to enable them to be as happy as possible and do the best job they can during the course of their career with Severn Trent.

So with that, I'd like to move on and just to close. It's been a very busy but a very rewarding year. A year in which we've landed Fast-Track status but also delivered strong operational performance in this particular financial year. And we feel as though we've made some real steps and strides forward in the preparedness for AMP7 delivery.



On the customer ODIs, the measures the customer care about most, we're now in a position that we can look forward to carrying over at least GBP 177 million worth of revenue into AMP7 earned by fantastic operational performance in AMP6.

On totex, we've learned to spend customer's money, every single last penny, incredibly wisely. And at the back of that, we'd given ourselves optionality now to get ourselves ready by spending now, in the last year of this AMP, for a strong start on day 1 of AMP7.

Financing has been a real highlight over the last couple of years and you'll see that we've managed to get ourselves in great shape against our peers, which again, we believe, is good momentum as we head into the next 5-year regulatory period.

And longer term, we want to do more. We want to be seen as a company that's a leader in terms of how we deliver results as well as what we deliver, and that's why we're excited about announcing the triple carbon pledge today, as our people, our greatest asset, they stand eager and ready to deliver the plan which has been approved by the regulator.

So with that, we're going to open for questions. I'm going to ask my colleagues to come and join us now to field the tricky ones. And we look forward to hearing what you've got to ask.

QUESTIONS AND ANSWERS

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Okay. So start there, James, all right.

James Brand *Deutsche Bank AG, Research Division - Research Analyst*

James Brand from Deutsche Bank. Three questions, please, 1 for James and 2 for Liv. A question for James, you've highlighted the hot weather costs of GBP 22 million impact in a functional year just completed, but then you gave guidance for next year for OpEx up year-on-year. And in the commentary, you didn't seem to mention anything around any reversal of weather costs. So just wondering whether that GBP 22 million, whether they are costs that you expect to reverse? Or maybe you're just being prudent in assuming obviously on forecast for what the weather is going to be like next year.

The second question is on the early contracting of the supply chain. Surely you don't want to give any guidance at this stage on totex outperformance or anything like that. But I was just wondering whether you could comment based on the contracting that you've done so far, whether that gave you optimism around being able to meet what you're incorporating into your business plan or maybe outperform it for the next regulatory period.

And then thirdly, apologies to ask a question on nationalization. But there's a raging -- well, somewhat raging debate at the moment around whether Labour would want to pay market value and a debate around whether they could even want to pay IFRS book value. And obviously, there's lots of parliamentary safeguards that will probably prevent that ever happening. But just wondering whether you could comment on that discussion point and whether you think they really understand what a RAB is and that it is actually the book value.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Well, James first about the costs.

James Bowling *Severn Trent Plc - CFO & Executive Director*

Yes, so the -- next year, we're hoping that the weather will be a little bit more normal that it was last year. We can't guarantee that, obviously. The -- so there will be some reversal of those costs, not completely because we are still working hard to make sure that we're on the right trajectory for AMP7. So on things like leakage find and fix, that does mean we're probably spending a little bit more certainly in the first half of the year to make sure we're on great shape on that. And of course, there are some other pressures. The power pass through costs just continue to be a drag. They have been for the last 2 or 3 years. And there's probably around another GBP 8 million worth of additional power costs that go on that would be offsetting any saving you get if the weather returns to normal. So I am being quite cautious about what the weather looks like and also how those costs will flow through.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Very good. So Helen has done all the hard work in terms of appointing our contract partners and getting ourselves in great shape. Though she's definitely not going to give you any guidance, I can assure you, of that next AMP in terms of that forwards, but she can share a little bit about why we feel good about the rates and the partners we've chosen.

Helen Miles *Severn Trent Plc - Chief Commercial Officer*

Thanks, Liv. Yes, so we're actually delighted we've been able to appoint our contractors so early in the AMP and then mobilizing literally as we speak. We had a kickoff event with them all a couple of weeks ago, where Sarah, Liv and James joined me in welcoming the new organizations into Severn Trent. So clearly I can't -- there's no detail I can share and it's very, very early. But we've run a competitive tender process. We've got more suppliers, so that in itself makes it more competitive. But the real value that we're going to get is through the design that we're bringing in-house and that really helps us unlock value. Having the ownership of what we're actually going to build. Having -- being able to standardize what we build, so we can design once and build many times is really going to help us drive that efficiency. So lots of hard work to do, lots of hard work already done, but we're in good shape.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Very good. And on nationalization, I mean, the way that way that I view is there's 3 independent think tanks that consistently looked of what the value would be if nationalization is to occur. And also there's one, a Labour, I guess, aligned think tank, one (inaudible) aligned think tank and one independent, they all come out with values of between GBP 80 billion to GBP 90 billion. So I think that is the detailed analysis I've seen done by any of the independents, so that it will be possibly plus some kind of premium. So that's what I believe.

Well -- so, let's go to Dominic next, then we'll go...

Dominic Charles Nash *Barclays Bank PLC, Research Division - Head of Utilities Research*

Yes. It's Dominic Nash from Barclays. So a couple of questions, first of all, on the GBP 220 million of return investment. Can you just kind of say how much have you spent so far and what will you be spending in the final year and will some of these ever run, do you think, into AMP7? And secondly, on the credit markets -- and again, sort of going back to the dreaded nationalization question. I think Thames issued a bond recently with a sort of covenant on nationalization. Are you seeing the trends going that way for debt issuance? Or are you seeing a potential increase in spreads to sort of like cover the increased risk going forward, please?

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Great. So just before James gives you some sense of the numbers. I mean the key thing here is, as I said earlier, we feel very confident we'll close the AMP6 very cleanly. So I think it's one of the things that we've set ourselves as a real ambition as a team is whatever we've committed to delivering in AMP6 to make sure it is delivered in AMP6. And I think one of the things that's happened -- I guess we struggled at the start of this AMP6, whenever we feel good and we're in better shape on that. So I don't you should worry about whatever we've chosen to reinvest drifting over, you should feel confident that we've got a good capital plan for the year ahead, and we're going to be in strong shape do deliver the revenue we've committed to. Yes, yes. James will answer that (inaudible).

James Bowling *Severn Trent Plc - CFO & Executive Director*

Yes, so that -- if you think about the GBP 120 million -- we break into GBP 120 million -- GBP 100 million, GBP 120 million was things like what's cost of the improvement. That's pretty much all spent. We are probably about GBP 20 million in today second GBP 100 million. So there's maybe around GBP 80 million to go. And if you think about it, that's what translates into the RoRE totex number I guided to that fully well. Yes.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Good. And then let's talk about (inaudible).

James Bowling *Severn Trent Plc - CFO & Executive Director*

Yes, it's not something we've seen all of our issuances have been at the opco level. So this is more of the holdco level. I think it certainly was percent, so we haven't seen any it. We don't have any of those covenants in our debt.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Good. I think we've got a question. There's one from the back.

Mark Freshney *Crédit Suisse AG, Research Division - Research Analyst*

It's Mark Freshney from Crédit Suisse. One of the major growing areas of your business is the green renewable generation and the services businesses. Can you talk about Agrivert and how the integration of that has gone? And secondly, next review, the dividend appears to be a little bit tighter, but do you have extra capacity to invest in green generation?

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Very good. So we'll get Andy to share the hard work he's been doing on integration, and we've had some really good early finds. Andy, you want to talk about that.

Andrew P. Smith *Severn Trent Plc - MD of Business Services*

Yes. Going very well. Thank you for asking. We're delighted with the acquisition. As I said at the time we bought it, we're running the 2 operations separately for a while until we can work out how best to integrate. We've already integrated the commercial teams. That's being led by Pamela Lloyd, who's doing a fantastic job for us in focusing on longer-term contracts. If you remember, that was something that Agrivert had done a great job on with the balance on the spot market as well. We've seen 1 or 2 opportunities to take some early wins in insurance costs, and we can sell around at a better price because we're selling more. So all very good and we'll continue with that. So I look forward to telling you more in the future events.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

And Andy is hiding his light under the bushel there. We recently said we'd be at 50% self-gen energy. We're now actually now saying that we're definitely going to exceed that through the course of this year. So 50% higher than we've guided to you before, which is a positive tick-up considering energy costs are rising. So James, do you want talk about capacity in terms of investments?

James Bowling *Severn Trent Plc - CFO & Executive Director*

Yes. So we'll be updating our dividend policy in January, so I won't give you a hint on what that is today. But if you're talking about non -- of our nonreg business and do we have the capacity to invest more, I think the answer could be yes. It will depend on how good Andy's performance is and whether he can see some good opportunities. But I would say that we're fairly -- we're not particularly aggressively leveraged on our nonreg business, so there is some capacity to do some more investment. But it'll depend on what opportunities there are. So the short answer is yes, but we'll wait and see.

Andrew P. Smith *Severn Trent Plc - MD of Business Services*

If I could just add a little bit more on that. Because I'm -- on the investment front, we're investing our Derby food waste plant and that's ongoing with some innovative technology there. We spent some money expanding our crop plant as well. And again, that's performing. So we are continuing to invest. So we need to see that performance coming through. But it's -- as Liv alluded to on the slide, it's an exciting environment with the focus on carbon, focus on biomethane and so on. So we're keeping a very close eye on developments there.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Very good. Okay. Nigel.

Nigel Bligh Spencer Hawkins *Hardman & Co. - Utilities Sector Analyst*

Nigel Hawkins, Hardman. First of all, congratulations on getting the Fast-Track status.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Thank you.

Nigel Bligh Spencer Hawkins *Hardman & Co. - Utilities Sector Analyst*

Second my interest is now in test areas assessments. I noted that Hafren got 5 Ds out of 9 and even Thames Water and South only picked up 3 each. In fact, I almost choked on my cornflakes when I actually read Ofwat's commentary on Hafren. And what I wanted to ask is

this: it was actually jampacked with coruscating criticism. And a, how much of Ofwat's trenchant criticisms do you actually think is fair? And secondly, what did surprise me was presumably the business report was compiled by some, at least from the same team, whose Severn Trent report managed to secure a Fast-Track status.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Well, it's 2 different teams, right? We had a red team working on the Hafren plan and a red team working on the Severn Trent plan. So the things I would take from the Hafren feedback is -- first of all, Ofwat said we're a high-efficient company. They gave us not just the money we asked for, they actually gave us GBP 5 billion extra. So don't forget the first phase is have you got the budget you need for base models and also to be able to invest in enhancements for the future, and we were given all of that and more than we've originally requested. The business is in great shape in that kind of financial situation.

Hafren is 1% of the size of Severn Trent. It's tiny versus some of the large waterwaste companies. It's dramatically smaller than any other company and that brings with it challenges. It brings with it data challenges based on historic data wasn't available. It brings with it comparison challenges, so one difference in one particular measure can really move you from upper quartile to bottom quartile. So it brings that. So I think Ofwat gave us very constructive piece of feedback. We've worked with them really well since then. And we've resubmitted a good plan on the 1st of April, and I'm confident that Ofwat will be poring through that now.

But in my time what I've seen is a regulator that is robust, that is stringent, but actually is also constructive and balanced, and I'm confident will receive a good settlement for Hafren in the end that actually reflects our hard work. They've helped us a lot on the basis we're a brand-new company that has only been in existence in a matter of months before that price review. To be fair, it was inevitable we're going to get a good chunk of Ds because when you've got a brand-new company with less historic data than anybody else, you're going to fare less well on some of those comparative measures.

Nigel Bligh Spencer Hawkins *Hardman & Co. - Utilities Sector Analyst*

If our consumers like, "The final bill was not tested with customers." Is that correct?

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Well, I mean we could go through every line of the detail and run through and -- I'll tell you what, Nigel, we'll do it over a glass of wine later. We would dig out the bill and we'll go through it. We'll go through all of it. But the overall sense of it is Ofwat gave us good feedback. We've learned from it and we've submitted a revised plan that takes on board that feedback. But we're in good shape to deliver because we've landed the financial budgets already, which means Hafren as a business is already live with advanced AMP7 planning. It will be locking on the same contract that we'll be looking at. I don't know, Tony, is there anything you'd like to add to that as the man leading the charge now?

Anthony J. Ballance *Severn Trent Plc - Director of Strategy & Regulation*

Yes. It's probably reiterating, I mean, we've put in a very substantial response to that criticism. Much of that response is around doing deeper customer insight, market research. Probably the only other point I'd add is -- which is an observation, that most of the smaller companies received quite a lot of harder scores in Ofwat's IAP test, which I think is due to the fact that, to some extent, smaller companies are finding it hard to satisfy what were pretty high stringent tests with only 3 companies getting A scores out of that whole matrix. So the test that Ofwat set were pretty hard and pretty stringent. And obviously, we were pleased to get Fast-Track for Severn Trent, but as you say, we have to swallow our pride a little bit with the Hafren plan. But we did get the costs that we put into the plan.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Thank you. Brilliant. So can we pass it to first row now.

Alexander Wheeler *RBC Capital Markets, LLC, Research Division - Associate*

Alex Wheeler, RBC. Two questions from me, please. First of all, what are the GBP 103 million of Waste benefits in the year and how do you think about Waste outperformance going into AMP7? Secondly, do you see scope for further gains in financing performance going forward?

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Very good. So I'll get James to answer the financing situation first, and then I'll get Sarah [who personally] delivered most of waste outperformance to be able to share what her teams have done. James.

James Bowling *Severn Trent Plc - CFO & Executive Director*

As I look, I mean, into AMP7, we've got about GBP 3 billion worth of debt to raise. And around GBP 1.2 billion of that is going to be new -- GBP 1.2 billion of new debt and then GBP 1.8 billion of refinancing. So I think we've got plenty of opportunity in the current low interest rate environment to improve. But I won't give you a kind of firm guidance on where that is. But I do see it's a good environment for us to be. Probably refinancing more money than most of the other water companies I think. So I think we're in good shape.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Great. Sarah?

Sarah Elise Bentley *Severn Trent Plc - Chief Customer Officer*

Yes. So the favorites again of internal and external sewer flooding and category pollutions were things that drove the performance. As Liv mentioned in her speech, the incentivization that we've got under uncapping is substantially less, about 80% less reward. And they have locked in the toughest set of targets. So they've taken our best performers over the AMP and locked in that as the new baseline for performance going forward, which is why it's much more challenging. But I guess I'm quite excited about it, actually, because it aligns us brilliantly with what our customers most want and the teams are really up for it.

What's driving that underneath is a real understanding of where the sensitive areas are on our network, which areas are more prone to flooding or, therefore, areas such as our combined sewer overflows, which can lead to category 3 pollutions. And then through modeling and analysis, doing preventative work, so whether that's proactive flushing of these or doing inspections if there is flooding.

What's exciting going forward is that if I look at the sort of suite of waste measures for AMP7, there is a much broader spread. So we won't be chatting in AMP7 about 1 or 2 key Waste metrics, it will be across the basket of measures. And actually, Liv mentioned about driver trees and getting this whole systems thinking -- that James has talked about before, making sure that we tie up how blockages interacts with floodings and pollutions, and connecting them all together, that's going to be important.

Then the other thing that's going to be important to me is the advancement in innovations, of working totally with Bob Stear and his team to drive greater thinking. The Waste network has got very, very limited telemetry. We're probably one of the most advanced water waste companies but still only 1% of our network has sensors and telemetry on it. So there's a great opportunity. The challenge is that there hasn't been much innovation, which is why this World Water Fund is so important. It's just not the sector that's attracted investment and innovation. So the cost per unit over a sensor is just disproportionately high. So we're quite excited. We've got a test case going on at the moment. So I think great use of analytics, great use of models and a much broader suite of measures, which I think will raise all our game and really align us with customers.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Brilliant. Fraser. It's coming. Build up the anticipation, now the question.

Fraser Andrew McLaren *BofA Merrill Lynch, Research Division - Director*

It's Fraser McLaren from Bank of America Merrill Lynch. In the planning that you're doing for the next regulatory period, how do you think about the risks of negative changes from Ofwat in July on returns and also efficiency benchmarks? And how much scope do you think there is for change in spite of the Fast-Tracks? And secondly, would you remind us, please, how much of the GBP 177 million ODI receivable is already reflected in your actual business plan?

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Great. So I'll get James to mention on the GBP 177 million in a second. So I mean, practically, it's never settled to the price that you settle, is it? Right? So that's why we have to wait for the final determination which lands in December. And I think there's only a handful of topics that we're in discussions with Ofwat over, but those handful of topics are important to us. And we've been quite balanced, making

sure that in the conversations in January and our conversations in April when we are discussing more work, we've been quite balanced around it is a handful, but we do think those things are important.

So we look forward to continue the constructive dialogue between now and December. And I think it will be good -- I'm sure we'll have phone calls after December, to talk about now the whole piece, what would that look like. But you're right, there could be wins and there could be losses between now and December. The key thing for us is to make sure that I think the regulator, our regulator, is typically goal-claused at flagging things. So I think it's making sure we're listening carefully to what it is that they're saying. It's making sure that we're understanding that and internalizing that and not traveling too hopefully on a positive path. So we're trying to make sure that we've got a balanced understanding of the pros and the cons, and the ups and the downs over the next 6 months.

James Bowling *Severn Trent Plc - CFO & Executive Director*

Fraser, so of GBP 177 million, about GBP 140 million was in the plan. The difference is, obviously, when we did that plan we had a view on year 4. But we also haven't got uncapping when we did the planning, so the benefit you get from uncapping is being added to that. So that's the extra GBP 25 million, GBP 35 million.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Very good. Any other -- oh, there we go. So Chris is going to go first, and then we'll turn to Iain. So Chris, just...

Christopher Robert Laybutt *JP Morgan Chase & Co, Research Division - Research Analyst*

Chris Laybutt, JPMorgan. Two very easy ones. Preparing for AMP7, you said that you're mindful of independency or interdependency.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Interdependencies.

Christopher Robert Laybutt *JP Morgan Chase & Co, Research Division - Research Analyst*

Could you just give us an idea of what that means in terms of driving performance? Maybe an example. And property sales is one of the areas that Labour have ID'ed that they have an issue with or is an area of concern for them. Is this the right time to be selling assets? And would it be prudent to step away from that program for a couple of years until maybe things die down?

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Well, on property -- and the reason that we're selling some of the lands on property is because in the Midlands, there is a shortage for good quality low-cost houses to be built. And that means that we have had lots of contacts from lots of councils asking us to support them in their ambition to create housing that every generation can afford to live in. And we take our responsibility quite seriously there.

Equally, if you ask our customers what they want from us in the future, they want fantastic service at low-value bills, and we'll share the benefits. Customers gain about half of the value of the property sales as well, so to keep those low for the future for the long term and to enable the next generation of people to buy houses, it is the right plan. I think regardless of any government, it is the right plan because they are societal desires that will exist through any political party in power. In terms of interdependencies, Sarah will give you very good examples. What I'm going to do now is ask James if he can give us an example, particularly on the pressure in the network and something like that which actually brings to life how interdependencies can work.

James Jesic *Severn Trent Plc - MD of Production*

Yes, of course. So if you take the water network, effectively there are a number of outcome measures associated with that that were measured on, say, things like leakage, supply interruptions, low pressure, that sort of thing. Now what we've been doing is we've been forensically analyzing the whole end-to-end process, right, from catchment all the way through to supply, and looking at different component parts of that end-to-end process and where we can intervene within that process to drive a number of those outcomes.

So if you think about pressure, for -- sorry, if you think about networking, for instance, we've obviously deployed a number of our traditional techniques around supply interruptions, making sure we respond a lot quicker and that's helped the lift the half -- the second half year performance. But we're now looking at how do we ultimately reduce the propensity of the network to fail in the first place. Some

of that traditionally has been around rehab, but what we're looking at now is how do we actually calm the network and reduce pressure variances across the network. Those pressure variances can lead to additional stresses and strains on the network which ultimately lead to failure. So the better we can be at controlling those, the better we can be in terms of reducing that propensity in the network to fail. And that's what we mean when we talk about that thinking across the end-to-end process. Did that help?

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Very good. So we're going to pass the microphone over to Iain if that's okay. Yes, brilliant. Oh, there's one [on the right].

Iain Stewart Turner *Exane BNP Paribas, Research Division - Analyst of Utilities*

It's Iain Turner from Exane. A couple of questions. On your ambition for more renewable energy for self-generation. Do you actually have sites within your state at the moment where you can put that equipment, if solo or window, whatever, or do you need to do it sort of outside of your sites? And then on Agrivert acquisition, you've given us a breakdown of the Business Services EBITDA in sort of mini segments. I was just wondering whereabouts, within those mini segments, would I find Agrivert? Maybe not this year but in the future.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Right. So James will answer the technical question of where you'll find it.

James Bowling *Severn Trent Plc - CFO & Executive Director*

Yes, so if you look -- yes, so you'll see it in energy, in nonreg energy eventually. But remember, we've only had it for 3 or 4 months?

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Three months.

James Bowling *Severn Trent Plc - CFO & Executive Director*

3 or 4 months, so you'll see a full year of it. The Agrivert business is around a GBP 10 million per annum EBITDA business, so that's where you'll see it.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Great. And Andy is primed and raring to go.

Andrew P. Smith *Severn Trent Plc - MD of Business Services*

I am. We do have land available, however, Green Power is agnostic on where it gets its land from. There's the -- we pay a rent for that or the Green Power business pays rent to Severn Trent Water. If we -- a lot of the power purchase agreements with Severn Trent it's great for direct supply, the Agrivert acquisition takes us out of our -- out of Severn Trent Water's area. So we have land to expand on and we are broad-minded as to where we can get that for the best deal for our business.

Iain Stewart Turner *Exane BNP Paribas, Research Division - Analyst of Utilities*

Direct supply, though.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Yes.

Iain Stewart Turner *Exane BNP Paribas, Research Division - Analyst of Utilities*

A much better business case in terms of using the power on sites are much better...

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

If you can you would always direct supply. So we can and we do that where we can. But if not, then there might still be further opportunities where you only take up a portion of that supply but actually it's got a good close-grid connection and that still makes good business sense. So we take that broad [church] into consideration.

Iain Stewart Turner *Exane BNP Paribas, Research Division - Analyst of Utilities*

So I guess just to rephrase my question, do you have enough land to work through that whole self-supply and direct supply?

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Ah, it's a different question. You're asking now if we have an ambition to do a 100% self-gen and supply, different debate. So not 100% currently today. It wouldn't cost in on the business case level. Now the world will keep changing and we'll keep looking at it. Originally, we said 30%, now we did 50%, we now exceed 50%. I'm sure we'll go higher than we are now but we haven't yet worked out how high that looks. We'll keep that under constant review.

Andrew P. Smith *Severn Trent Plc - MD of Business Services*

Rest assured that we're looking at all of the pros and cons of that across the portfolio.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Oh, yes. So first for Verity, right, you waited for your turn. Verity first and then it will be you, Nigel.

Verity Mitchell *HSBC, Research Division - Analyst*

Yes. Verity Mitchell, HSBC. I'm just looking at Business Services, so you talked a lot about Bioresources and Green Power, but I noticed your PBIT in Operating Services halved and you've set out the reasons. But just wondering, are we going to see a recovery next year? And what's your thinking about what essentially was the key part of that business historically?

James Bowling *Severn Trent Plc - CFO & Executive Director*

Yes. So last year, so '17/'18 did benefit from one pretty good big scheme in the MOD contract, RAF Marham, that was a nonrepeat. So that was one of the reasons why Operating Services came down a little bit year-on-year. It will recover. I think we're looking at an up year on Operating Services for next year. Sorry.

Verity Mitchell *HSBC, Research Division - Analyst*

Any further ambitions in this particular part of Business Services?

James Bowling *Severn Trent Plc - CFO & Executive Director*

Operating Services?

Verity Mitchell *HSBC, Research Division - Analyst*

Yes.

James Bowling *Severn Trent Plc - CFO & Executive Director*

We've got, I think, 2 or 3 -- 2 really good contracts. I don't think we've got any -- no, they don't come up that often, these kind of contracts. So I think we're really happy with the 2 we have. They're nice, long-term contracts, very similar to the kind of operations we do in Severn Trent essentially. So they work really well. But don't see any immediate short-term opportunities to increase the part of the business.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Good. Nigel?

Nigel Bligh Spencer Hawkins *Hardman & Co. - Utilities Sector Analyst*

Nigel Hawkins, Hardman, and not on Hafren this time. Two questions, if I may. First, what initiatives have you taken to protect shareholders in respect for possible renationalization by a future Labour government and concern any compensation will effectively be determined by anti-prioritization Labour MPs? And secondly, you may have seen that the new Chief Executive or your ex-employee British Telecom has announced GBP 500 shares to each employee at BT. I wondered whether Severn Trent might do likewise.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

Well, on the second one, we are -- we actually already further advanced in a sense. But what we do is that we have a bonus scheme that the whole organization, top to bottom, gets involved in. So it means that every single person at Severn Trent is paid on exactly the same core measures, and we find that works really well for us. You'll see that actually Severn Trent shares, is at exceptionally levels constantly, and we definitely think that that's makes all the difference. Although the vast majority will do share, say, as well is also having had previously -- having set shares and as well as also having the annual bonus across the whole company. So I genuinely believe that having a centralized workforce top to bottom is the right way to run a company, and I'm passionate about that and we've produced that in the first year that I arrived.

On the second part, which is what steps have we taken. I mean the first key thing is that if you listen to customers, they want great service. I think that's a first thing we're doing is making sure that we're investing a lot and we're delivering great service. You might have seen that support for nationalization has more than halved over the last couple of years. Originally those (inaudible) were 87%, the most recent poll says that support is only 29% for nationalization. So I think from a voter perspective, support is lower that it's been since this first conversation began.

What we're spending our time doing is making sure that we're working with the MPs, with all political parties. And we've seen a number of political parties come out recently and say they don't support nationalization. We're working closely across the spectrum to make sure that we're getting our views heard. And of course, as a Board, you can imagine that we keep an eye on all opportunities and all other ideas, and we'll just keep that under constant review. But the first answer is to invest strongly for the future, deliver great customer service and to make sure our message is being heard as to what the value of our business and the current model is.

Nigel Bligh Spencer Hawkins *Hardman & Co. - Utilities Sector Analyst*

I know the situation is somewhat different in the national groups, for example, they could theoretically shift a lot of their assets from the U.K. into The States, which might give them greater protection against renationalization. Obviously at Severn Trent, you don't have that sort of opportunity. And the message, I think, seems to be you're saying to shareholders, "Well, that was too bad. You're on your own," and the share price, to certain extent, reflects that.

Olivia R. Garfield *Severn Trent Plc - CEO & Executive Director*

I'm fascinated how you got that from my answer. So my answer was clear -- it was actually the total opposite. So my answer was really clear that we discuss it regularly as a Board. We take it seriously as a risk. We think it's a high-impact, low-percentage chance. And we're adamantly working through -- whether it's with political priorities, whether it's working with journalism, public opinion, whether it's making sure that we're in good shape for options, whether it's working with companies like (inaudible) that begin to look at their analysis and research on the legal protections. We are actively making sure that we protect shareholders' interest. That's my message.

Good. I think that might have been our last question. Marvelous. In which case, thank you very much, everyone, for coming. It is appreciated, and we'll see you in November.

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