

# PR19 UPDATE

4 September 2018



WONDERFUL ON TAP

SEVERN  
TRENT

# CREATING OUR PLAN

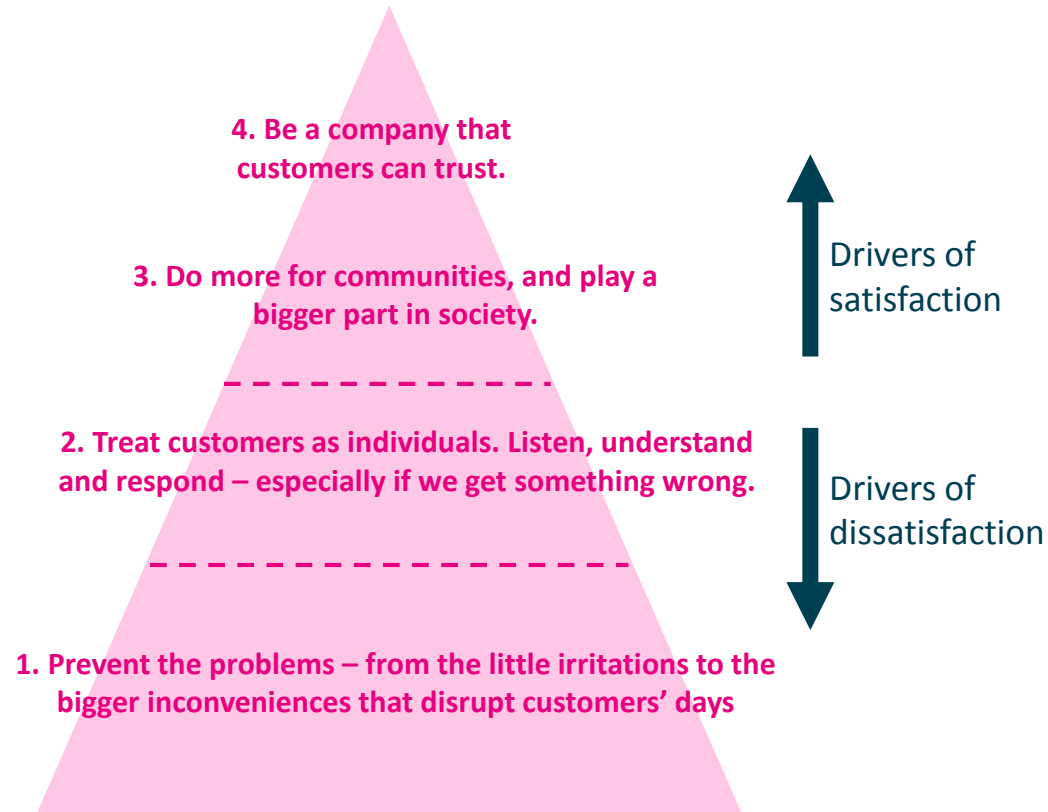
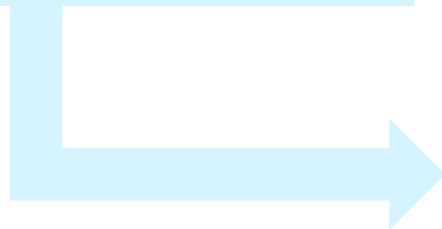
## A plan that starts with people

The most the most in-depth programme of customer engagement we've ever carried out

An outside-in approach: talking to people as individuals, not just customers

Developed a strategic framework, agreed with our Water Forum – our hierarchy of needs

We learnt four key things that our customers want from us



Approved by customers with an 85% acceptability rating

# THE SHAPE OF OUR PLAN

## A plan built through the eyes of our customers

### Our plan contains:

Nine customer outcome chapters (Part 3)

Key additional chapters to also address the nine Ofwat IAP tests, covering:

- Designing better outcomes (Part 2)
- Financing, efficiency and innovation (Part 4)

The plan is supported by a number of technical appendices, and also embraces the four Ofwat themes of great customer service, affordability, resilience and innovation.

### The nine Ofwat 'IAP' tests:

Engaging Customers

Affordability & Vulnerability

Securing long term resilience

Delivering outcomes for customers

Accounting for past performance

Securing cost efficiency

Markets and innovation

Aligning risk and return

Securing confidence & assurance

## A plan that meets our regulators and stakeholders' expectations

# HIGHLIGHTS

## A robust, ambitious and balanced plan

### Largest bill reduction in two decades

A real reduction of **5%** in CPIH prices

### Challenging ourselves on Totex

Total spend of **£6.6bn**, reflecting **13%** efficiency

### Continued strong growth in our RCV

Growth of **13.6%** in nominal prices

### Backing ourselves on Customer ODIs

Proposing a RoRE range for ODIs of **-3.0% to +2.6%**

### Stable and responsible financing

Average gearing<sup>(1)</sup> of **63.6%**

### Supporting our Community

Introducing a community dividend of **1%** of profits

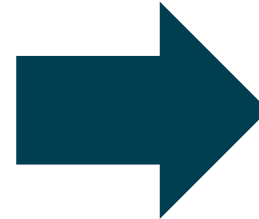
## Delivering for all of our stakeholders

<sup>(1)</sup> This differs from the average of 64.1% in our pro-forma business plan presentation which is calculated by applying year end indexation to closing net debt and average indexation to RCV. Our calculation uses year end indexation for both net debt and RCV, consistent with our existing APR reporting.

# CUSTOMER BILLS

## Our Principles

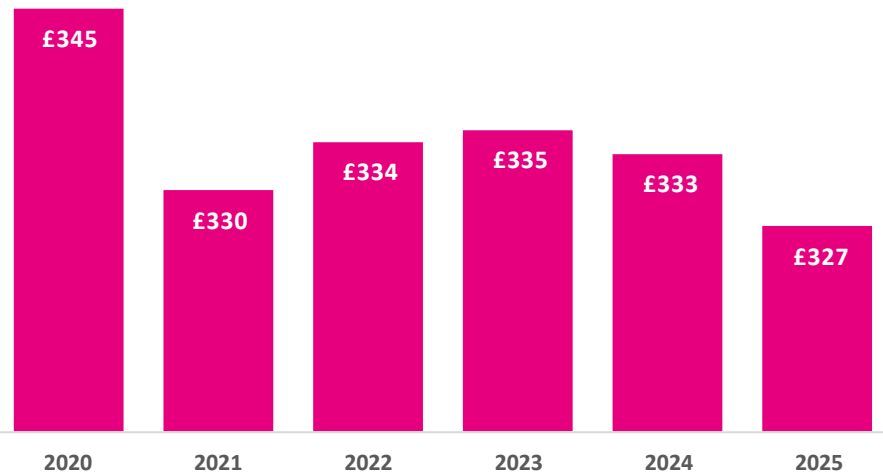
- ❑ Each generation of customers should pay its fair share
- ❑ Bills should be stable over time, where possible, avoiding big fluctuations
- ❑ We should be able to maintain a stable, low cost funding platform for investment



Applying a CPIH-based approach from 2020

Balancing debt interest costs paid by current and future consumers

## Average bill reduces by 5%



Note: Bill profile is shown in 2017/18 prices and includes revenue from AMP 6 deferred ODIs

## Financial assumptions

	PR14		PR19	
	Water	Wastewater	Water	Wastewater
PAYG rate	62%	55%	62%	55%
RCV run-off rate	3.8%	5.0%	4.6%	5.3%

- Average PAYG rate unchanged from PR14
- RCV run-off rate increased to:
  - Apply CPIH indexation from 2020
  - Crystallise some RCV inflationary return to smooth bills and maintain financeability

# TOTEX

**Our plan includes £6.6bn of totex – reflecting efficiency of 13%**

## Total Totex: £6.6bn

**Enhancement expenditure  
£1.7bn**

**Maintenance expenditure  
£4.9bn**

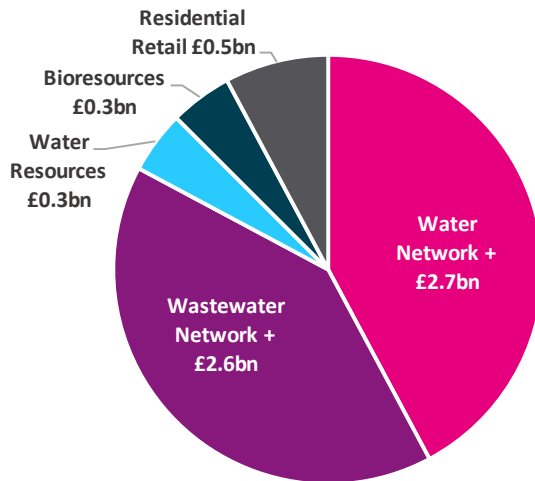
## Key enhancement schemes include:

**Environmental programme  
£0.43bn**

**Resilience  
£0.15bn**

**Supply demand balance  
£0.30bn**

**Sewer flooding  
£0.14bn**



## Real options:

An innovative approach to managing uncertainty

- Delivering better outcomes for customers
- Applicable where material outcome uncertainty exists
- Gives the right but not the obligation to act upon a defined trigger
- Totex figures shown do not include expenditure of up to £1bn over our water resource management plan period
- We have identified four areas in which a real option mechanism could be used – metering, climate change, wastewater environmental programme and a water trading interconnector

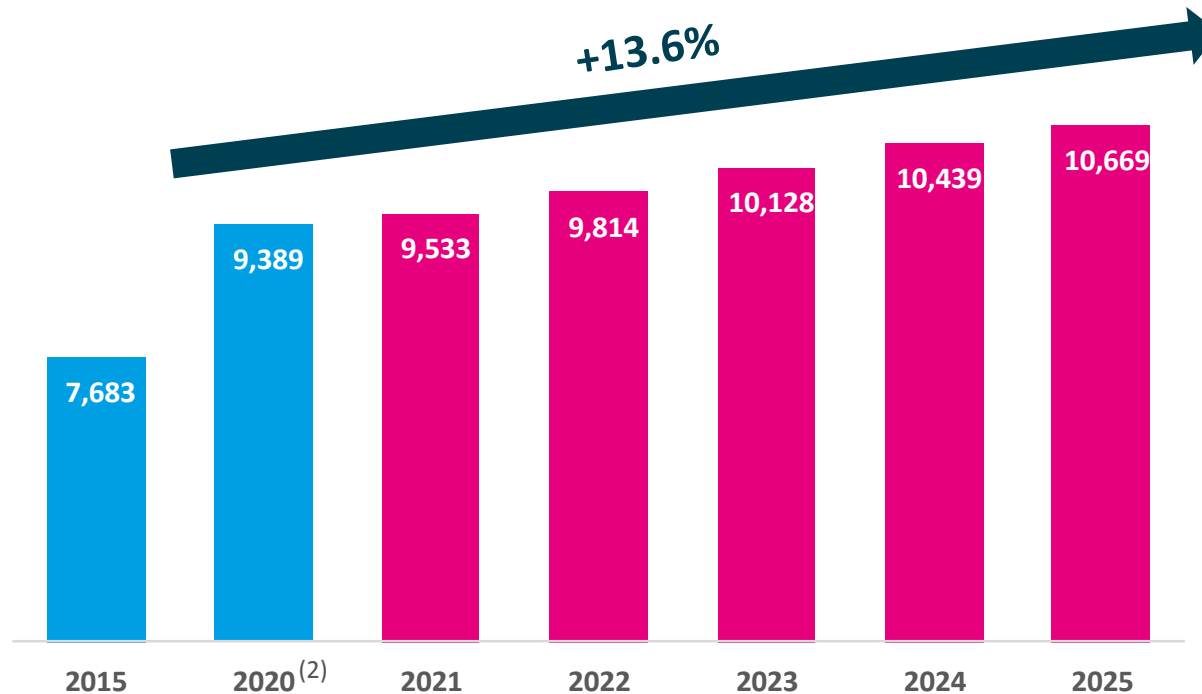
**Reinvesting £100m in AMP 6 for a fast start to AMP 7**

Note: All spend shown is in 2017/18 prices.

# RCV GROWTH

Investment in our business generating RCV growth of 13.6%

RCV growth in nominal prices<sup>(1)</sup> £m



Growth of:

- **13.6%** nominal
- **3.5%** in CPIH prices

50/50 indexation of opening RCV at RPI/CPIH

All new additions will be indexed at CPIH

RCV run off increased so that RCV inflation is brought into line with CPIH

<sup>(1)</sup> Assumptions:

	2020	2021	2022	2023	2024	2025
RPI	3.09%	3.32%	3.55%	3.47%	3.25%	3.00%
CPI	1.72%	1.76%	1.83%	1.90%	1.96%	2.00%

<sup>(2)</sup> Closing RCV in 2020 is stated post midnight adjustments of £191m in nominal prices and excludes the portion of RCV associated with our NAV

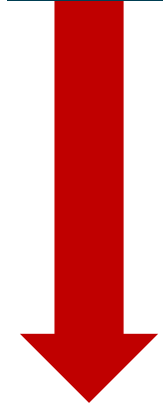


# CUSTOMER ODIS

+2.6%



**RoRE  
range**



-3.0%

## 41 Performance Commitments

### 33 Financial incentives

### 8 Reputational incentives

**3**

Comparative

**11**

Common

**19**

Bespoke

**5**

Common

**3**

Bespoke

Measured on:  
**UQ**

Measured on:  
**Company performance**



**We have chosen to apply for enhanced  
rates on two comparative ODIs**

### Pollution incidents

- Normal rate: **£597k** per incident per 10,000km of waste network
- Enhanced rate: **£895k** per incident per 10,000km of waste network

### Internal sewer flooding

- Normal rate: **£22.6m** per 10,000 sewer connections
- Enhanced rate: **£33.9m** per 10,000 sewer connections

For a complete list of all ODIs and associated incentives, please see the Appendix to this presentation

Note: All Customer ODIs are shown in 17/18 prices, post-tax.



# FINANCING

**63.6%**

Gearing average  
2020-25<sup>(1)</sup>

**£1.2bn**

New funding  
requirements

**£1.8bn**

Required  
refinancing

**BBB+/Baa1**

Targeted minimum  
credit rating

## Maintaining a stable and low cost funding platform

- Starting AMP7 with a balanced debt portfolio and gearing at the current notional level
- Average gearing of 63.6% - well below the trigger for sharing financing outperformance of 70%
- We have applied extensive scenario analysis to ensure we maintain our strong track record of financial resilience

As a reminder, the draft components of Ofwat's notional WACC are as follows:

Ofwat notional WACC	Nominal	Real CPIH	Real RPI
Cost of equity	7.1%	5.0%	4.0%
Cost of debt	4.4%	2.3%	1.3%
Appointee WACC (vanilla)	5.5%	3.4%	2.4%
Retail net margin	0.1%	0.1%	0.1%
<b>Wholesale WACC (vanilla)</b>	<b>5.4%</b>	<b>3.3%</b>	<b>2.3%</b>
<div> <div>→ Embedded debt</div> <div>4.6%</div> </div>			
<div> <div>→ New debt</div> <div>3.4%</div> </div>			

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# DIVIDENDS

## Our dividend policy core principles

- ❑ Dividends will be fair and balanced
- ❑ Dividends will be transparent
- ❑ Dividends should promote continued outperformance
- ❑ Dividends will support appropriate gearing

## Our community dividend

Helping our most vulnerable customers – Trust Fund

£3.5m

Enhancing our local environment – Volunteering

£1.0m

NEW Creating social infrastructure – 1% profit

£2.5m

**Community dividend (annual value)**

**£7.0m**

Illustrative  
figures

## Group dividend policy to be announced in early 2020

Components of our Group dividend will include:

- A base regulatory dividend of **5%** in line with Ofwat guidance from Severn Trent Water
- Carryover ODI incentives from AMP6 and any outperformance in AMP7
- Our Welsh regulated business – **Hafren Dyfrdwy**
- Our **non-regulated** business – including Operating Services, Property Development and our recently expanded Green Power



# OUR WELSH BUSINESS HAFREN DYFRDWY

Serving future Welsh generations through low bills, better service and a healthier environment

The lowest bills in Wales despite a small annual increase of 0.5% above inflation

Total totex of £156m including £19m on dams and treated water reservoirs

Proposed RoRE range on Customer ODIs of -0.46% to +0.24%

Investment in Lake Vyrnwy for customers, communities and the environment



# AMP6 UPDATE

## ODIs FY18/19<sup>(1)</sup>

We continue to expect a net neutral position for FY18/19. Forecast rewards include the remaining £5m of Waste cap and up to £9m reward on catchment management which is earned in year 4. These are offset by expected penalties in supply interruptions, due to a small number of major bursts this year, and water quality complaints, as expected.

## ODIs FY19/20<sup>(1)</sup>

For FY19/20, we are forecasting that without the benefit of Waste ODIs and catchment management, we will be in a neutral position in both Water and Waste. In Retail, we are expecting a penalty on SIM of around £19m, which is already reflected in our bill profile for AMP7. As a reminder, the customer service measure will move to C-MEX in the next AMP.

## Waste cap

We have asked Ofwat to consider uncapping our AMP6 Waste ODIs, to provide us with the capacity to invest substantially more in sewer flooding over the next two years to further reduce instances experienced by our customers as well as shift the sector UQ.

## Non- regulated

On 30 August 2018 we announced our purchase of Agrivert Holdings Limited and its operating subsidiaries which recorded revenue of £26million and EBITDA of £10 million in the last full financial year. It is anticipated that the transaction will be completed by the end of the calendar year.



**Liv Garfield**  
*Chief Executive*



**James Bowling**  
*Chief Financial  
Officer*



**Tony Ballance**  
*Director, Strategy &  
Regulation*



**Andy Smith**  
*Managing Director,  
Business Services*

# APPENDIX

# TIMETABLE

## Upcoming key dates

14 Sept 2018

Capital Markets Day when we will bring our plan to life

22 Nov 2018

Half year results presentation

Late January 2019

Ofwat published **initial assessment** of business plans

March/April 2019

**Draft determinations** published for exceptional and fast track plans

July 2019

**Draft determinations** published for slow track and significant scrutiny plans

December 2019

**Final Determinations** published

Early 2020

**Announcement of AMP7 dividend policy**

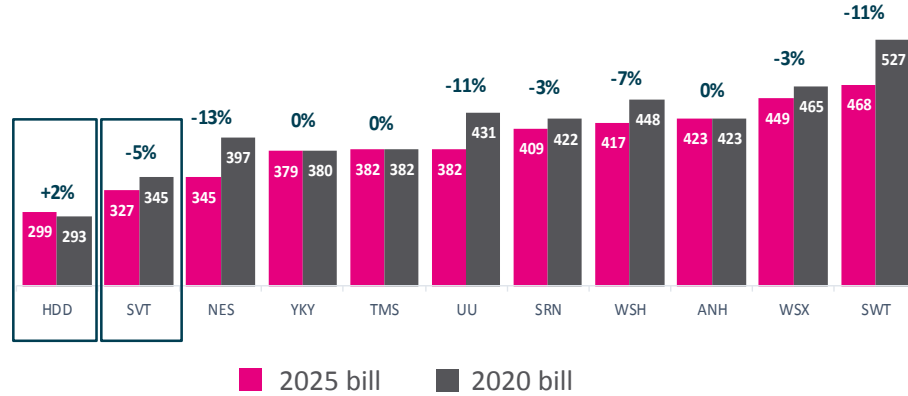


The comparative data shown below is based on our early interpretation of currently available information.

# COMPARATIVE DATA

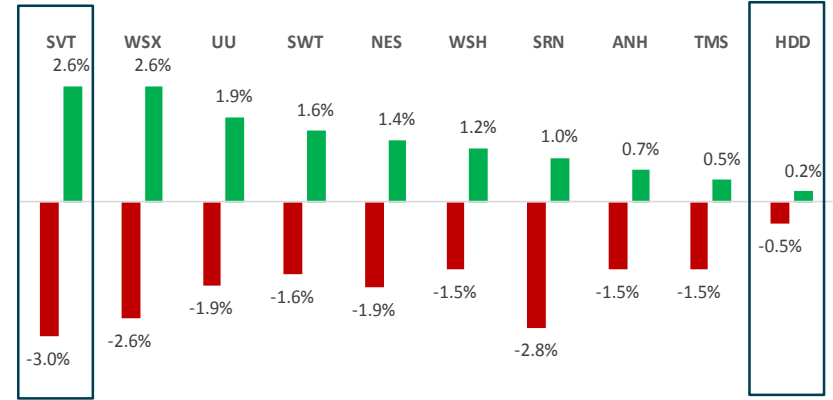
## Average combined customer bills

Real change

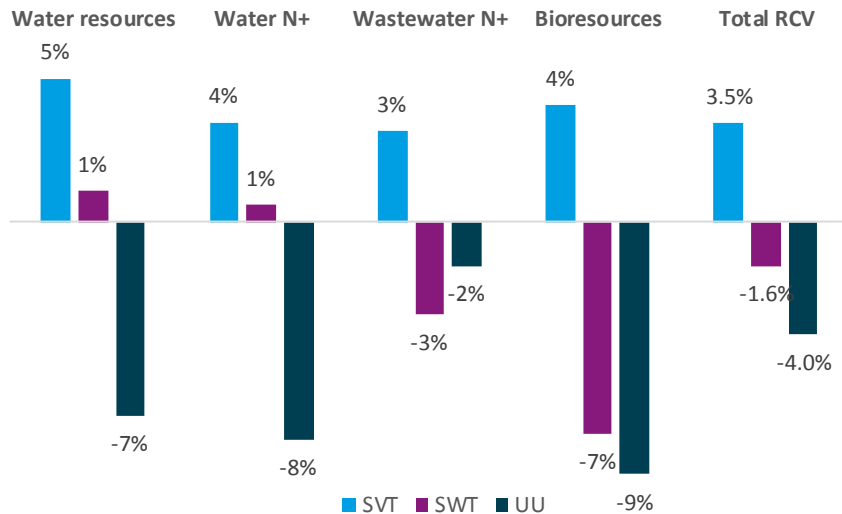


## Customer ODIs – P10 to P90 RoRE ranges

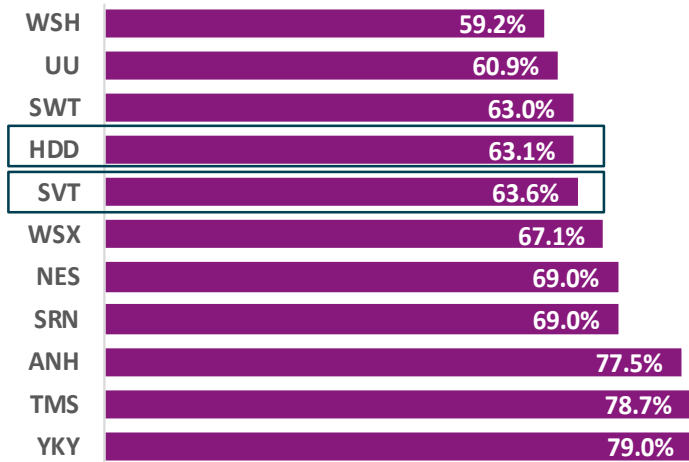
Excluding C-MEX and D-MEX



## Real RCV growth

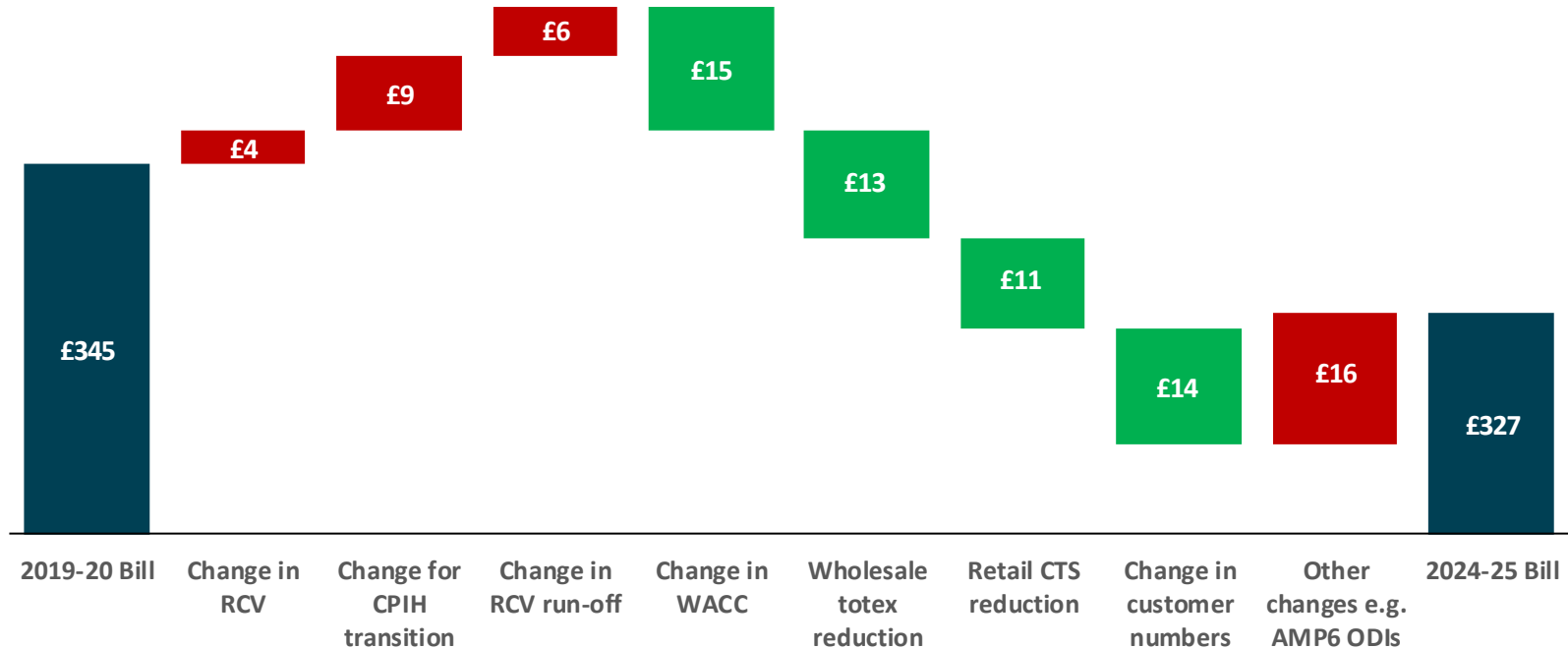


## Average gearing



# CUSTOMER BILLS

Customer bills will reduce by 5% in CPIH prices



## Change in WACC

- Bill reduction reflects WACC of 2.3%, versus 3.6% in AMP 6
- Based on notional financing costs of 4.4%

## Change for CPIH transition from 2020

- Supported by customers
- A smaller initial bill reduction but protects future bill profile

## Change in RCV run-off

- Changes in the natural rate of run-off
- Maintaining financeability and at least BBB+/Baa1 credit rating

## Wholesale totex and Retail cost-to-serve

- Reflects our stretching efficiency ambition
- Reinvesting £100m in AMP 6 to prepare for the challenge

# REVENUE SUMMARY

All figures in £m at 17/18 prices	2020-21	2021-22	2022-23	2023-24	2024-25
Pay as you go	679.2	697.6	691.9	683.6	688.8
Pension deficit repair contributions	9.8	9.8	9.8	9.8	9.8
RCV run-off	469.6	478.0	480.8	477.4	470.3
Return on RCV	253.4	257.2	262.6	267.8	271.3
Tax	17.3	16.7	16.7	16.9	18.6
Revenue legacy adjustments <sup>1</sup>	16.7	17.2	17.7	18.2	18.7
Re-profiling of revenue	(12.9)	(13.0)	(1.1)	16.5	10.3
<b>Total wholesale revenue requirement</b>	<b>1433.2</b>	<b>1463.6</b>	<b>1478.4</b>	<b>1490.2</b>	<b>1487.9</b>
Retail revenue	94.1	96.4	93.8	88.7	88.2
Grants & contributions	78.9	62.3	51.6	53.1	55.5
<b>Total appointee revenue</b>	<b>1606.1</b>	<b>1622.2</b>	<b>1623.8</b>	<b>1631.9</b>	<b>1631.5</b>

1. Includes revenue from AMP6 carry-over ODIs and other legacy adjustments.

# CUSTOMER ODIS

PC	Unit	ODI	Timing	Type
<b>ODIs where we intervened to resolve outliers</b>				
Persistent low pressure	per property per day	£464	In period	Revenue
Water supply interruptions	per minute	£1,081,045	In period	Revenue
Improvements in WFD criteria	ODI per point	£815,234	End of AMP	Revenue
Biodiversity (water & waste)	Hectare	£3,627	In period	Revenue
<b>ODIs incorporating the triangulate WTP results and findings of the Choices research</b>				
Pollution incidents (Cat 1-3)	per 10,000 km of waste network	£596,530	In period	Revenue
Internal sewer flooding	per 10,000 sewer connections	£22,602,484	In period	Revenue
Leakage	1 MI/day	£324,853	In period	Revenue
External sewer flooding	1 incident	£24,222	In period	Revenue
Public sewer flooding	1 incident	£24,528	In period	Revenue
Water quality complaints	1 complaint	£2,731	In period	Revenue
<b>ODI valuations identified directly through the Choices research</b>				
Sewer collapses	per 1,000 km of sewers	£982,785	In period	Revenue
Inspiring our customers to use water wisely	Per customer	£7.41	In period	Revenue
Sewer blockages	1 blockage	£11,166	In period	Revenue
Mains bursts	per 1000 km of mains	£561,861	In period	Revenue
<b>ODIs set directly from triangulated WTPs</b>				
Resilient supplies	% customers whose service can be restored in 24 hrs	£3,501,952	End of AMP	RCV
<b>ODIs set with reference to established ODI valuations</b>				
Resolution of low pressure complaints	per 1%	£75,122	In period	Revenue
Speed of response to visible leaks	per 1 day	£1,073,171	In period	Revenue
<b>ODIs based on marginal cost valuations</b>				
Reducing residential void properties	per void property brought into charge	£159	In period	Revenue
AIM – North Staffs sites	per megalitre	£1,204	In period	Revenue
AIM – Strategic Grid sites	per megalitre	£136	In period	Revenue
Protecting our schools from lead	per school	£4,491	End of AMP	Revenue

Note: All Customer ODIs are shown in 17/18 prices, post-tax.

# CUSTOMER ODIS

PC	Unit	ODI	Timing	Type
<b>ODIs utilising uprated PR14 values</b>				
Farming for Water	number of schemes	£1,157,119	End of AMP	Revenue
Treatment works compliance	per 1% non-compliance	£1,572,783	In period	Revenue
Collaborative flood resilience	per property or area	£34,361	End of AMP	Revenue
Satisfactory sludge use and disposal	per 1% non-compliance	£157,279	In period	Revenue
<b>ODIs with alternative valuation sources</b>				
Green communities	per £1m increase calculated in BEST evaluation tool	£500,000	In period	Revenue
Reducing business void and gap site supply points	per gap/void property brought into charge	£210	In period	Revenue
<b>Enhanced ODI rates that will apply for incremental super-stretch performance for PCs where we are UQ</b>				
Pollution incidents (Cat 1-3)	per 10,000 km of waste network	£894,795	In period	Revenue
Internal sewer flooding	per 10,000 sewer connections	£33,903,727	In period	Revenue
<b>ODIs for enhancement expenditure and/or uncertain expenditure requirements</b>				
Metering	per meter	£103	In period	Revenue
Security – reducing the risks to our sites	per surface water treatment works equivalent	£1,013,175	End of AMP	RCV
Increasing water supply capacity - penalty	per Ml/day	£659,855	End of AMP	RCV
Increasing water supply capacity – reward 1	per Ml/day	£1,400,000	End of AMP	RCV
Increasing water supply capacity – reward 2	per Ml/day	£750,000	End of AMP	RCV
Increasing water supply capacity – reward 3	per Ml/day	£1,000,000	End of AMP	RCV
Water trading	input	£40,000,000	End of AMP	RCV

Note: All Customer ODI rates are shown in 17/18 prices, post-tax.