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EDITED TRANSCRIPT

Half Year 2020 Severn Trent PLC Earnings Call

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PRESENTATION

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

Good morning, everyone, and welcome to the Severn Trent '19/'20 interim results. I'm Ms. Garfield, Chief Executive. I'm joined on stage by James Bowling, our CFO. And as has become tradition, we've got a few members of the management team. They're going to enjoy us later to answer some of the Q&A.

Now we've entered this year very much with the same approach that's looked at for the last 5 years, of AMP6, which is to make sure that our focus and our investments are in balance for all of our stakeholders. We genuinely believe that for a sustainable, successful company for long term that, that balanced approach to the stakeholders, whether it's investors or colleagues or customers or communities in which we serve, we feel that is the right approach. And we know that during the course of AMP6, we've signaled our intent, but our AMP7 plan, we believe, is the very embodiment of what a socially purposeful company feels and looks like. And of course, you're going to judge us based on actions, not just on words. And that's why recently, we contacted Ofwat to ask for a change in our license to operate. I wanted to, first, really crystallize that commitment for long-term decision-making thinking right in the heart of our license. It's also why, earlier in the year, we announced our commitment to the carbon triple pledge. We are going to have, by 2030, a 100% vehicles be electric, 100% of energy will be renewable and net 0 carbon emissions.

And with that introduction, let's zoom on and look at the first half year. And I'm pleased to share that we're on track to end AMP6 strongly. If I start with water, we had a really strong 6 months at the end of last year, gained some real momentum. And I'm pleased to share that's continued into the first 6 months of this year. If you look at water quality complaints, if you look at leakage or supply interruptions, we're seeing continued improvement performance on those 3 key measures.

On waste, we for the last few years have been busy beaver away on a whole range of environmental activities, improved 1,600 kilometers of river quality in our patch. And we're on track to complete that over the next few months. And it's the combined approach of these couple of areas, which gives us confidence around our guidance on ODIs of at least GBP 25 million for this year, that actually contributes to the GBP 177 million that will carry over from AMP6 to AMP7. And it's actually the fact that we're performing on a wider range of measures that gives us the belief that we'll be a net ODI winner in AMP7 as well.

Now this is also the year when our largest ever flagship project, the Birmingham Resilience project takes center stage. And I'm pleased to share, it's on time and to budget. We've learned lots of lessons on a scheme of this size. The experience that we've gained will be invaluable as we carry that over into AMP7 and look to invest wisely on over GBP 6 billion investment pot.

Now at the same time as creating sustainable operations for the future, we've also, if you've had a chance to look at all of the stands



earlier, been busy beavering away in the finance team to try and get a sustainable financing for the future as well.

I wouldn't steal any of James' thunder, so with that, I'm going to hand over to the man himself.

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

Thank you, Liv, and good morning, everyone. I'm pleased to report a good set of financial results today. So let's now turn to the highlights. Our group PBIT of GBP 286 million reflects continued tight cost control in our regulated business, but also increased investment in our infrastructure and a conscious deferral of customer ODIs that benefit AMP7 and smooth customer bills, and we achieved good growth in our nonregulated operating businesses, while recognizing that property profits are lower compared to last year's notable gains. Our focus on driving cost efficiency and innovation continued this half, and we're on track to exit AMP6 with a regulated cost base around 9% lower in real terms from 5 years ago.

Our effective interest rate is now 3.7%, a reduction of 170 basis points since the start of the AMP. And today, we're launching our sustainable finance framework, strengthening the links between the debt we raise and the commitments we make for the environment and wider society.

Our net pension deficit has continued to fall to GBP 391 million, thanks to strong asset performance, a successful hedging strategy and a sustainable schedule of contributions. And I'm pleased to announce that we've agreed our 2019 valuation with the trustee, which I'll expand on shortly. We're proud to have been accredited with the fair tax mark this month, which recognizes our commitment to paying the right amount of tax at the right time and applying the gold standard of tax transparency. And finally, we'll be paying an interim dividend of 40p per share in line with our policy.

So let's now turn to our Regulated Water and Waste Water performance. Regulated Water and Waste Water turnover grew by 1.6%, following GBP 24 million of RPI-linked tariff increases across both Severn Trent Water and Hafren Dyfrdwy. This was offset by our decision to defer all year 3 customer ODI awards into AMP7 with just the penalty element in this year's revenue, taking the total amount of revenue deferred to GBP 177 million.

Let's now turn to PBIT. Regulated Water and Waste Water PBIT for the first half of the year was GBP 260 million, a decrease of GBP 8 million. The fall, of course, reflects our decision to defer customer ODI rewards, but also the increased investment in IRE to put us in great shape operationally for the next 5 years. We see the benefits of our in-sourcing strategy across net labor and hired and contracted services. But as expected, this was offset by higher energy pass-through costs and increased chemical prices.

On customer debt, we've continued to see good cash collection on recent debt, but our performance on older items hasn't been as strong. So we've increased our provision against these receivables. We've refocused our debt recovery strategy for these older categories and expect to start seeing the benefit to new activities in the second half. And while we're firm on those who choose not to pay, we work hard to help those who struggle with their bills, and I'm pleased we'll be able to support as many as 200,000 of our most vulnerable customers annually by 2025.

So turning now to our Business Services division. Our PBIT comparatives have, of course, been impacted by the large Teal Close property sale last year, meaning our 10-year commitment of GBP 100 million from property sales by 2027 gives Business Services a lumpy earnings profile. This half, we've delivered GBP 6 million of property profits, which takes us 1/3 of the way through that commitment, and we continue to guide between GBP 5 million and GBP 10 million for the full year. Excluding Property Development, PBIT is up 25% to GBP 24 million for the half year. We've improved the efficiency of our Operating Services contracts, nearly doubling profit margins compared to the first half of last year. And we've also benefited from the rapid integration and strong performance of Agrivert in our nonregulated Green Power business following its purchase last November. And when combined with Bioresources, our total energy generation for the first half was up 27% to 242-gigawatt hours. That's the equivalent of 51% of our energy needs, helping us towards our triple carbon pledge by 2030.

So let's turn now to our financing performance. Our effective interest rate is down a further 20 basis points from the year-end to 3.7%. This means we continue to guide you to only a marginally higher interest charge for the full year despite this year's capital investment.

Our flexible financing strategy has enabled a 170 basis point reduction since the start of AMP6, the largest fall among our peers. And as a result, we expect to be well below the draft embedded debt rate PR19.

We're exiting AMP6 with a robust balance sheet and a lower risk, diversified debt portfolio. We now have a good balance of fixed, floating and index-linked debt, having reduced our proportion of floating rate debt 15%. We've also steadily increased our exposure to CPI, with around 1/3 of our index-linked debt now CPI-based. All of this gives us a good platform to start AMP7. We have GBP 3 billion of debt to raise across the 5 years, including refinancing some higher rate debt, particularly in the latter half of the AMP. And I'm pleased to announce today the launch of our sustainable finance framework, which links our future financing strategy with the delivery of our bold commitments to the environment and wider society. This independently assured framework will enable us to raise sustainable finance in a range of formats. Eligible projects will be aligned to our 9 business plan outcomes as well as the relevant UN Sustainable Development Goals, and we'll report each year on the environmental and social impacts of these investments.

Let's turn now to cash flows. The cash generated from operations was up GBP 7 million to GBP 497 million this year. And as guided, we've delivered a big 6 months of capital investment, up GBP 34 million on last year to GBP 374 million, as we close out our AMP6 schemes. This takes our total AMP6 capital expenditure to around GBP 3 billion, contributing to a real RCV growth of 9% since the beginning of the AMP. You can see from the chart, the sheer scale and variety of these projects, leaving resilience programs, network upgrades, water quality schemes and environmental improvements. The biggest of these, of course, is the Birmingham Resilience scheme, which Liv will touch on later. After accounting for tax, interest, dividends and other items, overall net debt increased by GBP 123 million over the period to GBP 5.96 billion.

So let's turn now to pensions. Now as you know, our net deficit peaked at over GBP 700 million in 2016. And since then, we've steadily and consistently reduced it back down to below GBP 400 million through strong asset performance, an effective hedging strategy and sustainable contributions. And this month, we finalized the 2019 valuation for our Severn Trent schemes with the trustee, and I was pleased to agree a sensible package of repair payments, including existing asset-backed financing commitments and a new schedule of additional contributions that run to 2027. These mean we'll be funding an average of GBP 60 million a year through AMP7, which is broadly in line with the GBP 56 million that we assumed in our PR19 submission. And of course, these contributions fall away if the scheme moves into surface.

So to wrap up, performance in the first half has been in line with our expectations with a PBIT of GBP 286 million, an EPS of 69p. As a result, our technical guidance remains unchanged. And looking back over the AMP, we've worked hard to put ourselves in a strong finishing position, delivering a 170 basis point reduction in our effective interest rates and successfully reducing operating costs by 9% in real terms, while absorbing considerable cost pressures and providing improved services to our customers. Having delivered around GBP 3 billion of capital investment, increasing our RCV in real terms by 9%, our balance sheet remains robust with gearing well within our target range. We have a low-risk, diversified financing portfolio and a sustainable finance framework under which we can implement our treasury strategy for AMP7.

And with that, I'll hand you back to Liv.

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

Thank you, James.

Now I know what you're thinking when you look at the slide, you're like, wow, that is one busy slide. And I actually love the fact that it is busy. I think it brings to life exactly how busy it has felt in the last 5 years in Severn Trent.

So when I reflect on AMP6, there are 4 things that kind of come to mind. The first is customer service improvements. We've made considerable progress on many of the key measures that truly count to customers. And often, we've been amongst the sector leaders on the improvement step change in those measures. The second thing, of course, is our cumulative RoRE outperformance of 9.1%. But importantly, I'd indicate to everyone that it's against all 3 levers that we've landed that RoRE outperformance, which we think will be genuinely pertinent in AMP7.

We've invested every pound wisely. We've seen that come through to improved ODI performance, improved asset resilience and a step change in some of those ops areas. We've also, we think, been quite clever, taking areas like the environment to maybe energy generation, thinking about that dual benefit, how do we land reduced costs going forward but, actually, a fantastic platform for sustainable business of the future? And finally, we've done all of this whilst doing the right thing. We've helped literally tens of thousands of customers each and every year that can't afford to pay their bills, and we've created a genuinely special culture internally of a really inclusive nature.

Let's jump on and talk about water, which has seen a considerable step change over the course of the last, yes, 12 months. We kept that momentum going from the last 6 months of last year and transferred it into this year. And on the 3 most pertinent measures that are relevant now, but equally relevant in AMP7, you can see some real continued improvements. So on water quality complaints, we're delivering a double-digit percentage improvement this year. And over the AMP6 period, we're confident of customers experiencing a quarter reduction in water quality complaints. On leakage, we're on track to deliver our target for 8 out of 9 years. But if you look at the AMP as a total, you'll see a 6% leakage improvement, and that positions us strongly for the 15% improvement that we've signed up to as part of AMP7. That's actually the second highest improvement of any company in the sector of this AMP. And then supply interruptions. We delivered last year a 60% improvement. This year, we're confident of a 40% improvement, further building on that. And of course, you can't legislate for any individual moment or any particular pipe, but we do believe that across the piece, we've made a real set of progress in terms of the resilience on our organizational structure around it.

I'd like to jump on now and do a bit of a deep dive on that particular area. Now for those of you in the room, you may have the chance to talk to the team that has delivered this step change. When we took a call to really cement our performance improvement to invest in 2 brand-new teams that we think will put us in a strong position for the future. The first team is all around, and it's against the strategy to contextualize it around the fact that we want to prevent issues, we then want to restore customers and then we want to repair the pipe. The basis being that actually, if we have restored the customers, it gives ourselves longer to then manage the pipe repair, which can, of course, be highly complex. So the first of the teams we've invested in is exactly that, it is the Trunk Main Repair team. And this is a team of guys and girls with fantastically brilliant skills, highly technical, really able to kind of jump on an issue with those skills experienced in our network and make a significant change as a result of that. On individual cases, they've been able to deliver these fixes 90% cheaper than our previous outsourced model. And then we've got our emergency Network Response team. And for this team, we've invested GBP 9 million in equipment and resource, and we're confident of a 2-year payback, both in the point of improved ODIs, but also reduced cost base as we manage less incidents, for those smaller number of incidents much, much better without the level of cost that can go with an emergency situation. We feel that having this level of energy in our organization, at a moment's notice, these skills ready to go and help will give us a much more resilient operation for the future and gives us a real confidence as we head from this AMP into next.

But let me now contextualize the overall operational excellence that we're striving to achieve. We asked all of our customers, as part of AMP7, "What do you really want? What does success look like for you?" And they kind of said to us, there's 3 areas. There's water, there's waste and there's the environment. And so we listened carefully, and what we committed to in our AMP7 plan is a range of measures spread across those 3 areas. And if I take each of those in turn, it will hopefully bring it to life. So on Waste first, I think it's fair to say we've had a really strong start. We invested very cleverly upfront with some significant investment at the start of the AMP, we targeted our interventions on the parts of the network we thought would give us the best results. And what that led to was literally sector-leading ODI performance on Waste, but also a reduced cost base, and we carry that outperformance very strongly from AMP6 to AMP7 as the sector leader on Waste. On Water, it's probably fair to say we didn't have as strong a start. It's taken us a bit longer to find our energy, to get ourselves really in the right shape, to be on the right momentum to track into the next AMP. We feel like we've really found that level of performance, and we're heading in the right direction. We've invested strongly again in some good areas. What we've had to do as well there was embracing new ways of working, the new teams we talked about, but also considerable innovations from around the world to get ourselves on the right trajectory. And we do feel as though it's coming together at the right moment for that transition into much harder, challenging targets in AMP7.

And then we move to environment, the third area. So often in this work that you just don't see us doing on the environment, we spent a lot of time on stakeholder management. We spend time mulling over what the long-term plans are in this space. We look for innovations around the world. And actually, it's trickier sometimes to bring that to life in moments like this because it's not the immediately 24/7 measures that you're used to discussing on a daily basis.



I want to use 3 case studies to give a sense of what it is that we're doing differently to really make a step change in this environmental area for customers and the company. Now one of those, I talked about last year. It's the work we've done with farmers, whereby we were able to educate them on how they treat their land, which actually improves the water quality that we draw from the rivers. It delivered us GBP 11 million ODI, but actually real goodness for our region is this new relationship and working model.

The second example is the Water Framework Directive. We've been spending hundreds of millions of pounds, again, behind the scenes for the last few years, improving the river quality on our patch, 1,600 kilometers of river quality in our patch. And next AMP, we're committed to 2,100 kilometers, a real sense of what we can do with different thoughts. And then, I guess, we've been trying to look at, well, what are the new challenges that arrived? Population growth, for example, an ever-reducing cost base, but also increasing constraints around what we can discharge into rivers. And that's when we began to look around the world for new ideas. And we found a sustainable sewage idea, which we brought back, implemented. And of course, these contribute towards the ODI guidance given this year. But more importantly, we know this is hugely motivating internally to be so heavily invested in the environment. We so carefully focused on what the future looks like and have such a strong story and such a strong plan for the long term. But we think it's a huge energizer internally as well as absolutely the right thing to do within our region.

Jumping on that, I'd like to want to talk about our largest capital scheme, which we're, I guess, have been busy beavering away for the last period of time on. It's a GBP 300 million scheme, and it's a feat of engineering. To bring it to life in numbers, we're talking about 26 kilometers of pipe work laid, a brand-new water treatment work actually built. And the number of customers affected by this is considerable. 1.2 million customers in Birmingham, drinking slightly different water, as we begin to play around with the sources of water that go into Birmingham. We set ourselves a challenge, not only to deliver the engineering parts to time and to budget, which we're on track to achieve, but actually to do it with a massive education so that as that water did change the taste, that customers wouldn't complain about it and said they'd understand it and acknowledge that this is part of ongoing commitment of resilience for the future, and we've achieved that without a single water quality customer complaint as a result of this project so far, which is great.

But we also did ourselves an even higher ambition. Wouldn't it be amazing if we could create a behavioral legacy as well as an engineering one? And so we chose to educate every primary school child in Birmingham for a whole range of media, including our very own clever book to try and make sure that children would understand more about water scarcity for the future, as we look towards some of these long-term topics, such as climate change.

And with that, I want to go now to talk about our fabulous people. So you know that I'm passionate about the fact that for an organization to be truly successful for the long term, it is all about culture. It's about creating the right atmosphere for every single person to come in every single day and do their very best work. And so we're super proud just to receive our engagement results this year, our annual engagement results, which places us in the top 5% of energy and utility companies globally, with clear, clear blue water between ourselves and U.K. benchmarks, which feels fantastic. We want every single colleague to have a very good day, every single day. And that's why we love the fact that 2,000 of our colleagues chose to get themselves trained up in mental health awareness, making sure that they can look out for maybe that first sign of someone that is struggling and have that chat, that time to talk and make sure that they intervene early to help that person out.

We also believe that we can do some really amazing things in our region, help out people that maybe would never have had a chance any other way, whether it's the employability scheme or whether it's the social mobility work that we've been leading for ourselves and also for the sector. Again, we think that it's a real opportunity for us to genuinely make a difference. When I look at it, I think it's about alignment. It's about top to bottom of the organization. Do we all feel like we're doing the same things? Heading the right way collectively? That's the culture we want to create. And our bonus scheme is set up against that alignment to try and create that sense of we're all in it together. But actually, the stat that I think brings to life what it feels like a Severn Trent is the fact that 70% of our colleagues choose to invest their own money in the Sharesave Scheme. They choose to really create and invest the future for themselves and the company at the same time, I think that is a really amazing opportunity for us for the future.

I want to summarize now before we just move onto our Q&A session. So I know that, like myself, you're all eagerly awaiting the 16th of December, we're all desperate to see what the final determination actually contains. I suppose I can't talk about that today, it's a matter



of weeks away. Instead what I can share is the bits that are in our control. What is it that we're doing, that we're focused on, making sure that we're in the right shape, whatever arrives on the 16th of December. When I look back at 5 years ago, I think there was some quite good parallels that show how far we've moved on the areas that are in our control. Five years ago, we were a slow tracked company. We had a management team in transition, we had a massive improvement agenda that we have to deliver, but we hadn't yet actually achieved. If we roll forward to where we are now, we've moved ourselves from a mid-table financing position to a strong upper quartile performance.

On ODIs, we've taken the nascent ODI regime and really shone at it, carrying over GBP 177 million of ODIs from AMP6 to AMP7, and we're certainly the sector leaders on ODIs. We think about totex. We've been really able to manage our cost base well. We've got a track record now, as a management team, of delivering good efficiencies at good cost savings, and that puts us on the right trajectory into AMP7, it means we're confident of doing well, managing within the budgets that we receive. And then, of course, I guess if you look at our non-reg business, it was a little bit diverse. We've been able to rationalize that back down. We've been able to get ourselves in the course of that. We've doubled the energy that we generate, which is key for the future as well as being able to monetize the excess land that we had as part of our organization. And as a management team, we're definitely 5 years older. We like to think we're 5-years wiser. And we're massively energized as a whole organization primed to deliver for the imminent arrival of AMP7.

So with that, I'd like to do a shameless plug for our Capital Markets Day on the 4th of March, I've literally -- have no shame at all. So we are passionately excited about our ESG Capital Markets Day. I'm hoping it's in all of your diaries. If not, it should be. It's going to be a corker. And we genuinely believe that we've got a differentiating story to tell in this space. We also believe that actually, if you want to be involved in any company, we want our investors to be proud to be associated with us. But this is part of the future. It's kind of like, this is the core basis on which management teams will be judged with delivering to the future in this area. And we're looking forward to sharing with you all of the range of activities, we've been working on and planned for the future on the 4th of March in Coventry. So please do add into your diary.

With that, I'm going to ask 3 members of my team to come and join us on stage, we're slightly light today, Sarah's at the Lloyd's Annual Strategy Day, and Andy's got a personal clash. So nonetheless, we've got James, Tony and Helen, who are going to shine and come on and help James on out with any tricky questions.

QUESTIONS AND ANSWERS

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

Brilliant. Thank you, James. No one wanted to go first, so you gave in first.

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

James Brand from Deutsche Bank. Neither of the questions are actually related to the results, but I'll ask them anyway because I might be interested in your answers. The first is, this year -- there's a lot of focus this year on climate change and the U.K. passed the net 0 emissions target for 2015 in July into law. And there's a lot of talk from gas companies -- or it's gas pipeline companies around green gases and biomethane. And I was just wondering from your perspective, how you can tie into that. And the obvious one is anaerobic digestion. Just wondering whether -- if the right incentives were put in place around that, whether that -- there might be -- what the growth opportunities in that technology might look like. Second question is just kind of looking at the review. And I know you're obviously going to be very cautious in commenting on yourselves and M&A, but I'd be interested in -- once we get the other side of the review, some companies are going to have very tough regulatory settlements. And interested in whether you thought that might birth some M&A in the sector. And obviously, for you specifically, you have got involved in more water company M&A in the past with Dee Valley. Probably you don't want to comment. If you are more open commenting, whether you might fit into that.

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

I guess you're right, we won't get drawn on M&A speculation. It's that kind of like hypothetical, futuristic stuff -- isn't it? I think it's almost like Christmas Day on the final determination for the chief exec, because you get a chance to trawl through your determination but also everybody else's. So we'll definitely be looking at what the regulators has outlined for the sector, but too early really to comment. But we'll look forward in January to sharing a few thoughts on what we think the impact of the sector is as well as for ourselves personally.



I know James is leaning towards absolutely desperate to answer the biomethane question.

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

It's -- I think it's very exciting. We're one of the -- we are one of the biggest generators of green gas in the country. And certainly, with the acquisition of Agrivert, it's turning into a really important part of our business. We're really excited about potentially the move to curbside collection of food waste. We think that will be a big game changer and will not only be good to Severn Trent, but I think will be good for broader society in terms of really focusing people on the energy that we throw away today, could be the energy that we power our homes with in the future. So we're really excited about that.

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

Lakis, yes.

Lakis Athanasiou *Agency Partners - Analyst*

Lakis Athanasiou, Agency. My question's going to be not as broad as James. Three things, first, your overhead. Can we take the double half year result as GBP 8 million as a good run rate going forward because it has been higher in the past. And we could tease it out, so GBP 8 million per annum? Second, Water Plus. Can you give an idea of where you see the profile on earnings is going to be? Where do you think we can come back down to breakeven? I mean it wasn't a surprise today because we had the results from UU yesterday, but can you give us an idea on that? And third, on pension assets. The surprise for me today was how well you did on deficit coming down. It all seems to be on the asset side. So if you can give a bit of color on how you -- and that just isn't derived from the basic asset performance, you're doing some stuff on top of that derivative swaps, whatever. So can you give some color on how you're managing the assets, what you're overlaying, what the risks are and what the links are to movements in gilts and iBoxx and whatever? And to kind of move on from the pension -- and just add on to the pension assets, your GBP 400 million IFRS 19 (sic) [IAS 19] deficit. Probably, you have to comment on -- from that GBP 1 billion actuarial doesn't quite square with a GBP 60 million per annum deficit contribution.

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

Good. Four good questions there. So we'll do them in order. So, James, you [want to answer first]?

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

Yes. So I think we've guided for the full year unchanged. So we do typically see a kind of a 50-50 split. So it's probably not a bad assumption to assume that.

Is it going to be ongoing?

Lakis Athanasiou *Agency Partners - Analyst*

Ongoing, yes.

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

What, in terms of 50-50 split? Or...

Lakis Athanasiou *Agency Partners - Analyst*

Everything.

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

I've given you guidance for the year. I'm not going to go out into AMP7, clearly. But we think that the...

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

What's your question, Lakis? Is your question, is the overheads going to continue at the current level? And I think what we're saying is we're not going to give you guidance for next year on subcomponents, but you can imagine that we're focused on costs going into AMP7. That's what we're doing is focusing on cost.

Number 2 was Water Plus. So on Water Plus, I think as -- certainly UU covered yesterday, we've -- it's been -- the market has been a tricky market to set up, and we've had to work our way through a chunk of activities. It feels like this year, this first half of the year, in particular, has been the big moment where we've been able to go through some of the issues that have been there for a while and actually make progress against them. In April, don't forget, you've got the margin injection that comes in that is preset by Ofwat already. That's worth quite a few million pounds. That definitely helps. So I think next year will be a considerably different year to this year, it's fair to say.

On pensions, James...

James Bowling Severn Trent Plc - CFO & Executive Director

Yes. Well, thank you for kind of recognizing that we've -- we're doing an okay job. And I know that you've got a proper master class yesterday on pension, so I won't be able to repeat that. But look -- so I think the 3 takeaways we've -- we are bringing it down quite substantially. And we've been doing that through a combination of -- on the asset side, really thinking about the assets that we've invested in. I think we have a good hedged position, but it's -- we also have got some opportunity to outperform in the form of some investments on the equity side that have done well. And we've also got a good relationship with the trustee, which is being reflected by the fact that we've 6 months earlier agreed our contributions going forwards for the 2019 valuation. And I think when you look at those contributions, they're very close to what we've put in our plan. So hopefully, no surprises for you in terms of the overall amounts that we've got there. But yes, I've been pleased with the progress we've made. It's -- it is something that I think is -- it's something that we manage over a decent length of time. And I think we've done a really good job.

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

And on the question on the GBP 1 billion actuarial.

James Bowling Severn Trent Plc - CFO & Executive Director

It's not a GBP 1 billion. No. I can talk to you later about it.

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

Brilliant. So let's get Dominic first and we'll get to Nigel after. That works.

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

This is Dominic Nash, Barclays. A couple of questions for me, please. First one's on bad debt. I see that the bad debt levels have also risen quite high in this half. I think you're saying that you're going to put measures in place to sort of reverse that in half 2. Can you just give some color as to why it's gone up? And what you're physically going to do to reduce that? And secondly, on your leakage levels. You say you're losing by 6%. And as I'm looking at your graph, I think that's 6% in 8 years. Is a 15% reduction from here really be economically feasible, which is a slightly different question to then? Is it actually achievable as well?

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

Yes. Well I'll solve the last one really easily. So we've got it built into a plan, and we're confident that it's fully locked in. We've got really good plans around it, and we will deliver the 15% reductions. So we feel good about that. We've known about it for a while, we chose that number. I know others have given that number. We chose that number as being what we would have thought was right for our customers going forward. And it was a really good stand. I'd recommend anybody who's got a leakage or geek desire to look at. Again, go and have a little chat at the stands afterwards because you won't get a better insight into why we're confident, unless you talk to Adam, who's one of the senior members of leakage team. And he can for bore you for a day about the plans in that place. So that would be that.

I guess in terms of bad debt, I mean, if you don't remember, we're still upper quartile. So there's more that we can do, and that's what we say. I'll get James add a bit of color as to what else we're doing. But we are upper quartile, still at the current levels of performance. It's just that we want to get back to our previously really leading performance.

James Bowling Severn Trent Plc - CFO & Executive Director

Yes. So we're collecting more cash than ever. It's just a mix of that cash. We are getting better and better at collecting debt earlier. So the younger debt is doing really well, and we are absolutely, let's say, probably sector leading in terms of the pace at which we're doing that. And we're doing that through simple things, improving the level of direct debit penetration. We've also introduced 2 or 3 new ways that people can pay, though it's easier than ever to pay your bill. It's really on that older stuff. And we're talking about the debt that's kind of 6 years old when you're really getting towards the end of that journey. We're just seeing a slight tick up in the level of debt that's getting trickier to collect. Now we've got a great plan that's going to kick in, in what we've already started, but I should start to see some benefit from that in the second half. It's about credit sharing, credit data sharing. We're getting better at that. There's more opportunity there. It will be improving the channels to pay, which I think will help make it easier for people. We'll be increasing our field visits in a sensitive way. And I think the other thing is that when you look at AMP7, we've got lots more opportunity to help those who struggle to pay their bills, and that will undoubtedly help in the long term.

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

Nigel?

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

Nigel Hawkins, Hardman Investment Research. Two straightforward issues for me. First, on pensions, you will have seen the famous thermometer that United Utilities presented at yesterday's meeting. Intuitively, do you agree with the proposition of theirs that their GBP 699 million should be added back essentially to their figures? And by definition, therefore, your GBP 391 million deficit should be reduced. You agree that you have a proper comparison between the 2, that would be correct? I also missed what you said about the GBP 1 billion, where that Lakis was trying to persuade you that on -- UU's numbers. You have a deficit of close to GBP 1 billion on a self-sufficiency basis.

Unidentified Company Representative

That's what Lakis said.

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

I think that's what's Lakis' second question, James is around later as well.

Lakis Athanasiou Agency Partners - Analyst

[Smart man.]

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

I don't...

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

Would you -- so I missed you -- did -- you denied that, did you?

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

On the first part, we're not going to get involved in cross comparisons of the organizations. We're going to plow our own path, so it's for you guys to judge the sector. Our job is to deliver a brilliant job for Severn Trent customers and for Severn Trent investors. So probably best...

James Bowling Severn Trent Plc - CFO & Executive Director

I've laid out the contributions that we're going to be making over the next few years. And I think you're more than capable of working out...

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

Rest your pensions case on that. Now secondly, I have a slightly left wing -- left field. You may or may not have seen today that the CAA's pricing review for [net] is going to the CMA, which could open a whole can of worms on the cost of capital for a regulated business. I'm



particularly interested in timing arrangements, if you were to accept hypothetically what Ofwat offers you on 16th of December. What's the latest period if you're accepting it? On the basis of it's almost like -- it's almost certain, I would think, a few companies, Thames and Southern, to the fore are likely to end up at the CMA. I'm concerned that you and others might accept on the current WACC of 2.4%, thereabouts, and they may get changed or indeed the CAA may have to do changes for [nets] on the WACC upwards, bearing in mind that [net's] figure looks a bit generous compared with water.

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

So I tend to think price estimates are in the rounds. That's one of the things we've said consistently for the last couple of years. It's to not over-obsess over one number. But look in the rounds, if the assessment is fair. So that's, I guess, the feedback I've consistently given. In terms of specifics on this question, I think, Tony, it's 6 weeks, isn't it, from when the FD's made?

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

Yes, 6 weeks. And obviously, we'd have to look at the timing of the [net] thing in that context. But as Liv said, it's the -- we'd be looking at this as the overall package that we've been given. So I wouldn't want to speculate on what might come out of that process.

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

Yes. So -- it will concern me, just say, hypothetically, if we say a tender or something managed to get a WACC of 2.8% once down the line, it doesn't necessarily mean it would be backdated to those who accepted in 6 weeks' time?

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

No. Correct. The way price reviews work is you accept your package in the 6 weeks hosting off of it in the round, and choose if you think that's the right answer for your investment to customers or not. That's the judgment. I guess Christmas Day arrives on the 15 -- on the 16th of December, we'll read to it and then look forward to talking to you in January about our reflections around that.

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

And just one final question for me. United Utilities is also very open about their leakage, this is after a long diatribe. But they did actually confirm that their leakage figure currently is 25% and Ofwat one's 20%. Your leakage figure was down 6% during AMP6. I'm just wondering what your overall leakage figure is projected to be going forward and what Ofwat wants. Do they want 20% from you as well?

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

No. They want 15% reduction from us.

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

And what's your current water leakage figure in percentage terms then?

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

In percentage terms, I think it's about 22.5% or something, I think, is the exact -- I can't remember the exact percentage, but it's like 22.5%, something like it. It's...

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

Is it up from you -- on the...

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

There's a useful chart. If you want to get independent data, I think, rather than us tell us -- tell you to cost compare, Ofwat publishes it. And actually, they said they just published recently the service report for last year. And we came out, of course, our own leakage in terms of absolute numbers. So worth taking a look at that.

Very good. Oh, Chris, just behind you.

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

Chris Laybutt, JPMorgan. Two questions, please. Just firstly, on the delivery of at least GBP 177 million of ODIs into the next AMP. What are the variables? And what might drive that higher? It's quite useful. And also, just on the pensions, is that inflating with CPI or RPI in terms of the deficit repair? And how much of that can you pass-through to consumers, the duration, the agreement you've got?

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

Great. James will answer.

James Bowling Severn Trent Plc - CFO & Executive Director

So the contribution -- the additional contributions you'll see in the RNS, they increased by CPI, not RPI, so CPI. And what was the last bit?

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

How much can you pass-through to consumers and...

James Bowling Severn Trent Plc - CFO & Executive Director

The amount that we can pass-through is about GBP 10 million a year through AMP7.

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

And AMP8?

James Bowling Severn Trent Plc - CFO & Executive Director

No. Ran out. It all -- it finishes for us at the end of AMP7. Not sure about other companies. But ours hard stop at AMP7.

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

There's no increase in your pass-through 7, I would've thought...

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

No. That's the set deal, deal was done a lifetime ago. And it's -- we've built it into our FD, it's no new news. That's exactly what we've known. On the, at least, GBP 177 million, you still got winter to go. So I guess that's one thing that is a flex as winter brings with it more weather, more change. So there's a -- yes, there's a number of in live measures this year that we still need to work through. We've got some more work to do on the WFD areas. I think I haven't actually -- just to share a couple of thoughts on what the WFD schemes are to bring it to life, but there's more work on those, that's one area. And the other area, I guess, is worth talking to, I guess, is some of the water measures that James can bring to light. So you've got quite a few moving parts. You've got 41 ODIs, and they all do play through right at the end of the year. So 4 or 5 close off in Christmas, but the rest goes through to the end of March, which is why it's the at least still figure. And in terms of what WFD just to give, Chris -- because that's the largest ODI up...

Helen Miles Severn Trent Plc - Capital Delivery & Commercial Director

Yes. It's one of the largest end of AMP ODIs, and we've got about over 100 sites, about 105 sites where we've got WFD work going on. And we have a combination of specific points, ODI points that related to sites and then combination points when we affect the catchment area. So it's quite a complicated picture when you look at it, but we're going really well on those. And we've invested in new technology, like [Narita plants], which we've got up and running, absolutely fantastic. We've got those at 3 of our sites. We've got solutions which don't require any power for smaller sites. So -- which are going to improve our operating costs. So we've got a whole range of solutions to meet the ODI. And we're really confident about where we are. And we've just got finished off over the next 3 or 4 months, and we'll be there.

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

Very good. James just commented on a couple of schemes -- a couple of the notes that run right through at the end of the year.

James Jesic Severn Trent Plc - Managing Director of Production

Yes. So Liv shared earlier on, we've seen real improvements in a number of areas around things like, what's quality say, 25% improvement. We're on track to deliver a significant chunk of improvement again on supply interruptions this year. One of the things that we're doing across the whole water space and in the waste area as well, is really taking a view right from catchment, all the way through to customers tap and then back again. Well, that's enabled us to do -- for instance, Liv referred to the catchment investments that we've been doing. We've been able to really work hard with farmers to mitigate around GBP 40 million worth of investment needed in some of our treatment works by preventing issues and terminating water in the first place, rather than having to treat them at a later date. And we're taking that approach across broad areas of our catchment piece. Liv also referred to the prevent-restore-repair approach that we're taking across the water network. What that's enabled us to do is, first of all, look at how we prevent issues occurring in the first place by really looking at things like rapid pressure changes across our network, which could contribute to failure of the network itself. And we're addressing those and really calming the network and making sure that we don't see those issues. On top of that, as Liv said, we're getting a real better view of how the network's performing on a day-to-day basis. We've actually installed around 30,000 pressure loggers across our network, which gives us great insight. We've seen improved visualization across network control. And then on top of that, we're responding better when we do have an issue. So again, without repeating things too much, we've seen the Trunk Main Repair team, which is doing an incredible job, the level of complexity. They have complex work, that team can do. The efficiency in which they're delivering and the technical in-house capability that we're growing from that is tremendous. And we're also seeing the -- obviously, the tanker response team as well, which are really able to almost be a blue light service for us and make sure that we do get customer supplies back on as quickly as possible. And I think that is going to continue for the rest of this year, only to AMP7 as well.

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

Very good. Oh, there we go -- so there we go, we've got a mic coming over right now.

Martin C. Young Investec Bank plc, Research Division - Equities Analyst of Utilities

It's Martin Young at Investec. A couple of questions. First, continuing Chris' question on the ODIs. How much scope have you got in respect of the phasing of the cash realization of those in AMP7? And what are the considerations that come into play there and the interaction, perhaps, with your dividend policy for AMP7? And then secondly, on politics, if we put Mr. Corbyn's ideological ownership standpoint to one side, what do you feel could be the opportunities from the greater shift towards water quality, environment, et cetera, et cetera, in AMP7 that -- or post the general election that could play out in AMP7 and beyond?

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

Well -- I mean on the ODIs, the key consideration is around smoothing customers' bills. So that's how we will use the ODIs. It's clear there will be a step down as a result of the changes that will come out of AMP7, and we have this shield with a GBP 177 million that we will be able to use over those years, in the right years to create a very smooth bill profile. So that's how we'll use it. And that's -- we'll wait until what comes out of the 16th of December, and then we'll make formal commitments thereafter. That's the first thing.

In terms of politics, I think it's fascinating when we look at all the manifestos, I guess, that's touted or posted in the press over the last few days. I think of how strong the environment is in each of those, and we think that is great as a company that has been heavily investing in the environment for long term. I think we think it's great that this is going to be an even more live conversation for the future. So I think we'll likely see, you know, whichever government is empowered, they're going to want to invest strongly in the environment. I think we think the triple pledge that we've made is something that others would have to do. But we've done actually voluntarily in a good cost manner. It might become a negative cost drag to lots of other companies. Actually, we self-generate over 50% of our energy needs already, have plans to continue that. And have already focused on a talent set. It's entire solutions and entire works, where there is no carbon cost at all. But I think we're well placed for what is the next wave of business in any fiscal situation.

You can't hit him, Martin, over the head with the mic.

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

You had your opportunity there. Yes, it's Dominic Nash again from Barclays. Just a couple of quick ones. You've got a CPI, RPI, a hedge put in place of swap. Would you mind just letting us know what the duration and what the spread for that is for the CPI-RPI spread? And secondly, in the draft determination, so you have a pay-as-you-go ratio, which I think was your natural rate and a runoff rate and the

WACC. If the regulator were to reduce the WACC in the final determination, what iterative process or negotiation have you got to alter your runoff rate or pay-as-you-go ratio to bend your cash flow profile?

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

So on the second, it comes back to it -- I think it's hypothetical. We need to wait and see what comes out in 16th of December. It's in the rounds of the settlement. So if you look at the way to bring that out best, if you look between January and July, the WACC did move between January and July, but we equally. We also won some of representations around totex. So I think it's a total package. And we came up quite promptly the next day with the RNS and said, "As you look at the total number, don't look at just one measure." But I think that's what we're looking to see is the total assessment of the final determination on the 16th of December. They're not just looking at one in particular number.

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

It's the -- more the process around how you then set your bills -- just your revenues, hypothetically, if they were to change the WACC, that you increase...

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

There's always good constructive conversation between the regulation and the sector. So that's what we'll continue. So typically, you see constant conversation going on throughout all years of the 5-year rate period. And so let's see what comes out in 16th of December, and then we'll be able to look at it, whether it's ODI smoothing or whether it's other activities, we'll be able to look at it thereafter. So -- but it's so close to Christmas. We're not going to be talking to you, guys, until January, I'm afraid, that's the plan. On the first one then, James?

James Bowling Severn Trent Plc - CFO & Executive Director

Yes. So we've got around GBP 475 million of the RPI-CPI swap. So just to -- sort of to remind people what we're trying to do is as we go forward, obviously, the kind of the regulatory model is going to shift to a 50-50. So we're trying to get our debt to be broadly kind of matched to that. And we have about 25% index-linked debt. And we're -- we've got about 1/3 of our index-linked debt now -- is now sort of CPI-linked. Interestingly, the last couple of swaps we've done, we've actually kind of done them slightly shorter dated. So we're trying to keep these swaps to be this side of 2030 because many of you will have seen that there's a little bit of uncertainty at the long end of the RPI curve as the Chancellor announced a month or so ago that it was under review. So we're kind of -- we're treading a little bit cautiously about going too far on those swaps because we think the market's still kind of settling down and digesting that news.

In terms of the rate, I'm not going to give you the rate, but it is inside the market rate, I can tell you that.

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

Very good. Fraser's got a question there.

Fraser Andrew McLaren BofA Merrill Lynch, Research Division - Director

It's Fraser McLaren from the Bank of America. Two questions, please. First of all, may I ask about your latest interaction with Ofwat in terms of which areas you were speaking with them about most loudly in the last stages of the review and if you think they were listening to you? And secondly, on your net 0 pledge, I just wanted to check that any extra expense associated with the program is already reflected in your plans for AMP7.

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

So on the second, yes, all built in. So we announced the coverage of pledge quite a while ago, and we've got detailed plans in place at the ESG Day on the 4th of March. You'll get to see our plans in some detail just to pitch that again, totally shamelessly. So you can look forward to that in your diary. In terms of the first one, we made 5 representations in September, which is the last formal meeting with Ofwat. And we -- I don't think we've made any of them louder than the others. We had a good, constructive conversation, outlining these are the areas that we thought were worth looking at. And some were sector-wide, some were sector-specific. And we've been quite open about this 5, so we talked about the sector-wide as clearly in the rounds as the package ends up in the round for the sector has been in good shape for the future. And also, supply interruptions looks an incredibly bold target and glide path for the sector from its current

position. And then we had some Severn Trent-specific activities. We talked about, for example, business rates, we think is something which actually better based on actuals versus the hypothetical numbers that are there today. And likewise, at a couple of ODIs, I wanted to talk about. So we went through each of those. And I found -- I've never experienced regulatory conversation like I have this time around, which has been as open, as transparent and as constructive, but I'm sure they were listening. Clearly, we'll have to wait and see what comes out on the 16th of December, but I think they couldn't have engaged more through the process.

Oh, Rachel has got one now. I've meant to ask Rachel, did she have any on the web, but she's luckily put a hand up since I forgot to ask.

Rachel Martin *Severn Trent Plc - Investor Relations Manager*

Yes. Just one from the webcast. It's from Iain Turner. He's asked whether the GBP 60 million pension deficit payment goes.

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

No, it doesn't. So it's a balance sheet impact. And just to clarify, that GBP 60 million is an average nominal level. So I've kind of used the inflation forecast. So GBP 60 million a year, it doesn't go through the P&L at nominal rates, nominal prices.

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

Good. I think we are complete. So we have got a few minutes. Feel free to stay for the stands. And don't forget to put it in your diary the 4th of March, and thank you very much, everyone, for coming.

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