

PR19: INITIAL ASSESSMENT

6 February 2019

WONDERFUL ON TAP

SEVERN
TRENT

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SUMMARY OF OUR FAST-TRACK PLAN

Serving our Communities

Our Fast Track Plan for 2020-2025

We think water's wonderful. It plays a critical role in all our lives. And that's why we all deserve a bold and ambitious plan for the future. So we will be keeping bills low, improving our service and making a positive societal impact in our communities while remaining financially resilient and continuing to deliver strong returns for our investors.



One of only **three**
fast track companies

1%

dividend for
community schemes



Growing RCV by
c. **3.6%**
in real prices

41 PCs including
35 ODIs
with enhanced values for
internal sewer flooding



Commended
for work on
social purpose

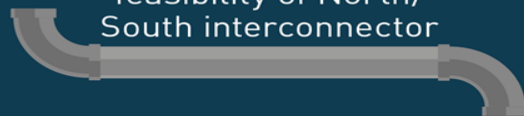
Base regulatory
dividend of **5%**
aligned with Ofwat
guidance range



£156m
of real options
approved

£26m

approved to begin
feasibility of North/
South interconnector



RORE range of
-2.7% - + 1.5%
on customer ODIs



Upper Quartile
on base costs



£6.4bn
approved totex

A PLAN DELIVERING FOR ALL STAKEHOLDERS

Customers

- Lowest bill in England, reduced by a further 5%
- 47% more struggling customers supported with their bill
- Reinvesting in communities with 1% of profits
- Creating an ongoing engagement community through 'tap chat' for AMP7 and beyond

Regulators

- As a fast track company, 'setting a new standard for the sector' (Ofwat)
- Responding to evolving stakeholder thinking with a responsibly financed plan and balanced sharing mechanisms
- Working with the Environment Agency on our most ambitious environmental investment programme



Colleagues

- Continue to share success with an all employee bonus based on customer outcomes
- Investing in a £10m technical training academy to develop our people
- A leader in social mobility as demonstrated by our top 20 status in the social mobility index

Investors

- Creating the biggest opportunity to deliver outperformance benefits on ODIs
- The only listed water co. with growing RCV
- Entering AMP7 on the required cost run rates following AMP6 efficiency drive
- Upper quartile on financing heading into AMP7

"We also commend Severn Trent for its 'pathfinding social purpose company' thinking, and for their initiative with the Purposeful Company Taskforce. " Ofwat IAP

FAST TRACK BENEFITS

**Additional
10bps on RoRE
£18m¹ over
AMP7**

**Clarity on
investment &
commitments**

**Positive
engagement
with Ofwat**

**Early start to
contracting
AMP7 projects**

**14 months to
focus on
delivery**

¹ In 17/18 prices



DEEP DIVE

A SECTOR LEADING ODI PACKAGE

Translating our AMP6 momentum...

Our success in AMP6 and continued customer engagement led us to submit a bold package of performance commitments and customer ODIs for AMP7

100%

of AMP6 waste measures delivered so far, with no penalties incurred

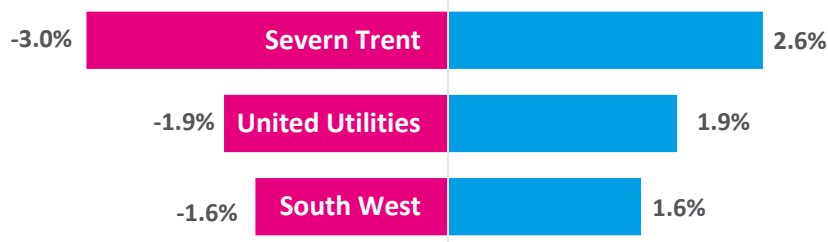
£150m

net customer ODIs earned in the first three years of AMP6

2.6%

Increased cap on AMP6 customer ODIs, after reaching the 2% cap on Waste

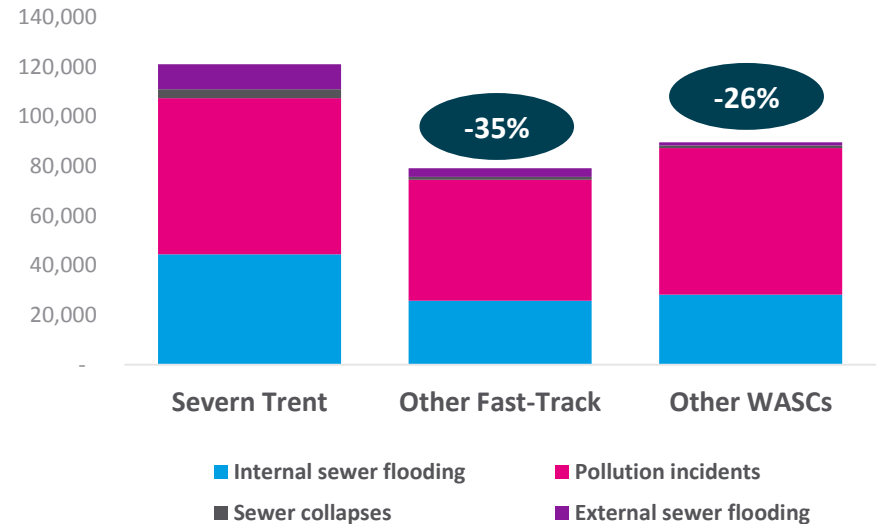
P10/P90 range on submitted customer ODIs



... into AMP7 outperformance

Following Ofwat's assessment, we still have the strongest incentives to outperform and deliver even better services to customers

Cumulative value of reducing one waste incident¹ (£)



¹ Based on IAP results, with further interventions signalled on Other WASCs

A SECTOR LEADING ODI PACKAGE

We are well placed to deliver our commitments following the IAP

	Number of Ofwat interventions made at the IAP				
	Tougher PC targets	Harsher penalty rates	Reduced reward rates	Penalties collared	Rewards capped
Severn Trent	3	8	8	9	7
Other Fast-Track (average)	6	13	9	7	7
Other WASCs (average)	11	17	17	5	5

- The only targets that were changed related to the three **comparative measures** which are based on upper quartile
- This compares to interventions on **11 targets at PR14**
- This means that the targets the business is already working to are still valid, and our **glide path remains unchanged**

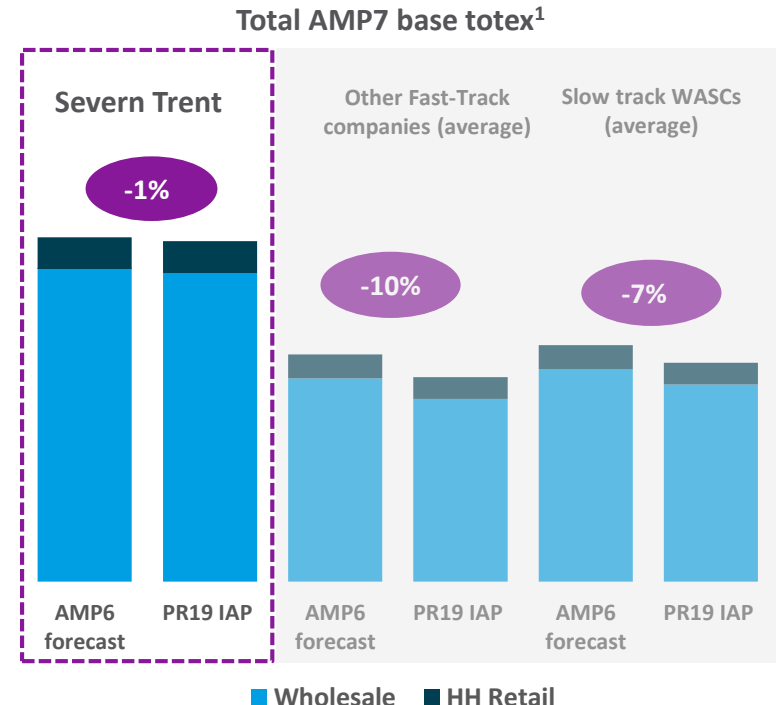
- Caps and collars on some of our individual customer ODIs mean we need to **outperform across a broader set of measures**
- **Downside risk has also been reduced**, for example supply interruptions have been collared at 14 minutes

- We submitted a plan with the most ambitious balance of **risk and reward**
- However Ofwat rightly needs to **strike the balance** between rewarding performance and impacting customer bills – some of our **incentive rates were amended** as a result
- We can still deliver a strong result with a **P90 estimate of 1.5%** - up from 0.9% at the same point in PR14

A SMOOTH TOTEX RUN RATE

AMP6 efficiency has enabled a smooth transition into AMP7

- New ways of working in Capital Delivery and stronger commercial focus across the business in AMP6 has driven cost **efficiencies that will carry into AMP7**
- Maintenance spend is **efficient across both wholesale and retail**. No material change to AMP6 run rates means we can continue to maintain investment in our network's asset health
- We have **secured funding for some important enhancement programmes**, including three new supply schemes which will deliver an additional 68.5Ml/d
- We are confident that further refinements to our cost approach will enable additional enhancement projects within our allowance

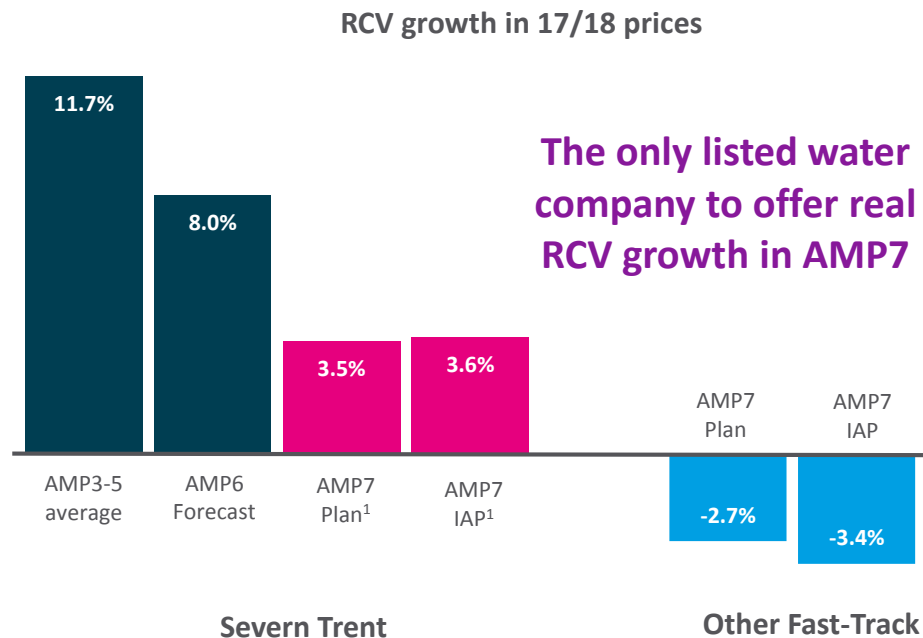


¹ AMP6 forecast is based on three years of actuals and two years of forecasts submitted in PR19 data tables. Excludes enhancement expenditure which is not directly comparable from AMP to AMP.

SUSTAINABLE LONG TERM GROWTH

Long term RCV growth in AMP7, balancing bills for future generations

- Support from Ofwat for **bill reduction of c5%** and we continue to offer the **cheapest bills in England**
- Able to reflect our customer views by balancing current bills and RCV growth to address **intergenerational fairness**
- Minimal intervention on financial levers, securing both **financial resilience** today and **shareholder value growth** for the future
- Historic track record of RCV growth continues in AMP7, and further long term investment needed for **environmental, demographic and climate changes** in the future



¹ Excludes real options of £156m

Frontier on cost efficiency but further work needed to finalise the plan

Frontier Efficiency

- IAP confirmed 3% (£5m) more totex than our plan
- Still the lowest bill across England and Wales

More ambition on incentives

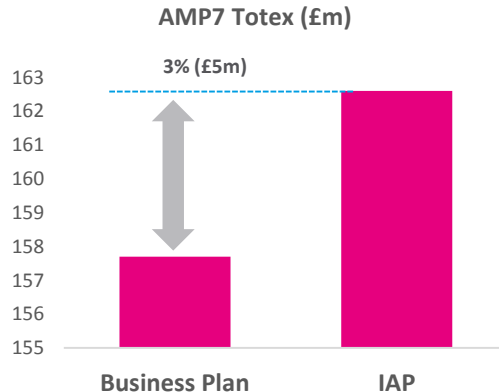
- Re-test incentive rates with customers and our Customer Challenge Group
- Set more stretching targets on eight measures
- More support for vulnerable customers based on industry wide Priority Services Register measure

More engagement

- Share results of our updated acceptability research
- Undertake customer research on long term bill profiles

Better data

- Cover the data history gaps created by the changes to the Hafren Dyfrdwy/ Severn Trent border
- Provide additional evidence for choices on risk and reward, PAYG and run-off



AMP7 READINESS

OPERATIONAL READINESS

Unlocking operational excellence through our systemic operation

- We consider the **end to end process** within one catchment area
- This approach, combined with our knowledge of underlying **drivers of performance** enables us to **link root cause and effect** in driver trees
- These show us which interventions will **deliver multiple outcomes**, and allow us to **target resources and investment** more efficiently
- This approach has been **key to our success on waste** measures in AMP6 and we're now implementing the **same approach for water**

Example: by targeting sewer cleaning efforts in a specific hot spot area, we know we can drive positive outcomes in six AMP7 customer ODIs

Targeted
sewer
cleaning

External sewer
flooding

Internal sewer
flooding

Public sewer
flooding

Sewer
blockages

Sewer collapses

Pollution
incidents

Our systemic approach

Identify hot spot



Identify root cause



Identify intervention

Targeted
maintenance

Capital
solution

Behavioural
change



Rigorous delivery

Through a performance driven culture

Using models and analytics

ORGANISATIONAL READINESS

Our organisation and people are already gearing up for the AMP7 challenge

Last year we reorganised our business:
streamlining our focus areas and
realigning our senior team

Production

Driving a 'food factory' mentality in our treatment works

Customer Delivery

Joining up the end to end customer experience

Capital Delivery and Commercial

Linking capital teams with the supply chain

Business Services

Applying commercial focus to a competitive Bioresources business

Our people stand ready to deliver



- Our teams **understand ODIs** and know what to focus on
- Our embedded **Safer, Better, Faster** framework and 'communication cells' enable us to **drive interventions quickly**
- We're investing in skills with a **£10m technical academy**
- Teams are **incentivised to perform**, with the only all-company bonus scheme in the sector

DELIVERING AMP7 CUSTOMER ODIS

Our sector-leading success in AMP6 has taught us valuable lessons for AMP7

We have a track record of turning around failing ODIs

- We committed to stretching targets on **external sewer floodings** – our AMP5 exit run rate would have incurred a penalty £56m penalty in year 1 of AMP6. We were able to target hot spots to turn this into a reward of £8m in year 1 and £111m over the AMP.
- We have delivered an almost 20% reduction in **water quality complaints** from its 2016 peak. We're confident we will reach our UQ target by the end of AMP6, positioning us well for AMP7.

We have carefully designed ODIs to deliver the right outcomes

- Our AMP6 **speed of response** ODI drove an inefficient use of resources
- We've re-designed the ODI for AMP7 to focus on the **end to end customer impact** instead

We have invested time in developing great stakeholder relationships

- ODIs like **partnership working** have enabled us to develop strong community relationships
- This will help us successfully deliver AMP7 ODIs such as **collaborative flood resilience**



A STEP CHANGE IN CAPITAL DELIVERY

AMP6 was our largest ever investment programme; we are building on its success for AMP7

The AMP7 challenge requires a different approach to deliver great outcomes

Our new in-house design team will drive fresh thinking on capital projects

Refreshed contracting model offers extra flexibility and a broader supplier base

We anticipate significant gains from our more innovative approach



Benefits

- A step change in our internal engineering expertise
- Greater ownership of solution design, better aligned to operational performance and efficiency targets
- In-house design will drive standardisation, and more cost effective solutions
- Trusted supply chain partners with external expertise and proven delivery capacity
- Time and capacity to explore more innovative solutions

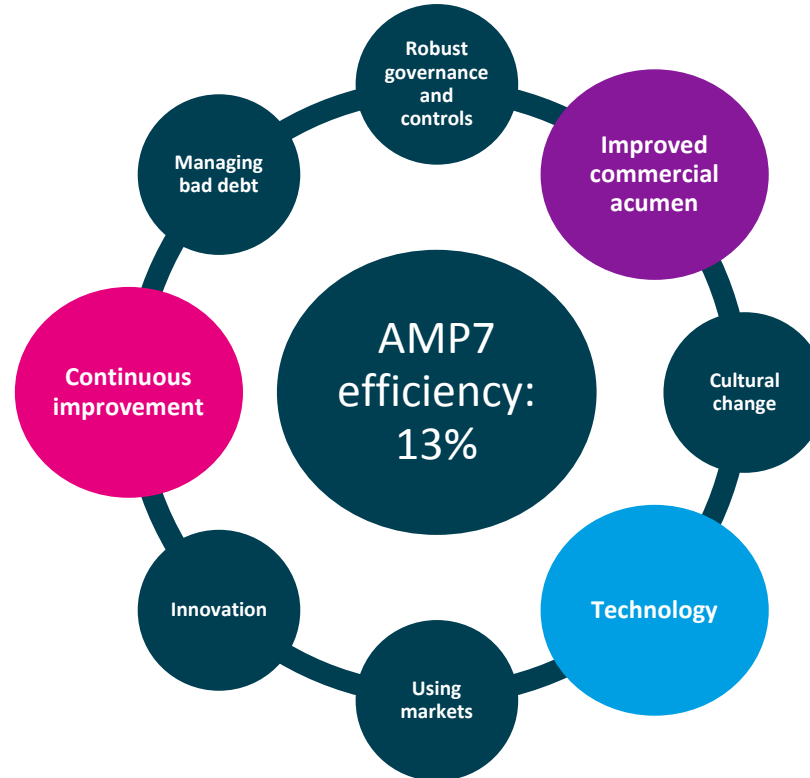
"This technically led delivery model, with innovation and standardisation at its core, will drive benefits in AMP7 and beyond"
- Helen Miles (Group Capital Delivery and Commercial Director)

DELIVERING OUR COST EFFICIENCY COMMITMENT

A multi-faceted approach exploring every element of the cost base to liberate efficiency

Continuous improvement

- **Energy:** Dynamic hedging, capital investment and treatment work initiatives delivering £80m energy cost savings across the AMP
- **Optimisation:** Factory thinking driving process efficiency and automation
- **Proactive asset management:** Reducing cost of failure and reactive work - £30m totex opportunity



Improved commercial acumen

- **Contracts:** Restructured and retendered all main contracts
- **Supplier partnerships:** taking out costs and using gain share mechanisms

Technology

- **Analytics:** Maximise insight and minimise physical intervention
- **Productivity:** 'Sitemate' workflow technology improving fieldworker productivity
- **Customer portal:** Reducing call volumes and handling times

A STRONG FINANCING POSITION

We've built a strong platform in AMP6...

Actions taken on our debt portfolio over AMP6 have driven substantial reductions in our cost of debt and raised us to the upper quartile on financing

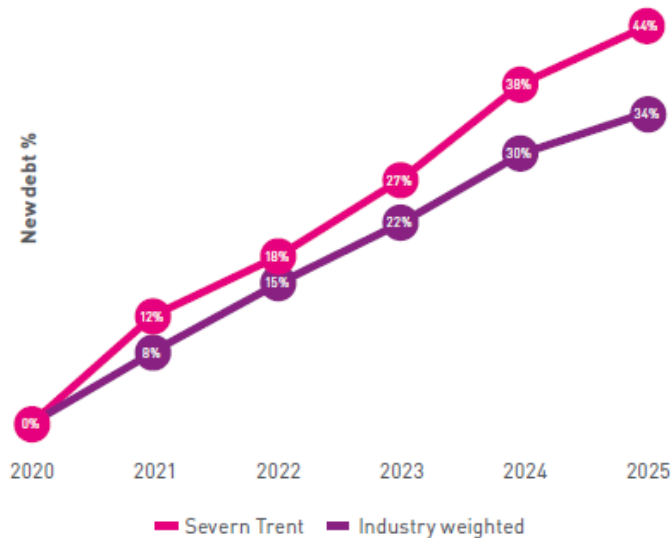


Strong financial results and balance sheet discipline in AMP6 mean we will enter AMP7 close to the new notional gearing level



... with further opportunities in AMP7

We expect 44% of our 2025 closing debt to be new in AMP7, compared to a sector average of 34%. Refinancing provides us with the opportunity to reduce our cost of debt even further



Based on draft plans

BUSINESS SERVICES

AMP7 will also be an exciting period of opportunity for Business Services

Food Waste



- We completed our acquisition of Agrivert, including **5 food waste plants** in Nov 2018
- This will add **106GWh** of energy generation to our portfolio, with **65% of gate fees secured** in long term contracts
- We see significant opportunity for growth, reinforced by the recent paper proposing **all UK homes** to have food waste collection

Property Development



- Developments in technology and processes have freed up land that can be **sold for development**
- We have insourced an experienced **Property Development team** to manage our portfolio and extract value from it
- We expect to **deliver £100 million profit** from property disposals by 2027 – so far we have achieved c.£25m

Bioresources



- A **competitive** market from April 2020
- We're already **at the frontier** but we've broken the end to end process down to identify how we can **widen the gap**
- For example, in logistics, we're rationalising our tanker bases, revising our working patterns and implementing sludge thickening technology to drive down costs

Underpinned by long term contracts in our **Operating Services** division, including our 25 year MoD contract

Q&A