PR14 Update From Severn Trent

Tony Wray – CEO
Mike McKeon – CFO
Dr Tony Ballance – Director of Strategy and Regulation

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Structure for this presentation

1 Update

2 Affordability & Investment

3 Execution

1 Update	2 Affordability & Investment	3 Execution
Recap of February webcast	Affordability	AMP5 delivery
PR14 Methodology	Investment	AMP6 delivery
Your Water. Your Choices & Customer Challenge Group	AMP6 vs. AMP5 capital programme	Stakeholder Context
Water Bill	Timeline to FD	

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① **Update:** In February we talked about...

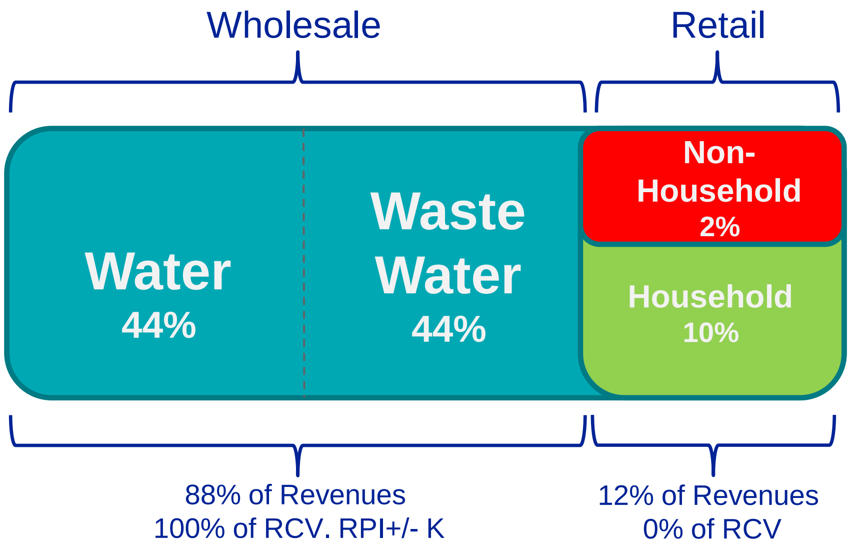
PR14 will be different	• First significant change since privatisation • But proposals are an evolution of the tried and tested industry framework • No significant change to industry risk profile • Increased customer engagement • Changes are aligned with our own proposals
STW is prepared for change	• Aligned to the PR14 methodology (water/waste/retail) • Taking action - e.g. non-household customer wins • Below average cost to serve in retail • Well placed to take advantage of opportunities
STW is positive about changes	• Made good progress on PR14 plan • More flexibility in delivery of plan & risk / reward appetite

① **Update:** Since February

① Update ② Afford' & Inv' ③ Execution

- PR14 Final Methodology
- Your Water. Your Choices & Customer Challenge Panel (Severn Trent Water Forum) Engagement
- Water Bill

① Update: PR14 Methodology



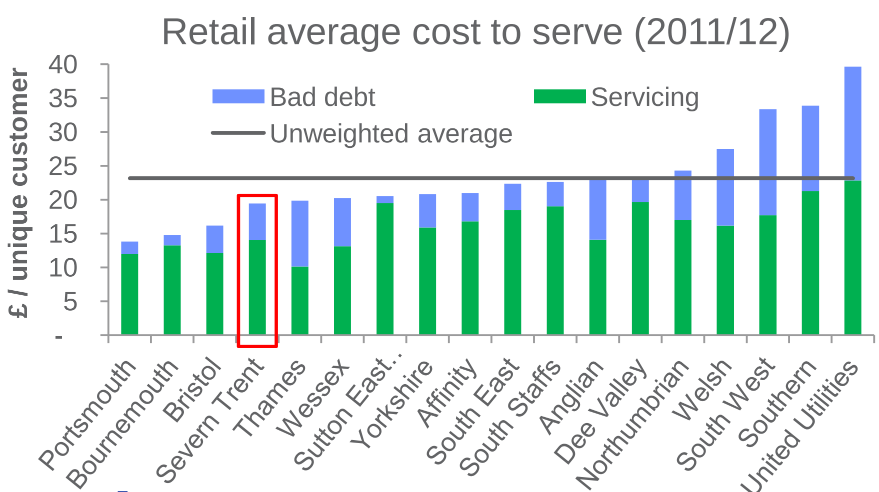
Default tariff

Average cost to serve + margin

Total revenue split by customer
Non-Household 28%
Household 72%

☑ Supportive of changes
? Require more information
= Same as PR09

Price control ✓



Source: EY Horizontal Audit, adjusted for combined customers
Does not include adjustment for metering

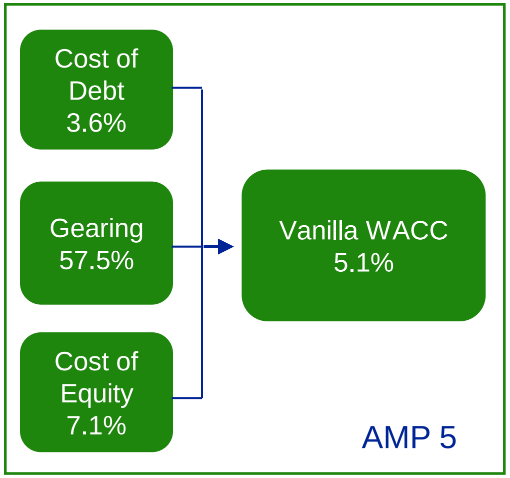
Combined customer 1.3 vs. 1 water only

Support adjustments for metering penetration

Efficient company = actual cost
Inefficient company = 3 year glide path to average

Average Cost To Serve ?

① Update: PR14 Methodology



- No change to methodology
  - notional gearing
  - single industry WACC
  - fixed cost of debt (no indexation)
- Higher gearing assumption (60%-70% vs. 55%-65% current)

✓ Supportive of changes

? Require more information

= Same as PR09

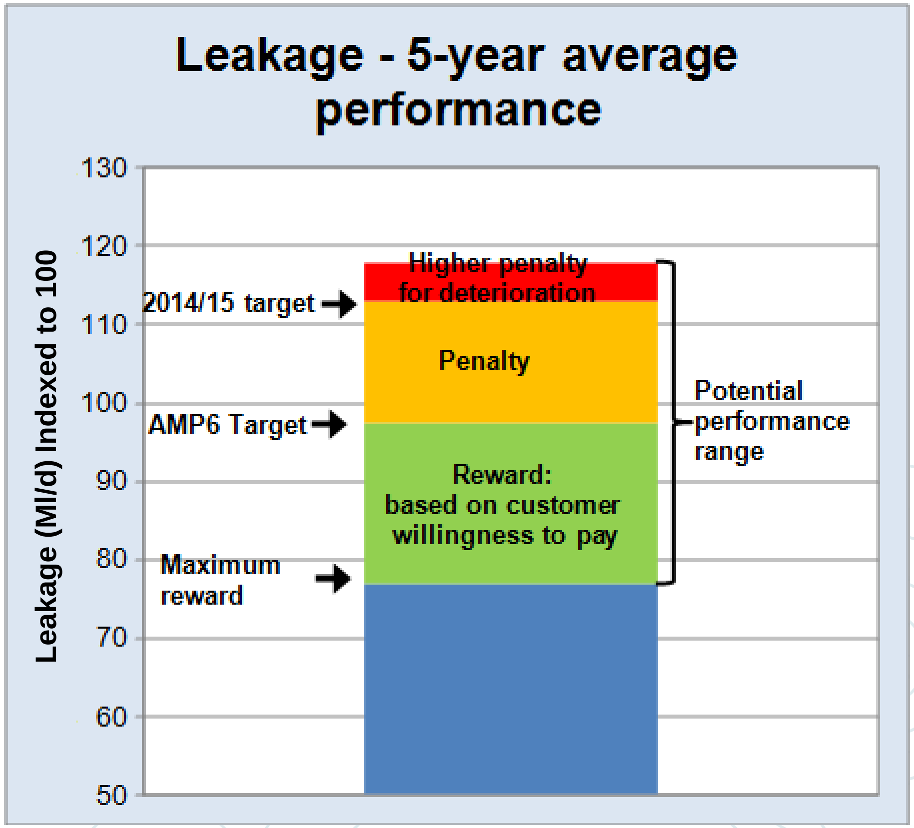
WACC =

- Service Incentive Mechanism
- Outcome delivery incentives defined by companies, e.g.
  - Sewer flooding
  - Interruptions to water supply
  - Leakage
- Totex menu mechanisms (extension of CIS)
  - Better menu incentive rates for Enhanced
  - No menu choice for Resubmission

Incentives ?

① Update: How rewards and penalties might work

- Rewards and penalty rates based on customer willingness to pay
- Based on performance to 2018/19
- Limit put on rewards to ensure that the overall package does not go beyond limits of customer acceptability
- Higher penalty rate for deterioration to reflect importance customers attach to this issue and desire for improvement



① Update: PR14 Methodology

① Update | ② Afford' & Inv' | ③ Execution

Business Plan Rating		Outcome
Enhanced	• Good outcomes • Meets statutory obligations • Good quality engagement • Cost efficient • Reasonable risk / reward balance • Affordable and financeable	• Get the plan you submit • Strong totex incentives • Early draft determination (April 14) • Potential early final determination (Sept 14) • Early totex menu choices • Reputational benefit
Standard	• Acceptable plan, small level of follow up required by Ofwat • Submission reviewed in similar way previous reviews	• Detailed regulatory scrutiny • Refine plan components • Standard totex incentives • Late draft determination (August 14) • Late final determination (up to Jan 15)
Resubmission	• Poor quality plan • Material failings in sections of the plan • Plan will need to be altered by the company and resubmitted	• Tough regulatory scrutiny • Redevelop plan • No totex menu choices and weak totex incentives

Update: Your Water. Your Choices & Customer Challenge Group

1 Update | 2 Afford' & Inv' | 3 Execution

- Our plan is being developed based on extensive engagement with our customers, stakeholders and Severn Trent Water Forum (CCG):
  - 18 months of engagement in 3 phases
  - 25 Severn Trent Water Forum and sub-group meetings
  - c.15,000 customers involved in research
  - c.3,000 customers met in person at roadshows
  - c.160 different stakeholders' views

Your Water. Your Choices link

- Our latest consultation, *Your water. Your choices*, sought views on the right balance in our plan (c.40 stakeholders and c.2000 customers involved)

Consultation Responses

- Water quality and security of supply remain priorities – leakage and sewer flooding are key customer issues
- More support for environmental improvements than anticipated
- Majority of respondents supported central proposal of flat real bills

Update: Your Water. Your Choices & Customer Challenge Group

Next steps:

- Severn Trent Water Forum to continue to challenge plan as we prepare for submission
- Key areas of challenge to date have been level of ambition regarding:
  - environmental programme
  - leakage
  - bills, and
  - how to best help those who struggle to pay
- Severn Trent Water Forum to report to Ofwat (2 December) on quality of engagement; and extent to which plan reflects the outcome of that engagement

Longer term:

- Retention of Severn Trent Water Forum to monitor delivery
- Continued programme of customer engagement
- Customer priorities embedded as measures of success

① **Update:** Water Bill

Draft Bill (July 2012)	Bill (June 2013)	SVT view
Full non-household competition by 2017	Same	Supportive
Broad wholesale competition	Wholesale competition, but narrowed in scope. Third parties not allowed to operate network infrastructure. Main areas for wholesale competition are water resources, last mile infrastructure and sludge.	Supportive, but devil is in the detail on access prices
No separation of retail licences	Same	Would prefer to see the option for separation of licences
Measures to encourage water trading (standard codes and charging rules)	Same	Supportive
M&A regime reforms – designed to make some M&A easier without a full competition referral	Largely the same	Supportive
No mention of sustainable drainage	Clarifies that water undertakers can fund and manage sustainable urban drainage schemes	Supportive

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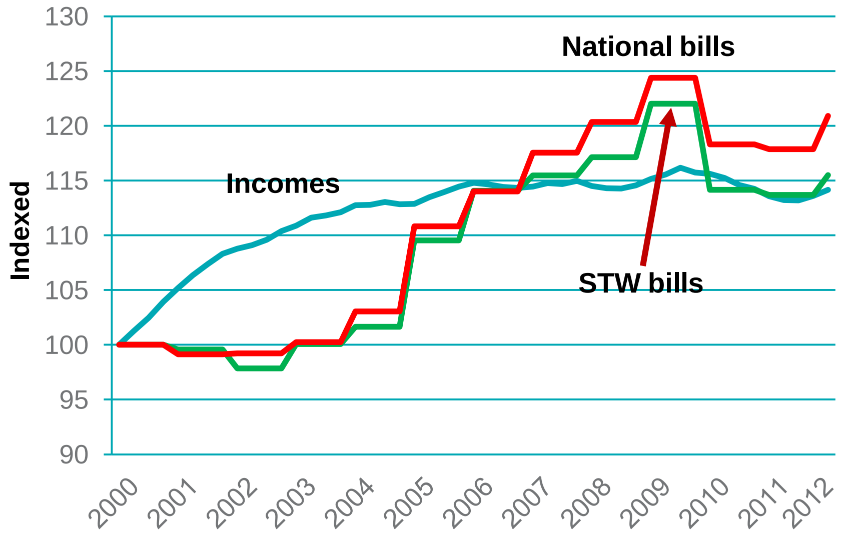
② Affordability & Investment: The challenge

① Update ② Afford' & Inv' ③ Execution

- Declining real incomes
- Rising poverty rates
- Increasing bills

- High/deteriorating poverty rates are not specific to certain companies

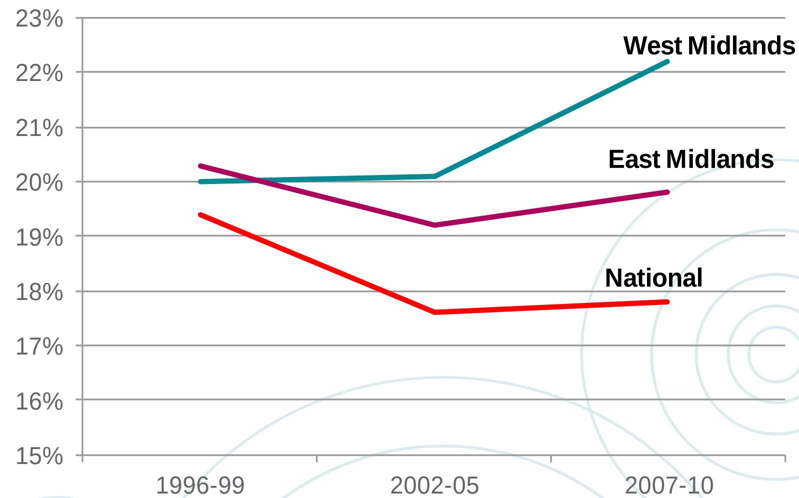
Real average household disposable income per head and water bills



April 2000 = 100 Sources: ONS, Ofwat

Average poverty rate

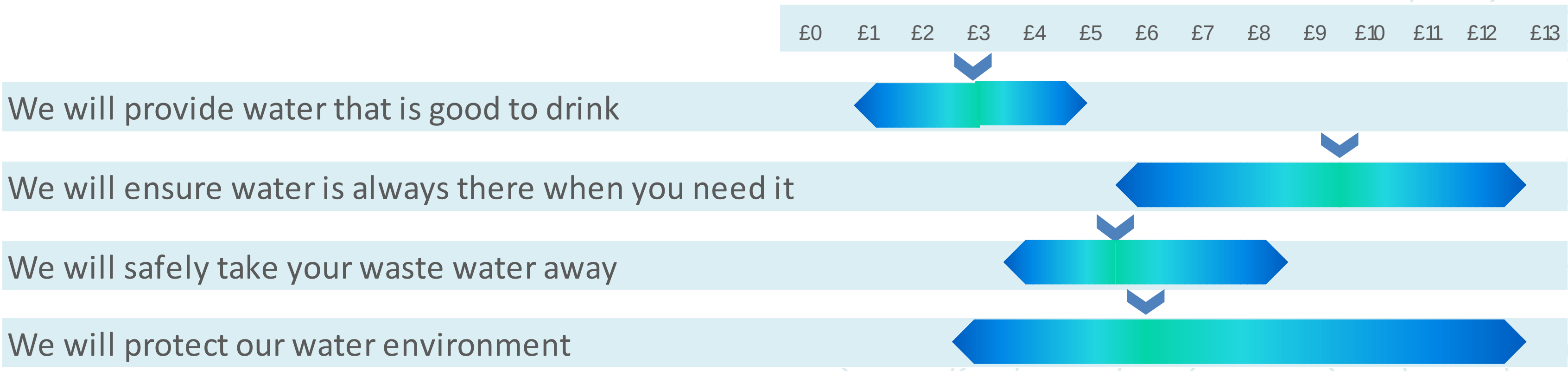
(% households below 60% of median national income)



Source: ONS

② Affordability & Investment: Starting point for Bills

- Our consultation has set out:
  - The potential overall bill
  - Options with bill impacts and the impact on service for each of the main areas of choice
- We have sought views through the published consultation and customer acceptability research



② Affordability & Investment: Customer choices

- We have consulted on whether these are the right measures, and given options for these measures
- For example, on sewer flooding:

We will safely take your waste water away

Number of internal sewer flooding incidents:

Current performance	2020 indicative performance
1,000 incidents	About a 15% improvement

Number of external sewer flooding incidents:

Current performance	2020 indicative performance
2,650 incidents	About a 9% improvement

Estimated impact on bills

Options

1. Higher bill

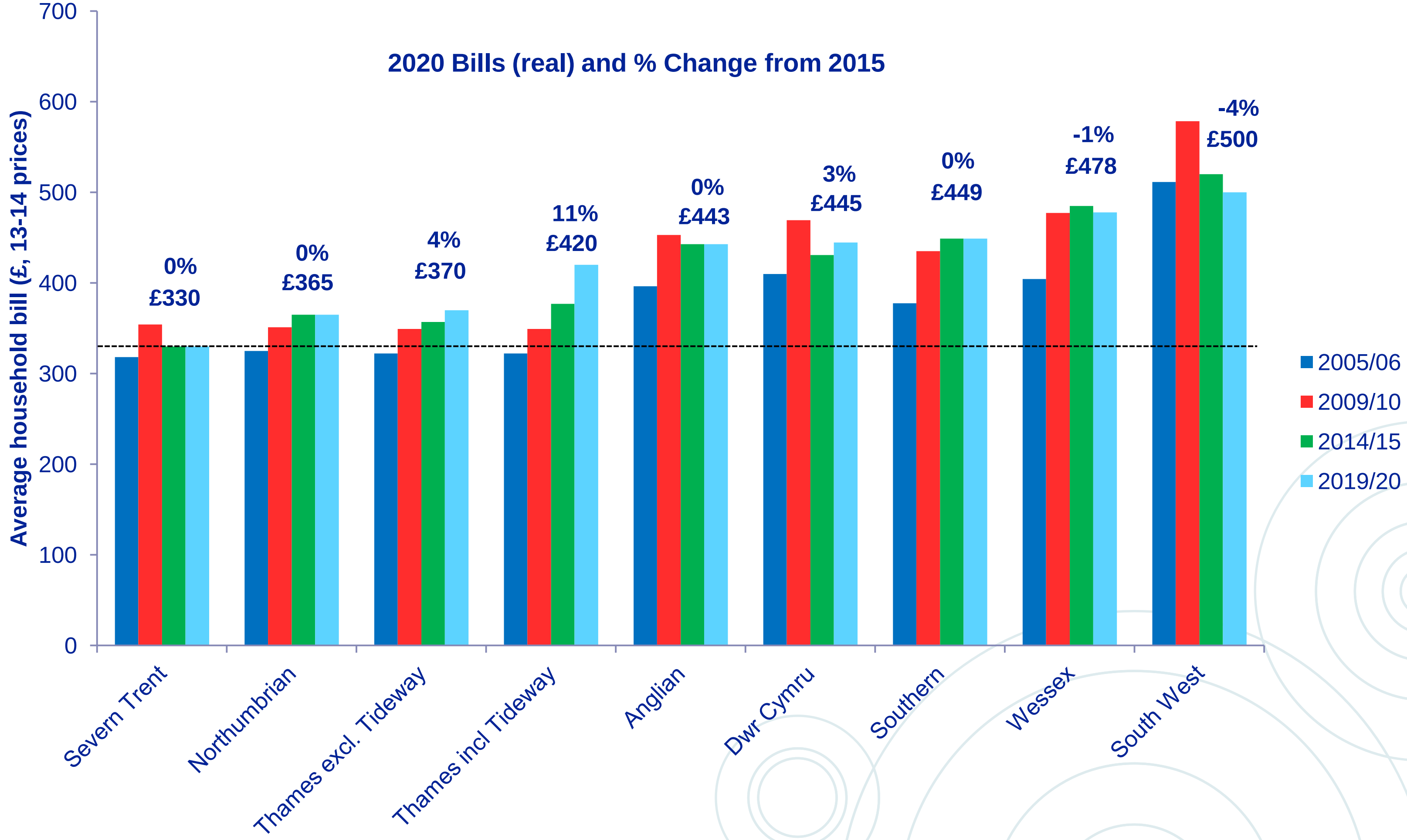
Investing more would allow us to:	
Achieve a larger reduction in internal sewer flooding incidents	**About a 21% improvement**
Achieve a larger reduction in external sewer flooding incidents	**About a 10% improvement**
Bill impact	**£8.00**

2. Lower bill

Doing less would mean:	
A smaller improvement in internal sewer flooding	**About a 6% improvement**
A smaller improvement in external sewer flooding	**About a 5% improvement**
Bill impact	**£3.50**

Affordability & Investment: Severn Trent vs. Peers

1 Update | 2 Afford' & Inv' | 3 Execution

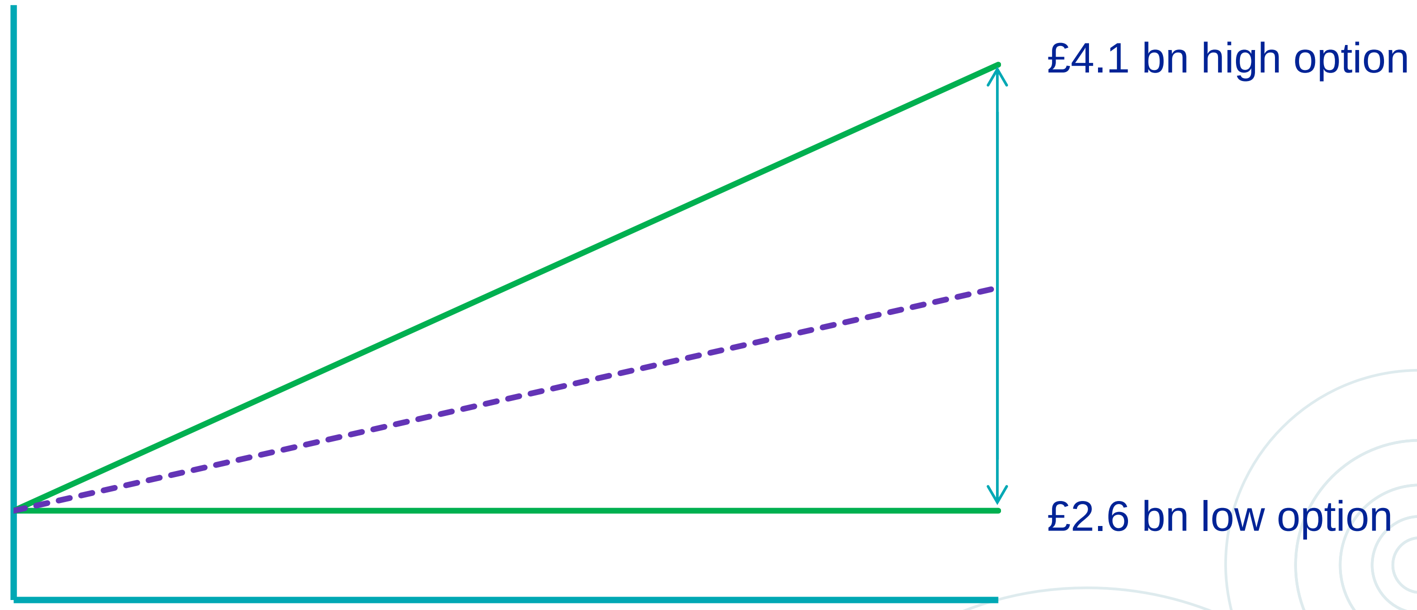


Source: Severn Trent analysis of publicly available company draft consultations and plans

Affordability & Investment:
AMP6 Capex Envelope

① Update ② Afford' & Inv' ③ Execution

Within Your Water. Your Choices we included a range of investment options with a potential capex envelope:



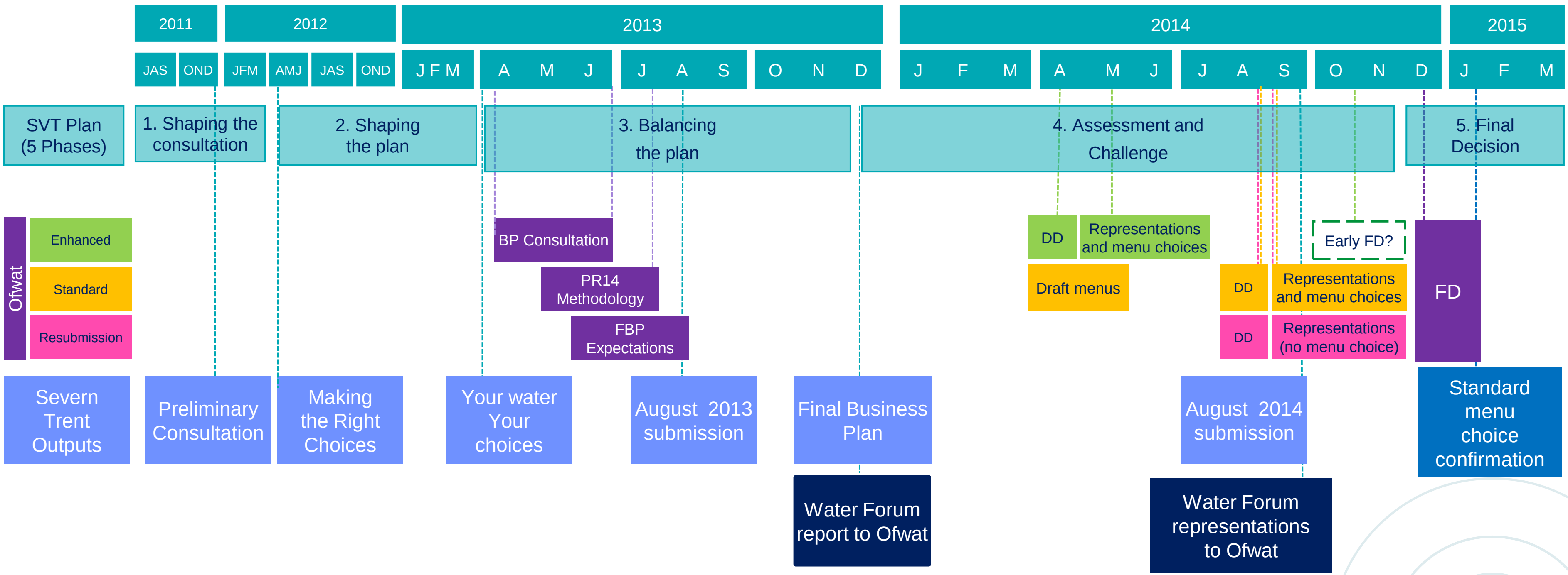
Our final capex spend will be announced in our final submission to Ofwat in December

② **Affordability & Investment**: An overview of the emerging plan

① Update ② Afford' & Inv' ③ Execution

	Your expectation	Our objective	AMP5 Capex Spend (12/13 prices):	AMP6 Capex Spend (12/13 prices):
	Quality water	**We provide water that is good to drink**	**£0.3Bn**	**£0.3Bn**
	Service you can rely on	**We will ensure water is always there when you need it**	**£0.9Bn**	**£1.1Bn – £1.2Bn**
		We will safely take your wastewater away	**£0.5Bn**	**£0.7Bn – £0.8Bn**
		We will provide you with excellent customer service	**£0.1Bn**	**£0.1Bn**
	Affordable bills	**We will have the lowest possible charges**		
		We will help you if you struggle		
	Responsible service	**We will protect our local environment**	**£0.8Bn**	**£0.8Bn – £0.9Bn**
		We will protect the wider environment		
		We will make a positive difference in the community		
	Sustainable finance	**We will finance our business sustainably**		
		TOTAL	**£2.6Bn**	**£3.0Bn – £3.3Bn**

② Affordability & Investment: Timeline to FD



2nd December 2013 – Final Business Plan Submission

April – August 2014 – Draft Determination (business plan rating dependant)

May – November 2014 – Totex Menu Choices (business plan rating dependant)

12 December 2014 – Final Determination (potentially early for enhanced)

DD = Draft Determination; FD = Final Determination

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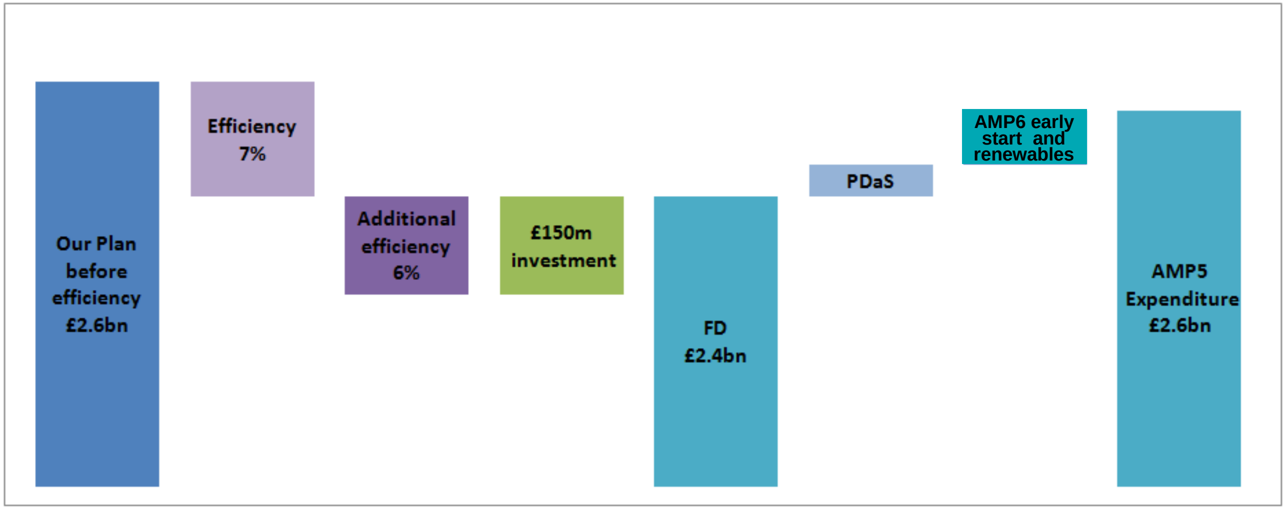
3 Execution

- AMP5 delivery
- AMP6 delivery
- Stakeholder Context

③ Execution:
Delivering Efficiency in AMP5

- Adopted an expert client model in AMP5 establishing 'One Supply Chain' organisation



- Focus on collaboration and culture of mutual benefit
- Reduced number of contractors from 22 in AMP4 to 7, co-located with supply chain and improved processes using Safer, Better Faster and SAP
- Delivering against a target of 20% efficiency on major programmes through innovation, productivity and better process
- Efficiency been used to fund additional £150m investment

Execution:
Delivering Efficiency in AMP6

- The move to Totex is in line with Severn Trent's whole life cost approach
- Contractors have helped build plan
  - benefitting from 5+5 year agreements put in place at start of AMP5
  - committed programme of work well in advance
  - enable investment in innovation with repeatable solutions
- Full partner engagement in development of AMP6 efficiency plans mean greater confidence in future delivery
- Leverage buying power with a shared supply chain with long term relationships
- Successful commercial models trialled in AMP5 built into AMP6 plans
- Early contractor involvement and visibility of AMP6 programme will avoid the investment 'rollercoaster', reducing delivery risk and delivering efficiency

③ **Stakeholder context:** Latest views

① Update ② Afford' & Inv' ③ Execution

- Affordability is a key concern
  - Government
  - Customers
  - Ofwat
- Sustained investment levels
  - Government
  - Environment Agency
  - Ofwat recognise importance
- Non household retail competition
  - Government support
  - Customer support
  - Ofwat
- Efficient financing with lower cost of debt

Summary

Methodology broadly in line with expectations

Making good progress with engagement and plan

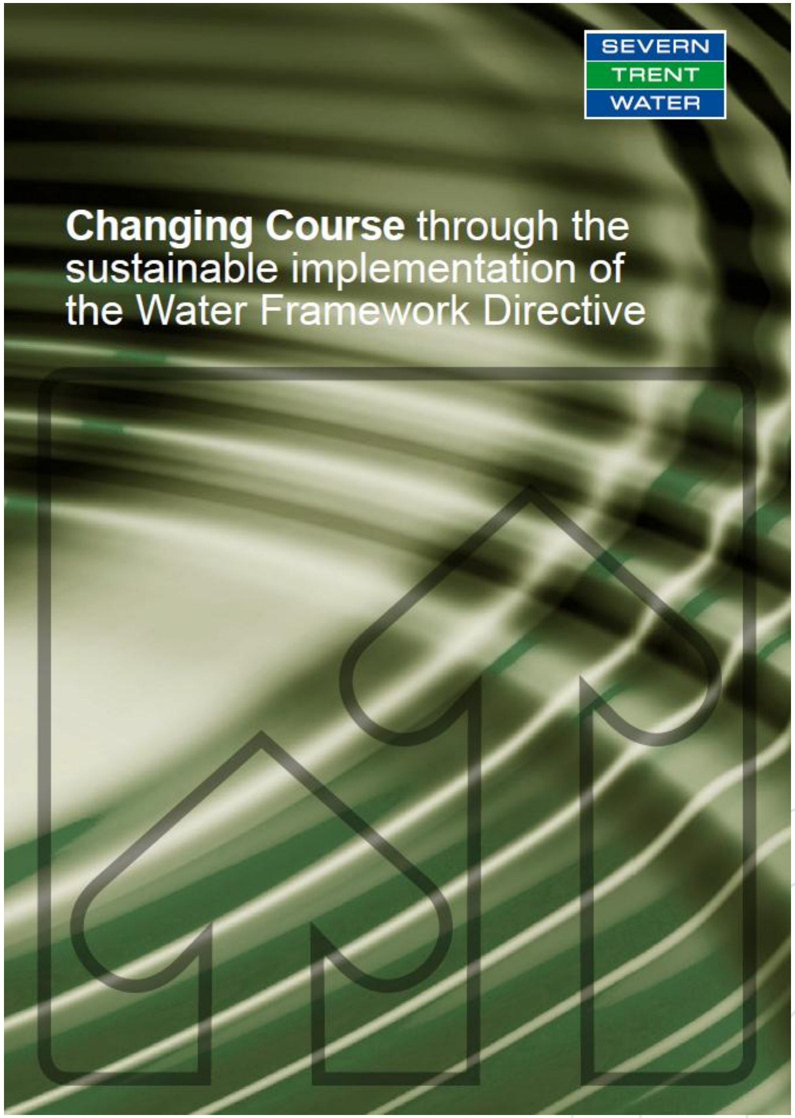
Affordable outcomes for customers with a Capex programme between £3.0 bn and £3.3 bn

Stakeholder views incorporated in plan

Delivering in AMP5 and well placed to deliver in AMP6

Will update you again after plan submission

Our Next Publication: Early November



Q & A

Contact details

John Crosse, Head of Investor Relations

M: +44 (0) 7775 226260

e:mail: john.crosse@severntrent.co.uk

Chris Johnson, IR Manager

M: +44 (0) 7834 419715

e:mail: chris.johnson@severntrent.co.uk

Severn Trent Plc
PO Box 5309
Coventry. CV3 9FH
United Kingdom
T: +44 (0) 2477 715000

www.severntrent.com

www.stwater.co.uk

www.severntrentservices.com

Useful Links

Ofwat
www.ofwat.gov.uk

Defra – Department for Environment, Food and Rural Affairs
www.defra.gov.uk

Environment Agency
www.environment-agency.gov.uk

Appendix - Publications

Regulatory compliance – a proportionate and targeted approach: A consultation
Publisher: Ofwat
Web Hyperlink

Future price limits – a consultation on the framework
Publisher: Ofwat
Web Hyperlink

Consultation on wholesale incentives for the 2014 price review
Publisher: Ofwat
Web Hyperlink

Consultation on retail controls for the 2014 price review
Publisher: Ofwat
Web Hyperlink

Consultation on Ofwat's section 13 proposals to modify company licences
Publisher: Ofwat
Web Hyperlink

Involving customers in price setting – Ofwat's customer engagement policy statement
Publisher: Ofwat
Web Hyperlink

Setting price controls for 2015-20 – framework and approach: A consultation
Publisher: Ofwat
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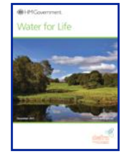


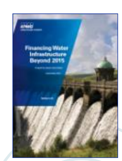
Water for Life
Publisher: Government/Defra
Web Hyperlink

Changing Course – Delivering a sustainable future for the water industry in England and Wales
Publisher: Severn Trent
Web Hyperlink

Changing Course – Through water trading
Publisher: Severn Trent
Web Hyperlink

Changing Course – Through sustainable financing
Publisher: Severn Trent
Web Hyperlink

Designing incentive packages
Publisher: Severn Trent
Web Hyperlink



Financing water infrastructure beyond 2015
Publisher: Severn Trent
Web Hyperlink

The Water Bill
Publisher: Government
Web Hyperlink

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