

# Severn Trent

## Bond Investor Presentation

October 2012

# Agenda

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# Severn Trent Investment Case

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A focused water company:

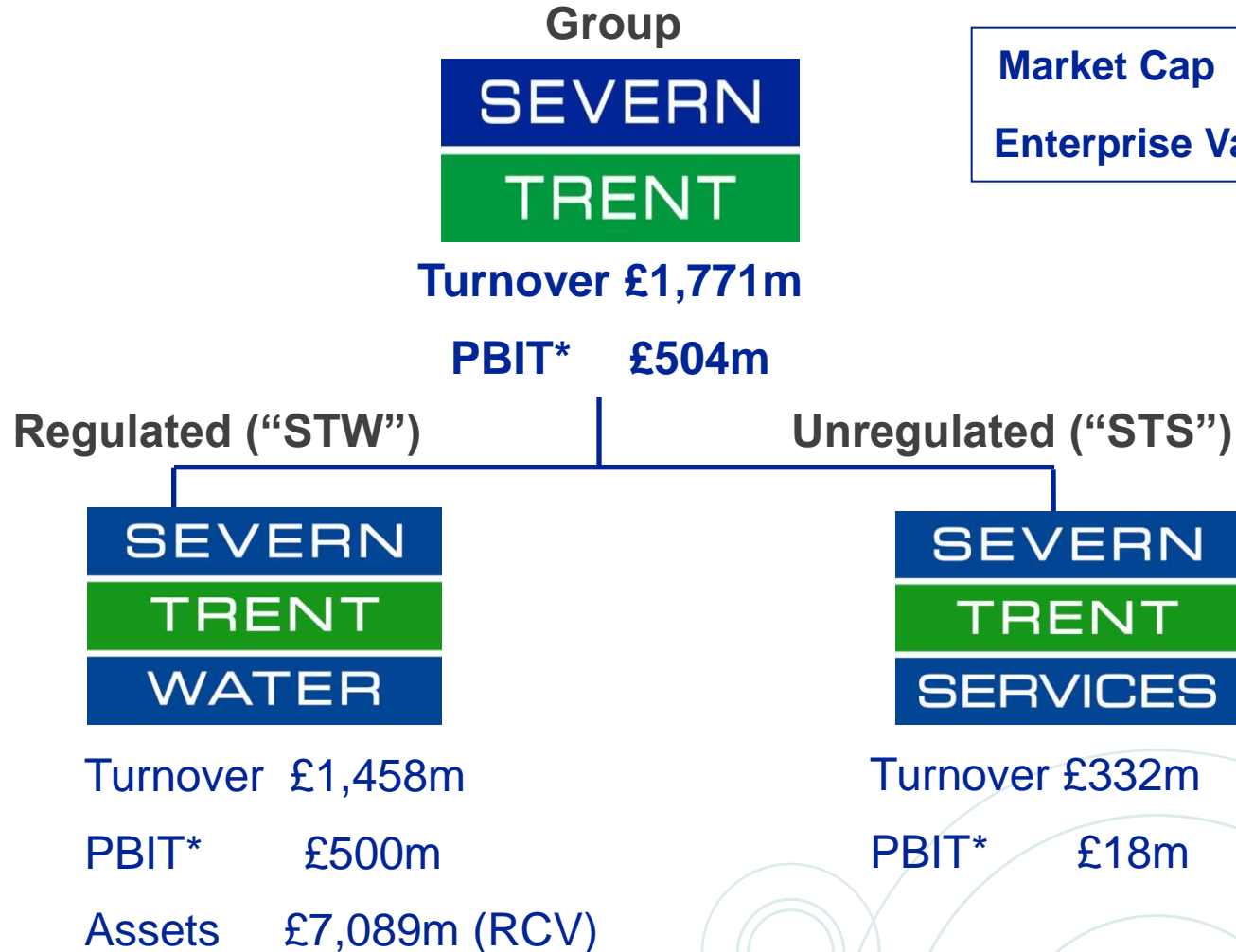
- Sustainable, efficient, long term investments
- Regulated, inflation linked assets and income
- Operational excellence
- Efficient financing

Exposure to unregulated markets via ST Services

Water sector facing change

- But evolutionary, not revolutionary
- Severn Trent well placed to mitigate risks/benefit from opportunities

# Group Structure



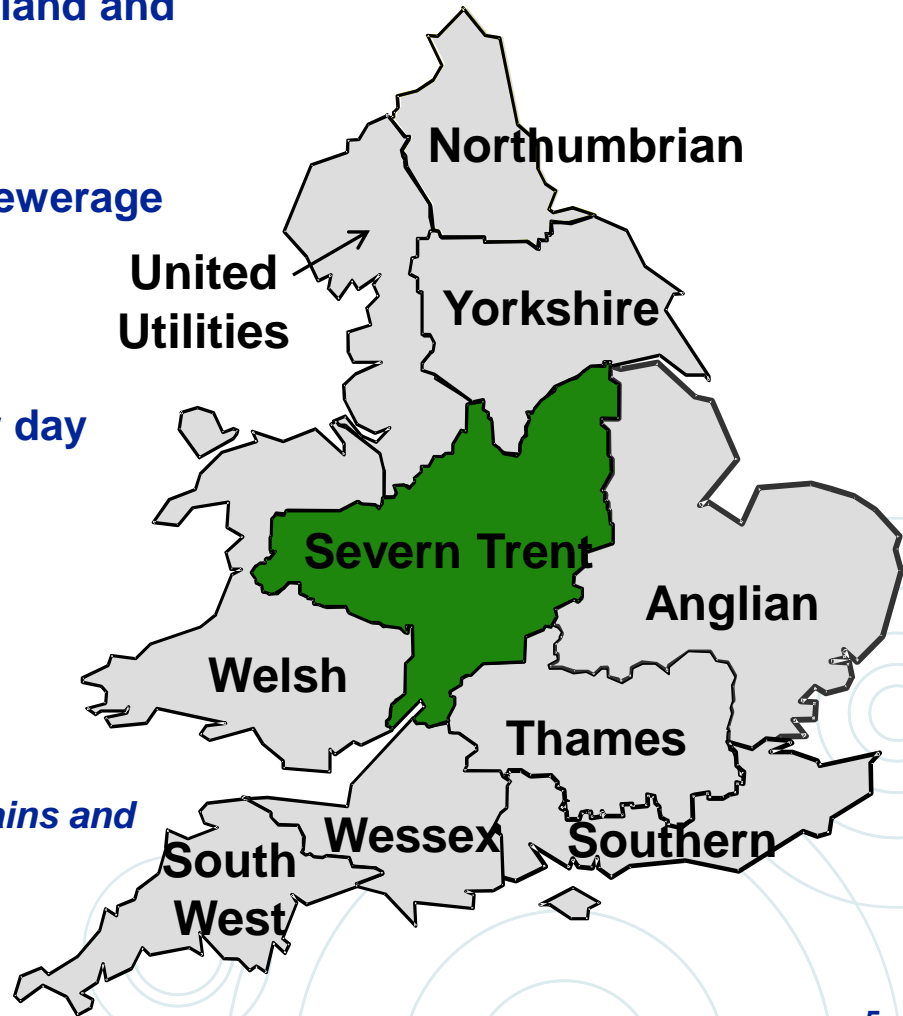
Market Cap	£3.9bn
Enterprise Value	£8.0bn

Year ended 31 March 2012. Other smaller activities not presented i.e. excludes Corporate and eliminations

\* Profit before interest, tax and exceptional items

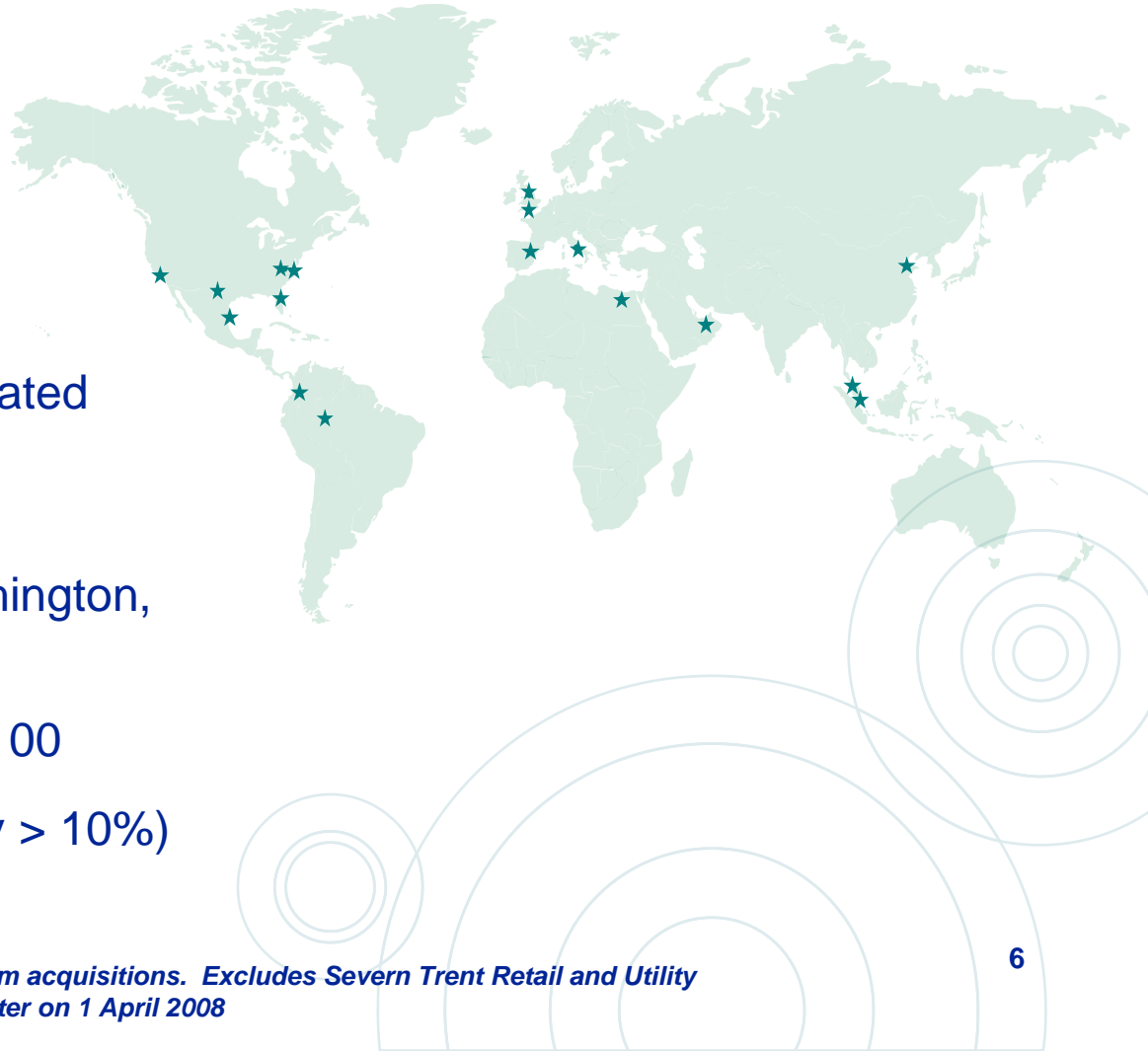
# Severn Trent Water - Overview

- **Severn Trent Water is one of the largest of the 10 Water and Sewerage Companies in England and Wales**
- **We cover an area of 21,000km<sup>2</sup> and:**
  - **supply water to c.7m people and sewerage services to c. 8m people**
  - **supply 1.8bn litres water per day**
  - **collect 1.4bn litres waste water per day**
- **Our physical assets include:**
  - **46,000 kilometres of water mains**
  - **134 water treatment works**
  - **54,000 kilometres of sewers**
    - *additional 37,000km of private drains and sewers adopted October 2011*
  - **1,026 sewage treatment works**



# Focus on water - non-regulated

- Severn Trent Services - global water technologies and services business
- Products
  - Disinfection
  - Filtration
  - BALPURE®
- Operating Services
  - UK& Ireland – non-regulated activities
  - US municipal contracts
- Headquartered in Fort Washington, PA, USA
- Global workforce around 3,100
- ROIC = 8.2%<sup>1,2</sup> (historically > 10%)



1. Year ended 31 March 2012  
2. Net operating assets plus gross goodwill from acquisitions. Excludes Severn Trent Retail and Utility Services – transferred from Severn Trent Water on 1 April 2008

# Highlights

	2010/11	2011/12	Change %
Group turnover (£m)	1,711.3	1,770.6	3.5
Profit before interest and tax (PBIT <sup>1</sup> ) (£m)	519.1	504.2	(2.9)
Profit before tax (PBT <sup>2</sup> ) (£m)	288.6	275.4	(4.6)
Adjusted basic EPS <sup>3</sup> (pence)	105.6	88.9	(15.8)
Basic EPS (pence)	115.2	72.5	(37.1)
Total ordinary dividend per share (pence)	65.1	70.1	7.7
Special dividend proposed (pence)	-	63.0	-

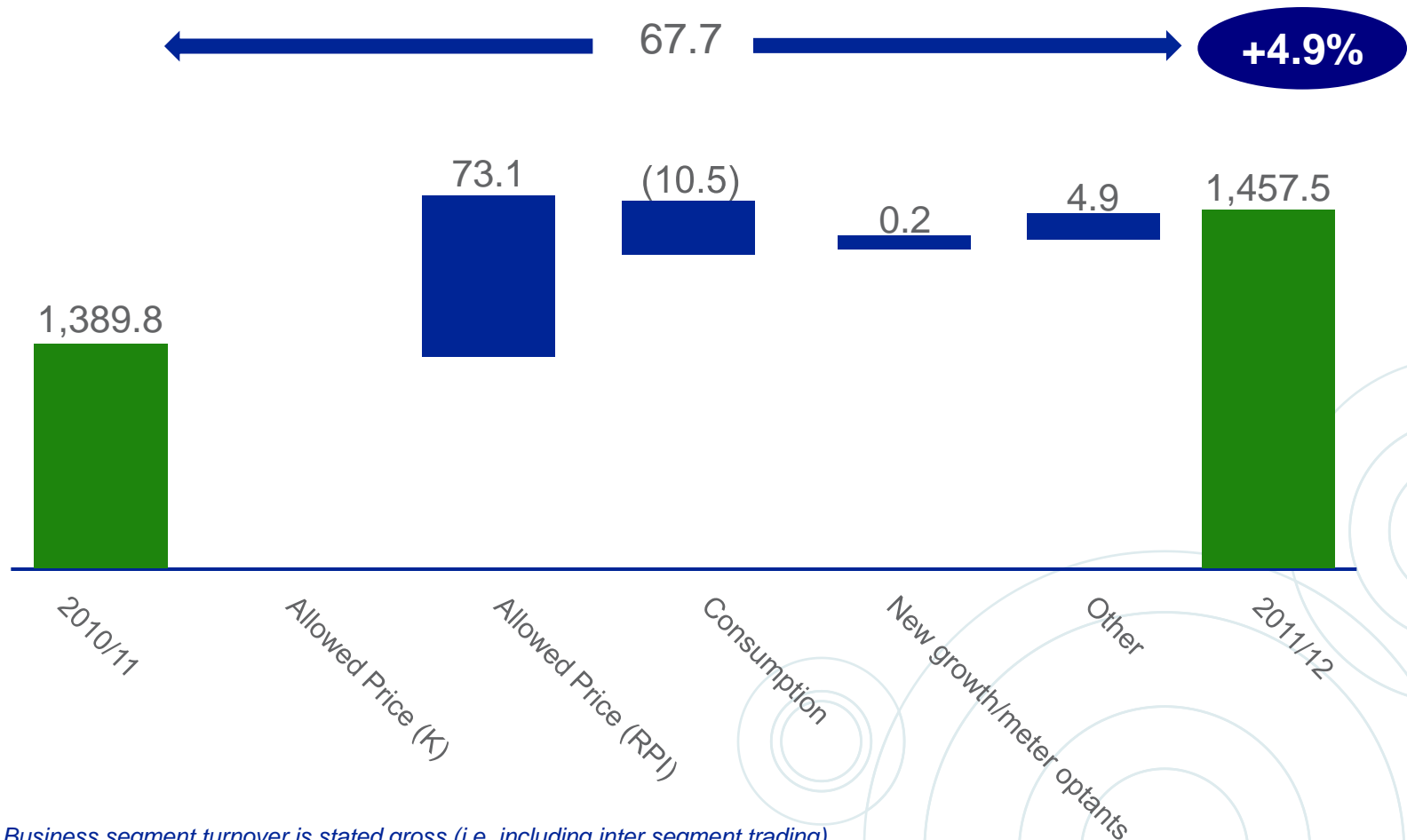
1. before exceptional items

2. before exceptional items and gains/losses on financial instruments

3. before exceptional items, gains/losses on financial instruments and deferred tax

# Severn Trent Water turnover

## Severn Trent Water Turnover\* 2011/12 £m



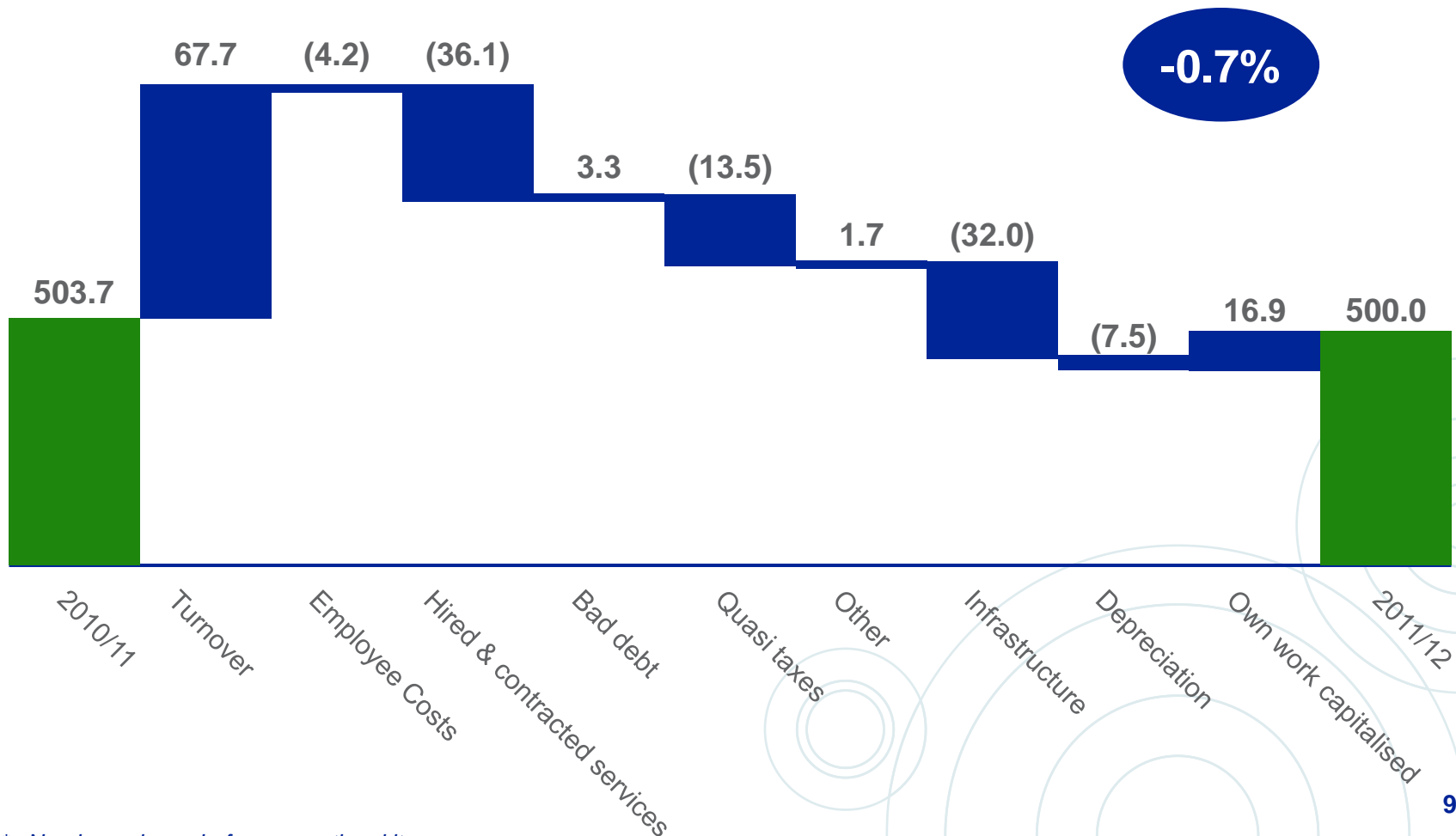
\* Business segment turnover is stated gross (i.e. including inter segment trading)



# Severn Trent Water PBIT

## Severn Trent Water PBIT\* 2011/12

£m



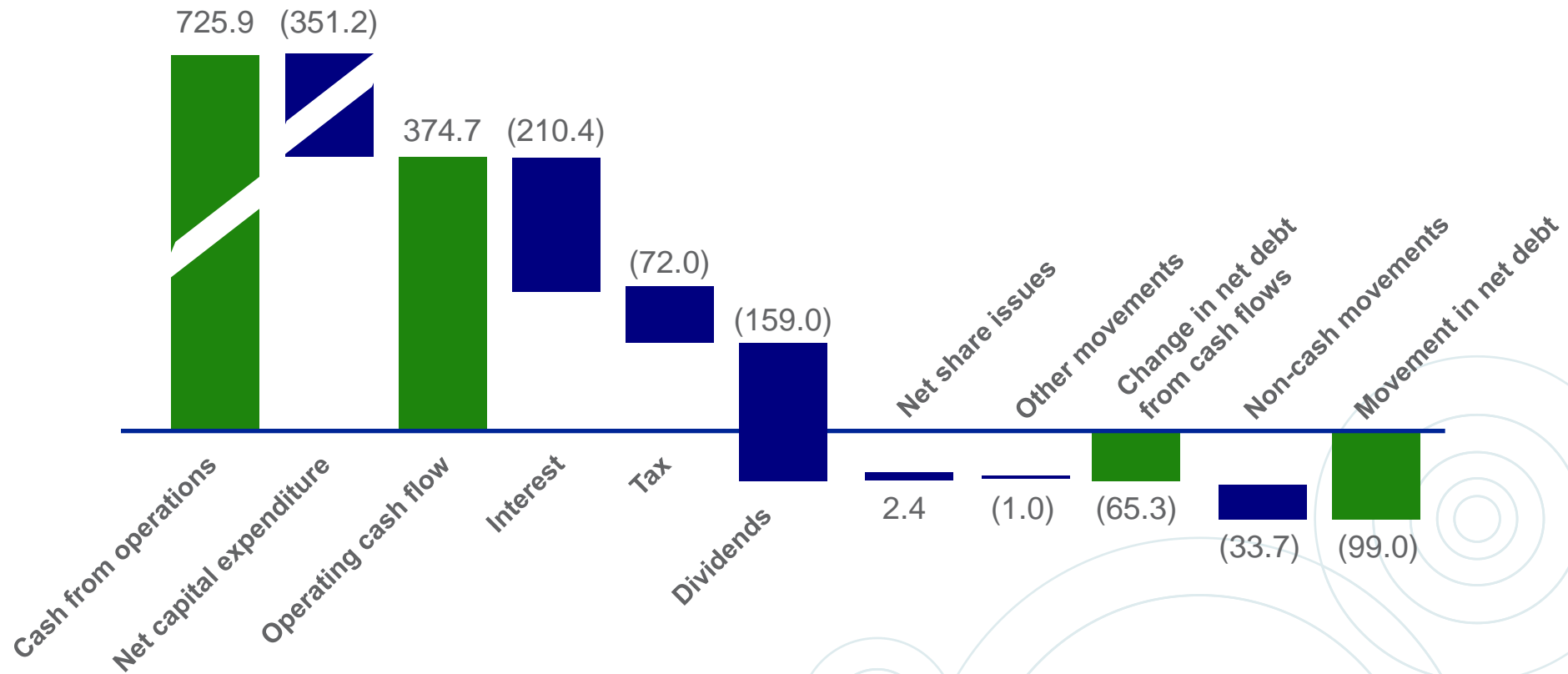
\* Numbers shown before exceptional items

# Exceptional items

£m	2010/11	2011/12
<b>Severn Trent Water</b>	13.0	<b>(10.3)</b>
<b>Severn Trent Services</b>	4.5	<b>44.7</b>
<b>Corporate and other</b>	3.9	-
<b>Total exceptional operating costs</b>	21.4	<b>34.4</b>
<b>Exceptional finance costs</b>	—	<b>16.5</b>
<b>Total exceptional items</b>	21.4	<b>50.9</b>

# Cash flow

£m



# Interim Management Statement July 2012

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Trading in line with expectations

## **Severn Trent Water**

- Opex in line with level of final determination
- Bad debt forecast to remain broadly stable at 2.2%
- Capex £570m-£590m range; IRE £140m-£150m

## **Severn Trent Services**

- Low single digit revenue growth; PBIT impacted by investments in business development

## **Group**

- Interest charge slightly lower y-o-y (lower RPI)
- Tax rate 24% to 26%

# Outlook for AMP5 - STW

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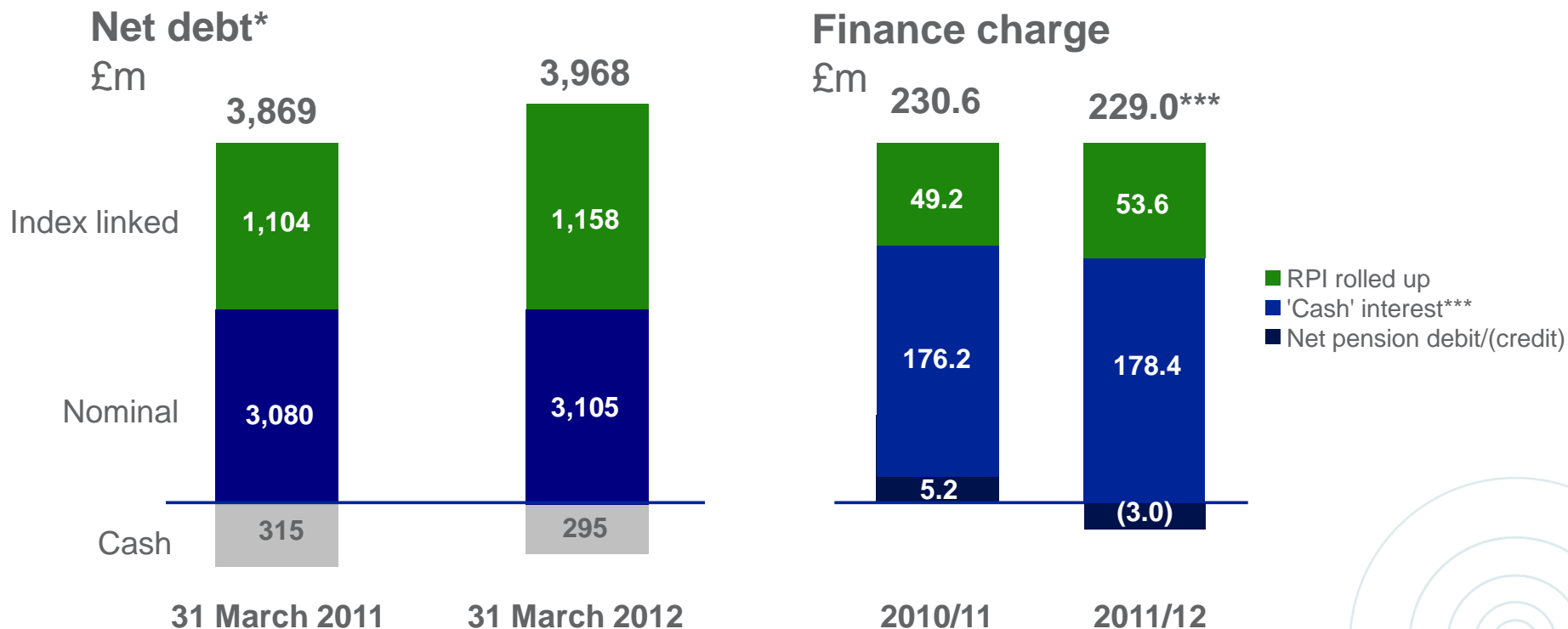
- Remain confident we can meet regulatory settlement
  - Continuing to drive performance improvements. Operating costs below level of final determination in first two years
  - Power – years 1-4 fully hedged, saving of c. £30m vs. final determination & renewables growing (natural hedge)
  - Revised capital programme in line with final determination (efficiencies re-invested)
- Cost of significant proportion of existing and anticipated debt for AMP5 fixed
  - c. £100 million saving over AMP5 vs. regulatory settlement
- During AMP5 we expect to have:
  - The lowest operating costs and one of the most efficient capital programmes
- Track record of improving the business and the aim of being the best Water and Sewage company in the UK

# Balance Sheet

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- Strong and flexible balance sheet
  - Net debt/RCV 56.0%
  - Consistent with strong investment grade credit rating
- Severn Trent Water – additional £150m capital investment
  - Improved customer service and network performance
- Return to shareholders paid - £150m
- Funding requirement in AMP 5 c£0.7bn and £2bn in AMP6
- Undrawn RCF £500m, cash £200m

# Group net debt and finance charges



- 74% at fixed interest rates
- Regulated Entity (Severn Trent Water) net debt £4,163.9m
- Group net debt/RCV\*\* 56.0%

- Effective rate circa 6.4%
- Effective cash interest cost \*\*\* 4.9%
- EBITDA cover \*\*\* 3.7x
- PBIT cover\*\*\*\* 2.4x

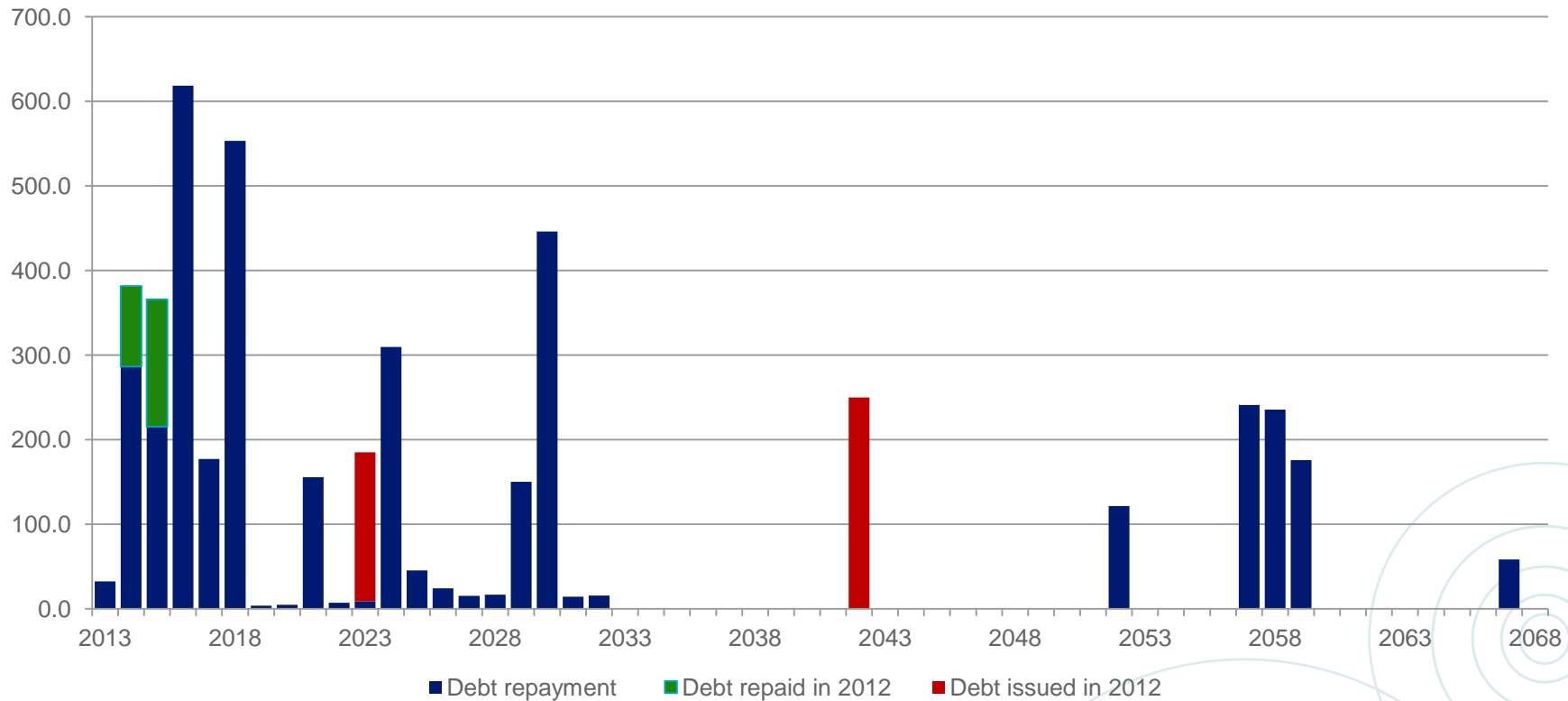
\* Including cross currency swaps

\*\* RCV at 31 March 2012 at year end RPI

\*\*\* Before exceptional finance costs

\*\*\*\* Before exceptional items

# Debt maturity profile



**Average debt maturity of 16 years**



# Credit ratings

31 March 2012

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Long-Term	Severn Trent Water	Severn Trent Plc
Moody's	A3	Baa1
Standard & Poor's	BBB+	BBB-

Short-Term	Severn Trent Water	Severn Trent Plc
Moody's	P2	P2
Standard & Poor's	A2	A3

Moody's – long term rating is stable

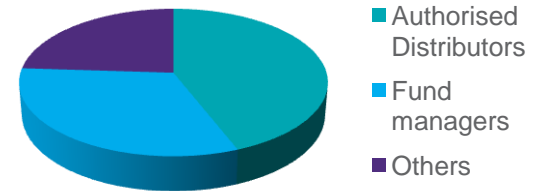
Standard & Poor's – long term rating is stable

# Retail bonds a new and alternative approach

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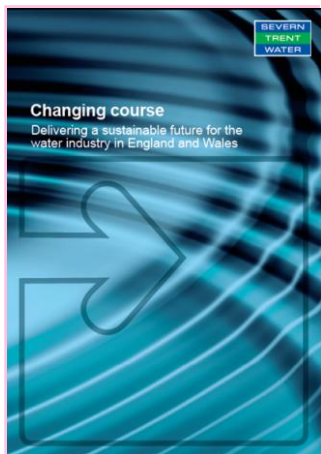
- Bond available to retail investors – individuals, private wealth investors, fund managers
- Distributed via stock brokers to:
  - Discretionary fund managers
  - ISA, pension investors
- Small denomination notes – £2000 + £100
- No benchmark size - <£50m and potential for repeat issue
- Investors seek name recognition and absolute returns
- Need programme documentation

Source of Retail Bond orders



**Severn Trent 1.3% index linked ten year bond - £75 m**

# Ofwat consultations and White Paper



- Involving customers in price setting – Ofwat’s customer engagement policy statement (August 2011)

[www.ofwat.gov.uk/content?id=0a559eee-6048-11e0-85fb-9366962d43d0](http://www.ofwat.gov.uk/content?id=0a559eee-6048-11e0-85fb-9366962d43d0)

- Regulatory Compliance – a proportionate and targeted approach (October 2011)

[www.ofwat.gov.uk/content?id=f956a963-ef60-11e0-bef5-b560843f3a7f](http://www.ofwat.gov.uk/content?id=f956a963-ef60-11e0-bef5-b560843f3a7f)

- Future price limits (November 2011)

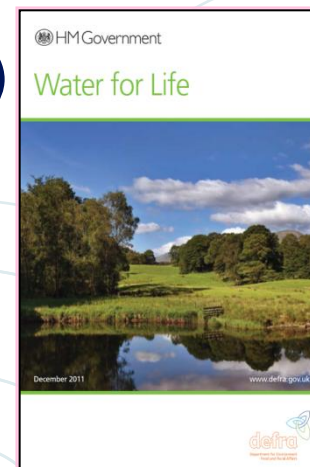
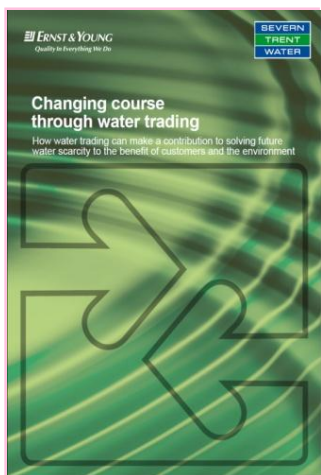
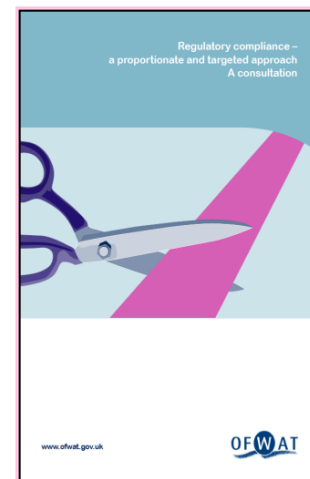
[www.ofwat.gov.uk/consultations](http://www.ofwat.gov.uk/consultations)

- White Paper (December 2011)

[www.official-documents.gov.uk/document/cm82/8230/8230.asp](http://www.official-documents.gov.uk/document/cm82/8230/8230.asp)

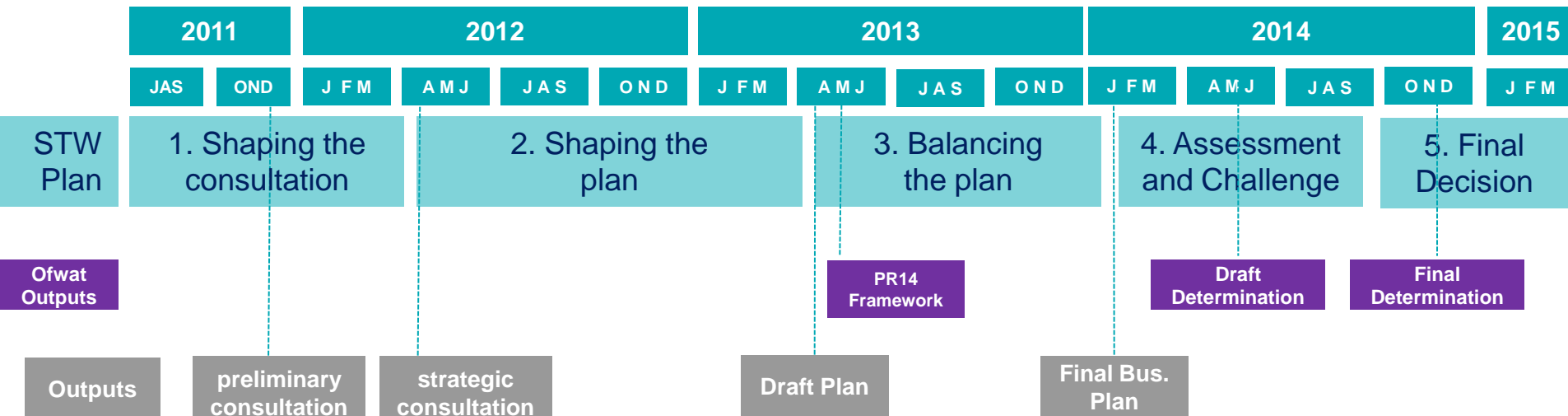
- Draft Water Bill (July 2012)

<http://archive.defra.gov.uk/temp/draft-water-bill-2012.pdf>



# Planning for PR14

Now in Phase 2, building Draft Plan for consultation



## Ofwat future price limits, statement of principles

- Separate retail and wholesale price controls – retail margin not funded by lower wholesale returns
- 5 year period remains
- RCV indexed to RPI
- 100% of RCV goes to wholesale
- Encouragement for water trading

# Water Trading

## The issue

### Abstraction levels



Environment  
Agency

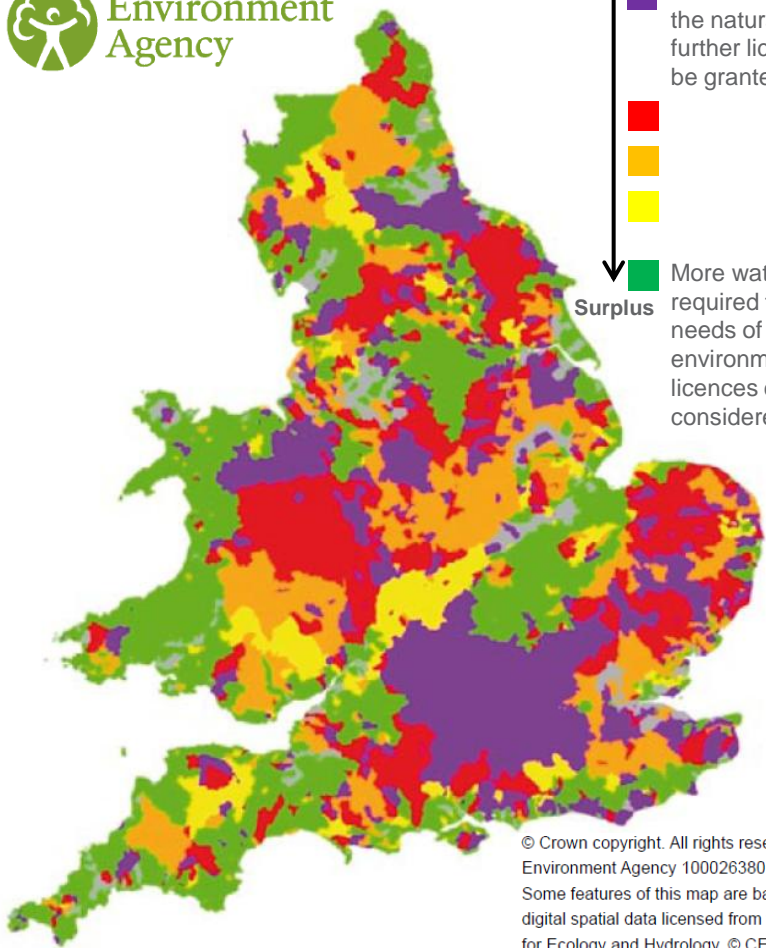
Deficit

More than 25% below the natural flow. No further licences should be granted.



Surplus

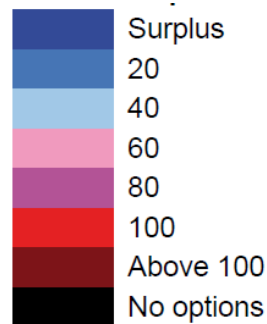
More water than required to meet the needs of the environment. New licences can be considered.



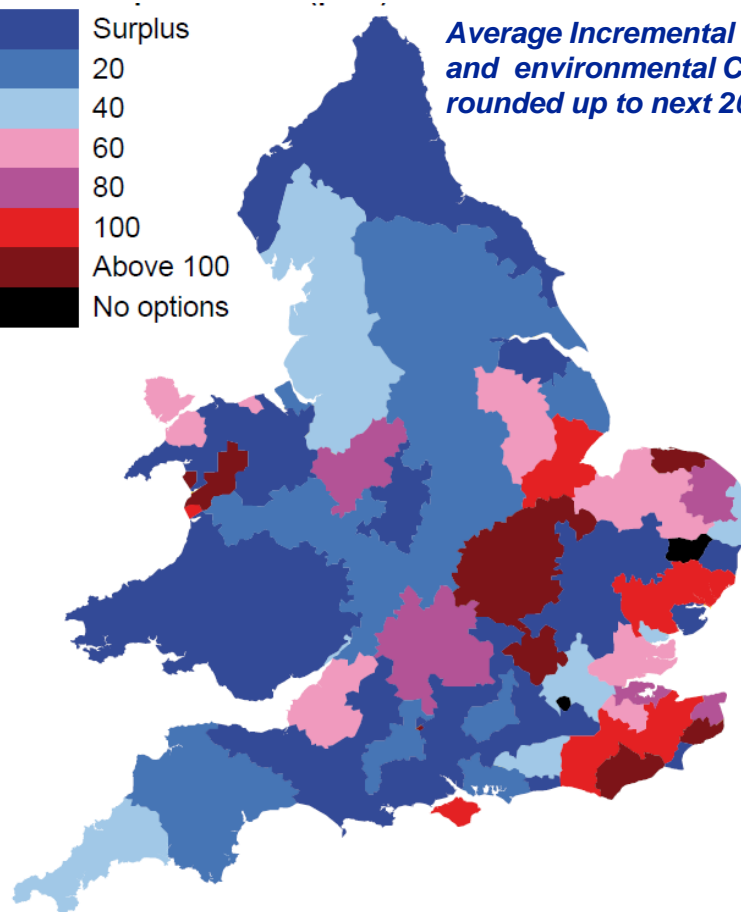
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Environment Agency 100026380, 2004.  
Some features of this map are based on  
digital spatial data licensed from the Centre  
for Ecology and Hydrology, © CEH

*Indication of abstraction across England and Wales, taking account of needs in downstream catchments, Environment Agency, July 2010*

### Resource zones for water companies in England & Wales

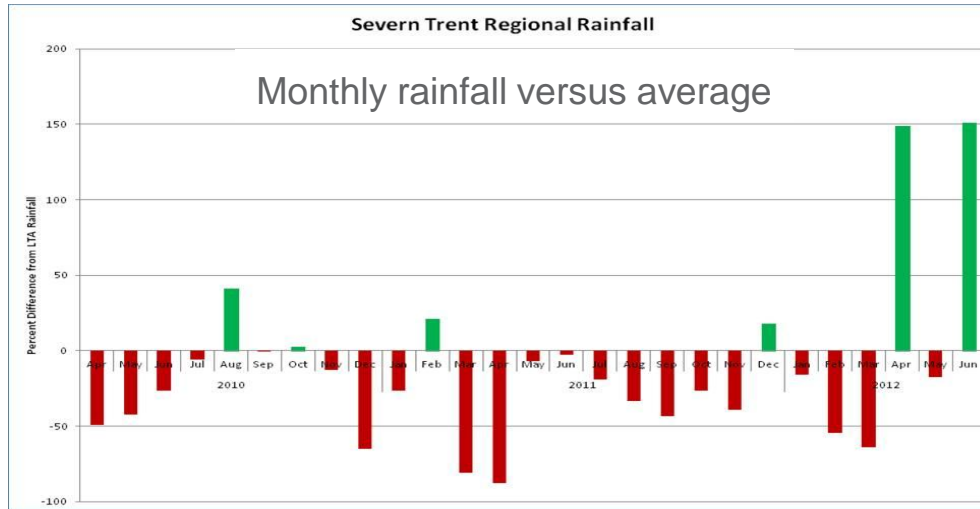


*Average Incremental Social and environmental Cost, rounded up to next 20 (p/m3)*



*A study on potential benefits of upstream markets in the water sector in England and Wales, Ofwat, March 2010.*

# Drought and water trading



Two exceptionally dry winters, but no hosepipe ban

Lowest level of leakage (464 MI/d)

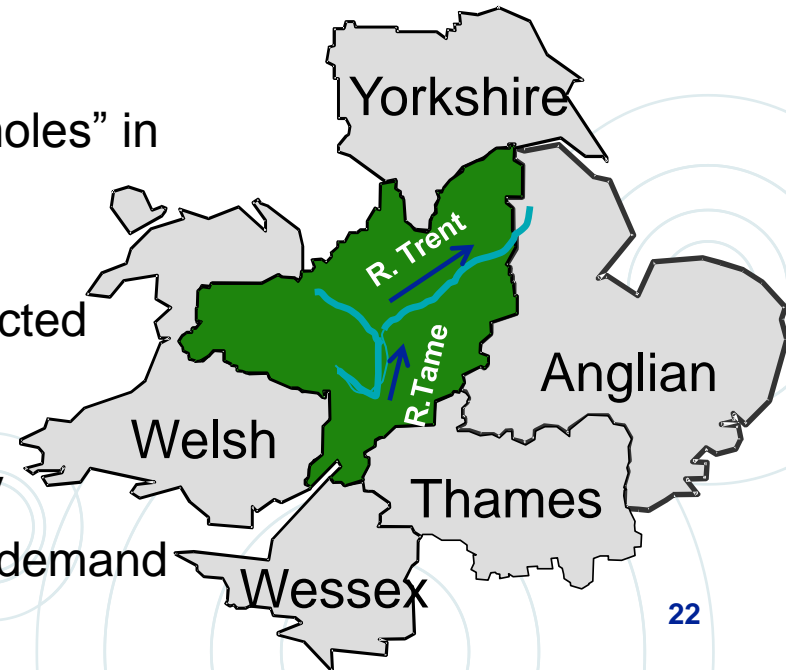
We have not had any hosepipe bans in the last 15 years – last one 1997

- **Anglian proposal:**

- Pumping 30 MI/d from 5 “drought boreholes” in Birmingham into the River Tame
- Flows to river Trent, then 80 miles to Gainsborough, Lincs, where it is abstracted

- **Equates to 100,000 properties**

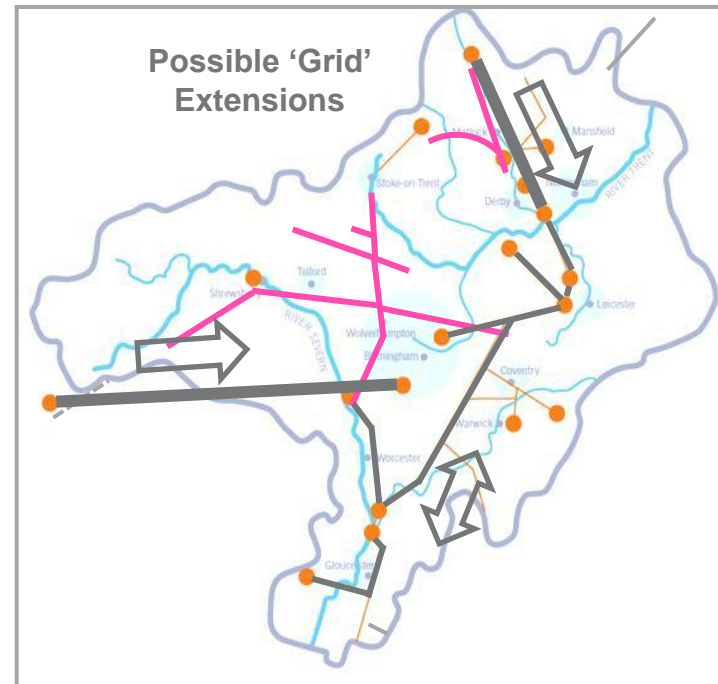
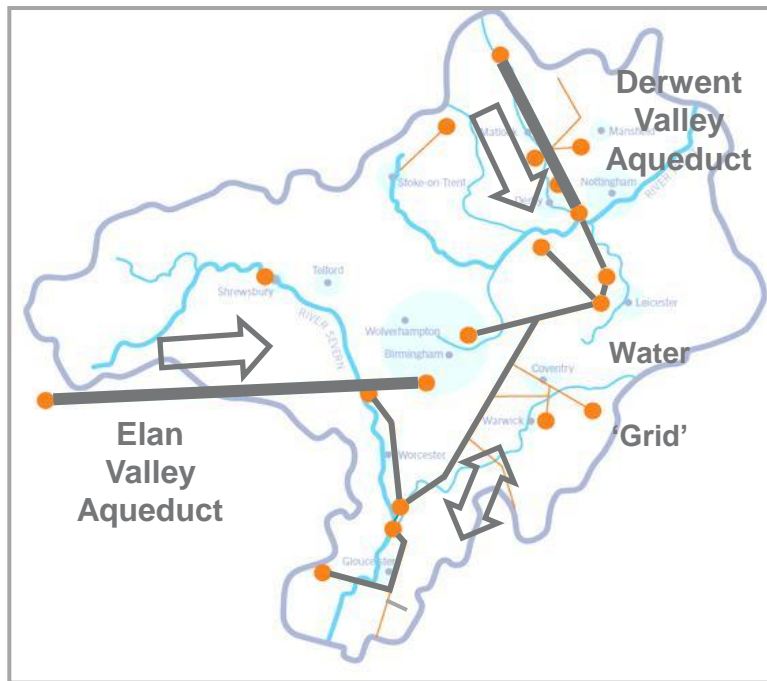
- Equivalent to supplying whole of Rugby
- Approx 3% of total Anglian Water daily demand





# Our response

We benefit from the ability to move water from North West to South East



We will continue to develop our grid during AMP6

# Private Drains and Sewers (PDaS)

## Progress

- Successful operation of PDaS assets following transfer on October 1st
- To end of March, volume growth lower than expectations
  - Customer awareness lower than anticipated but showing steady growth
  - Capital investment will ramp up – initial focus on understanding the volume and condition of transferred asset

	<b>2011/12 Actual</b>	<b>Updated AMP5 total</b>	<b>Previous AMP5 total</b>
Exceptionals	£4.6m	£4.6m	£6m
Opex	£4.7m	£30m-£36m	£52m-£85m
Capex	£3.2m	£55m-£97m	£43m-£87m
<b>Total</b>	<b>£12.5m</b>	<b>£90m-£138m</b>	<b>£101m-£178m</b>



# Contact details

## John Crosse, Head of Investor Relations

M: +44 (0) 7775 226260

e:mail: [john.crosse@severntrent.co.uk](mailto:john.crosse@severntrent.co.uk)

## Gerard Tyler, Group Treasurer

M: +44 (0) 7824 623941

e:mail: [gerard.tyler@severntrent.co.uk](mailto:gerard.tyler@severntrent.co.uk)

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

[www.severntrent.com](http://www.severntrent.com)

[www.stwater.co.uk](http://www.stwater.co.uk)

[www.severntrentservices.com](http://www.severntrentservices.com)

## Key Publications

Water Trading

[www.stwater.co.uk/watertrading](http://www.stwater.co.uk/watertrading)

Changing Course

[www.stwater.co.uk/changingcourse](http://www.stwater.co.uk/changingcourse)

## Useful Links

Ofwat

[www.ofwat.gov.uk](http://www.ofwat.gov.uk)

Defra – Department for Environment, Food and  
Rural Affairs

[www.defra.gov.uk](http://www.defra.gov.uk)

Environment Agency

[www.environment-agency.gov.uk](http://www.environment-agency.gov.uk)

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# Appendix

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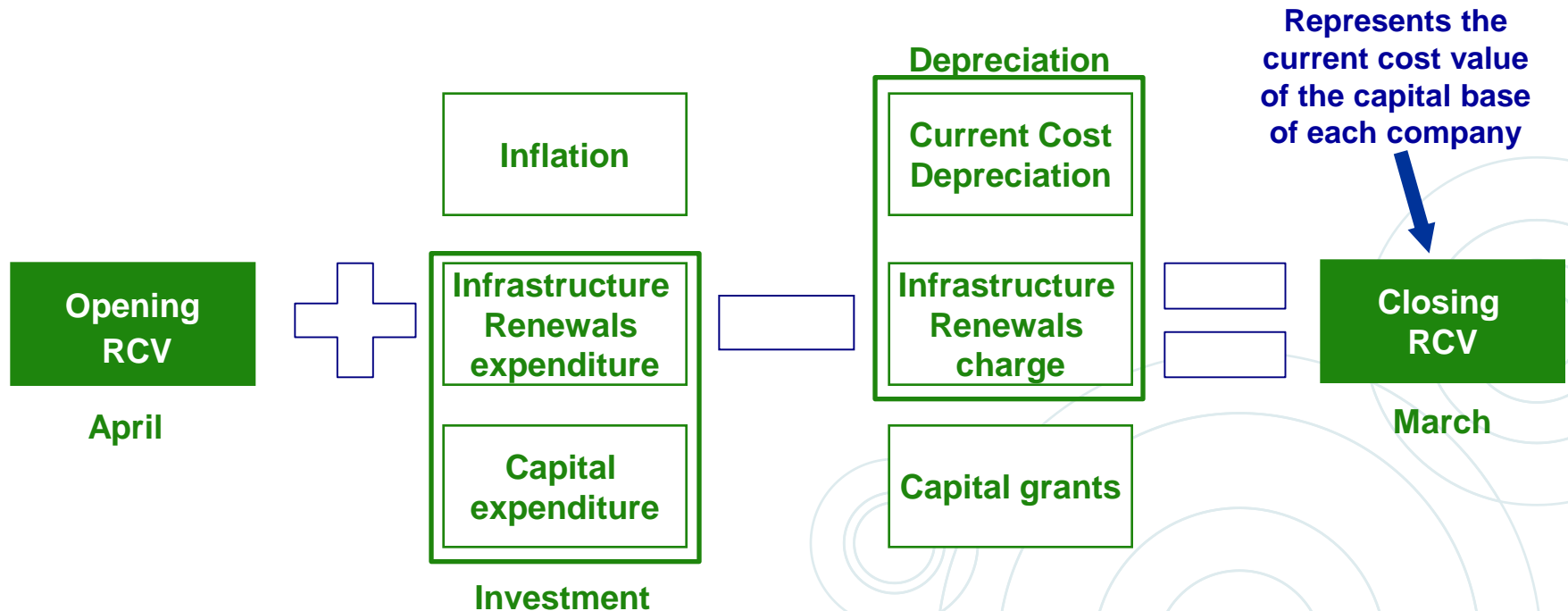


# The UK water industry

- Water Companies privatised in 1989 – licences cannot be terminated until 2014 (i.e. 25 yrs after privatisation) and only then with 25 yrs notice
- Investment led industry – capital investment is added to the RCV (Regulated Capital Value)
- Economic returns allowed on RCV through price setting process
- Inflation linked model - asset base and prices adjusted by RPI (Retail Price Index) each year
- Supportive and stable regulation
  - 5 year review cycle (“AMP periods”, current 2010/11 - 2014/15)
  - Prices set by economic regulator Ofwat. Primary legal duty to ensure that licence holders can finance their functions
- Interim price reviews (“IDOK”) also possible between AMP periods, where revenues have unexpectedly been lost or costs have risen significantly. In current period this includes:
  - Bad debt
  - Adoption of private sewers
- Past 20 years – **focus on raising quality and standards**
- Next 20 years – **focus on security of supply**
- Industry on verge of change – but evolution, not revolution

# Regulated Capital Value (RCV)

- RCV is the value of the capital base of the Company used by Ofwat for setting price limits
- RCV is widely used as a proxy for the enterprise value
- RCV is adjusted by inflation (RPI) each year

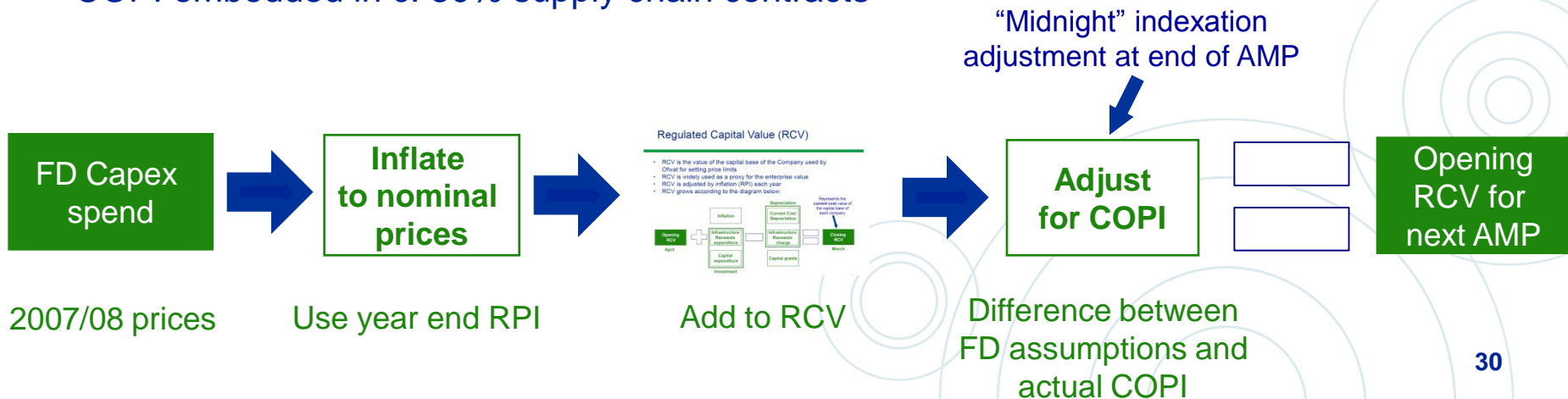


# COP1 Adjustment to RCV

## Ofwat's model

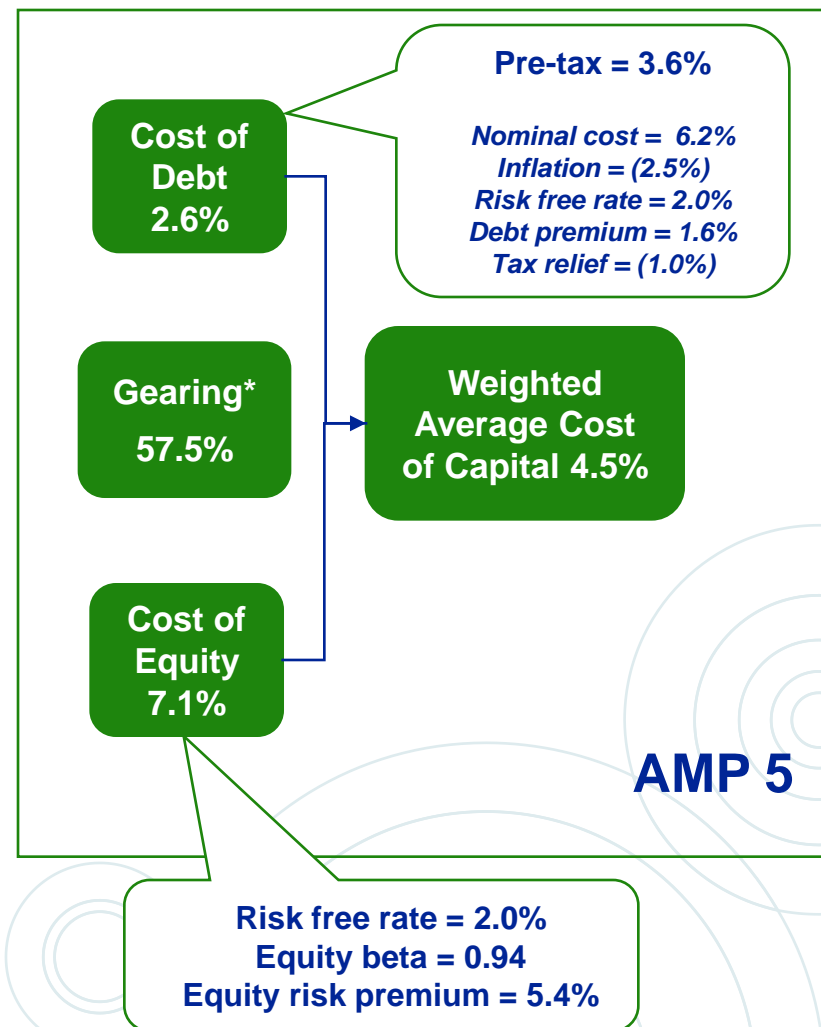
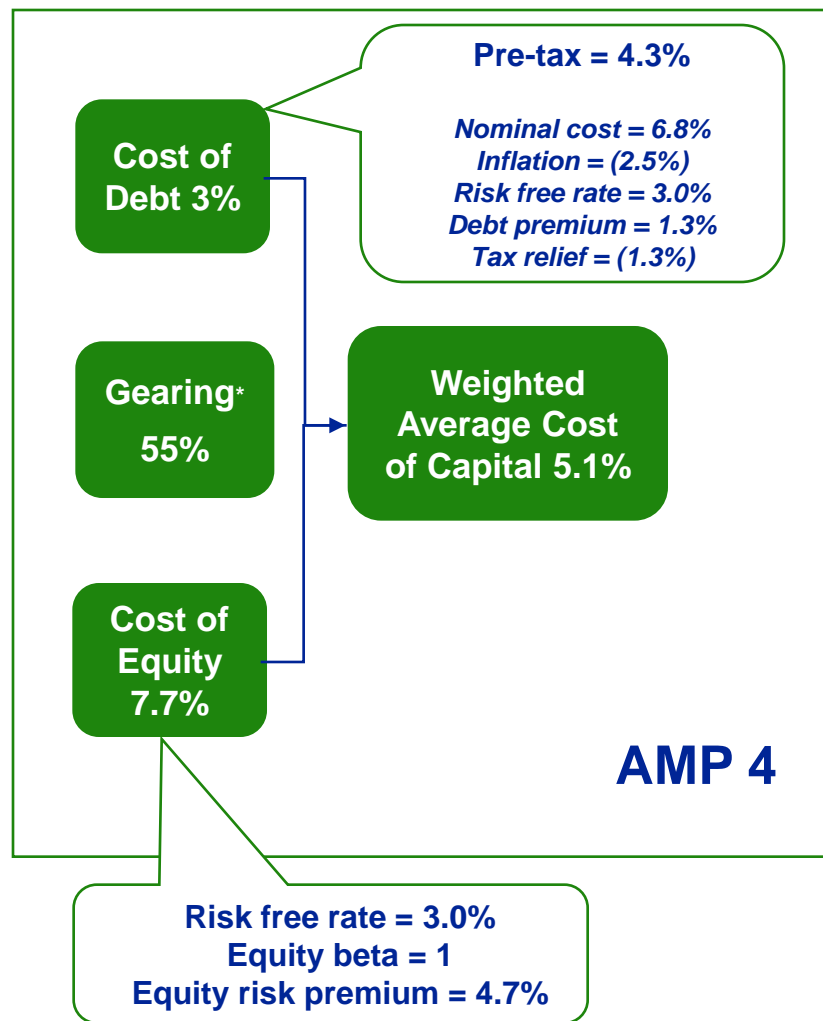
### COP1 – Construction Output Prices Index

- In the Final Determination (FD), Ofwat's allowed capex spend is stated at 2007/08 prices
- This capex spend therefore needs to be inflated to nominal (outturn) prices before being added to RCV, to arrive at forecast RCV at end of AMP (2014/15)
- However, capex spend is also adjusted by COP1, but only at the end of the AMP period
- In the past, COP1 has broadly tracked RPI, so the adjustment has been modest (AMP4=£93m)
- COP1 has been negative in recent months, and below Ofwat's assumptions in the FD
- COP1 embedded in c. 50% supply chain contracts



# Cost Of Capital (net of tax - 'real')

## How the regulated return is derived – AMP4 vs. AMP 5

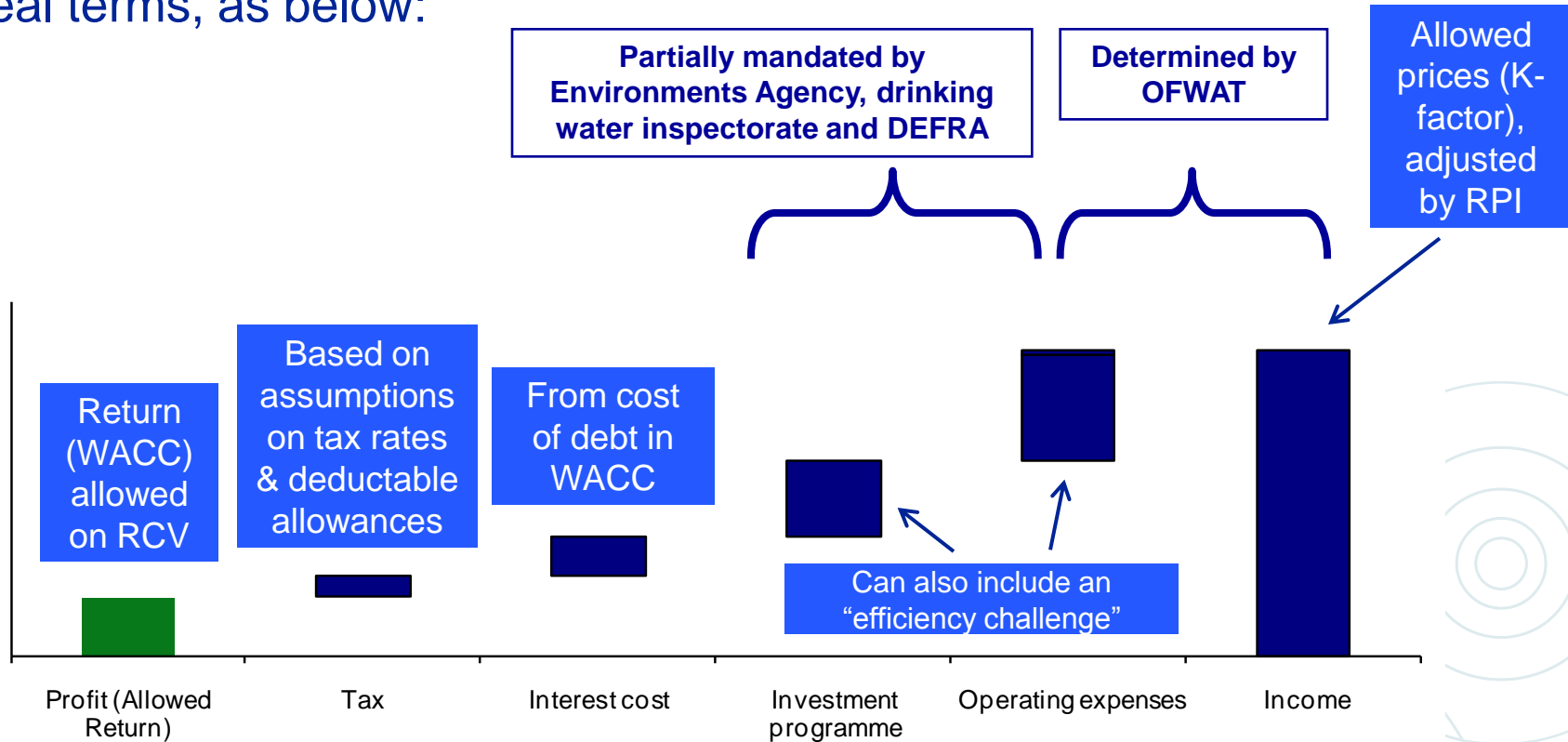


\* Gearing = net debt to RCV. Ofwat uses pro-forma balance sheet

# How is Severn Trent Water profit made up?

## Illustrative

- Ofwat is obliged to ensure water companies can fund themselves
- Ofwat sets prices set over a 5 year cycle (current 2010/11 to 2014/15) in real terms, as below:



- “K factors” adjusted by RPI from November of previous year (i.e. Nov. 2011 RPI = 5.2%, 2012/13 K-factor = 0%; Severn Trent Water prices rose by 5.2% on 1st April 2012).



# Our customers

We have 3.6m customers with active accounts (*c.8 million people*)

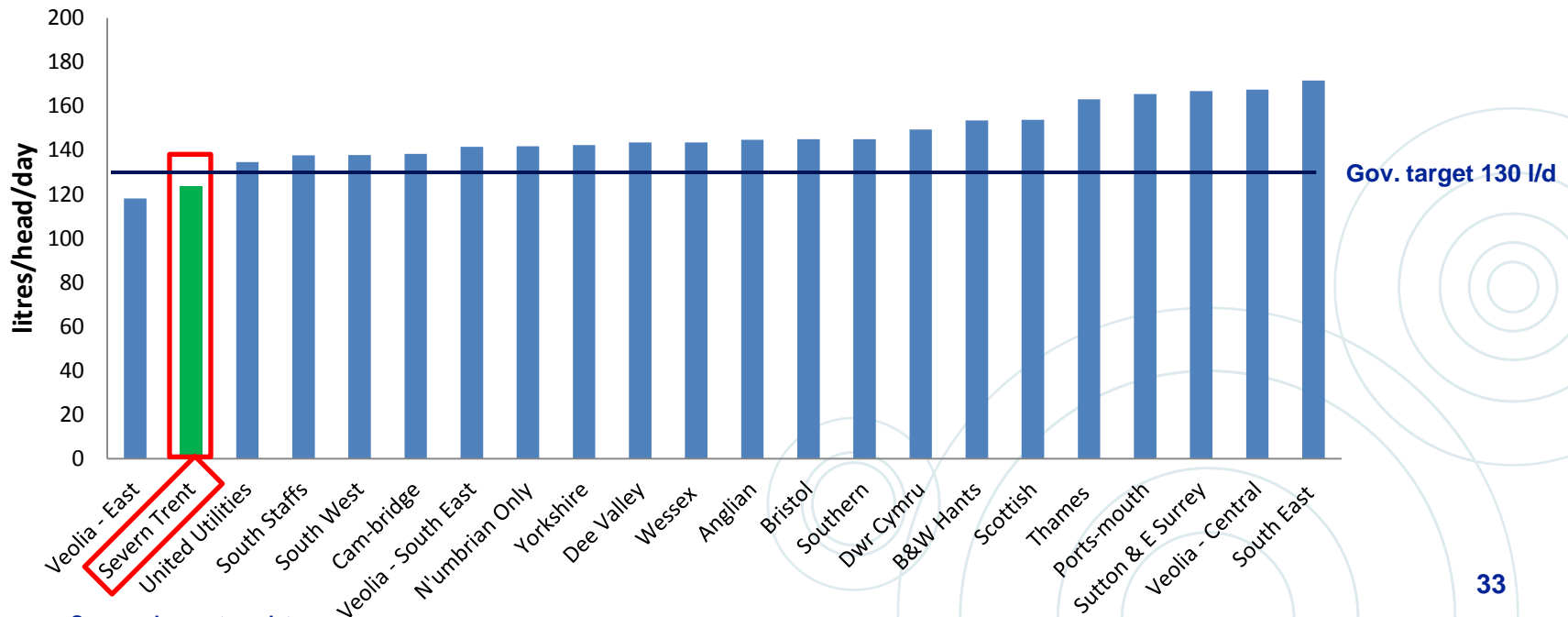
## Domestic

- 3.3 million
  - 1.1 million billed on a meter (33%)
  - 2.2 million billed based on their property (67%)

## Commercial

- 250,000 all billed via meters

**Per capita consumption (average weighted – excluding s/pipe leakage)**



# Key Performance Indicators

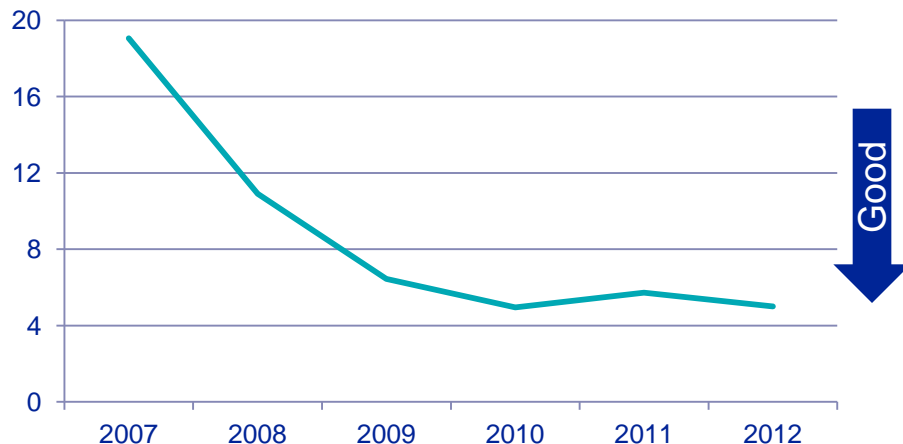
## Track record over 5 years - highlights

SEVERN

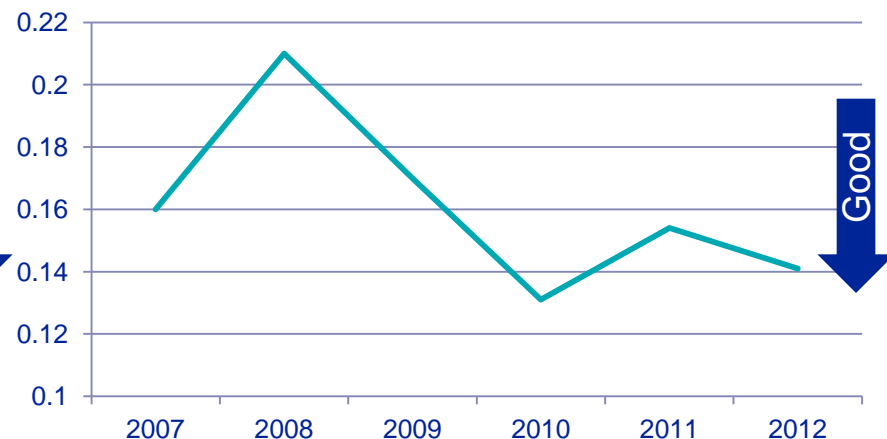
TRENT

WATER

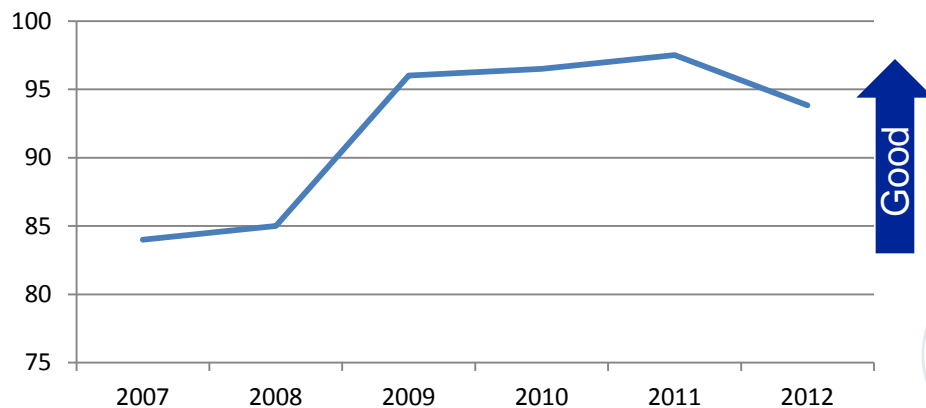
### Customer Written Complaints per 1,000 properties



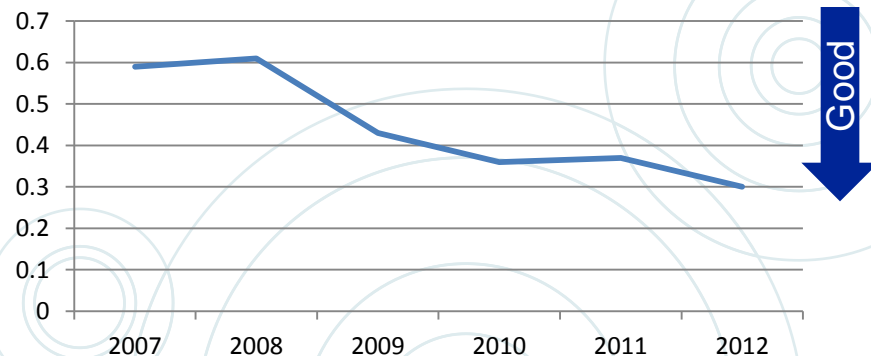
### Sewer flooding - other causes per 1,000 properties



### First Time job resolution %

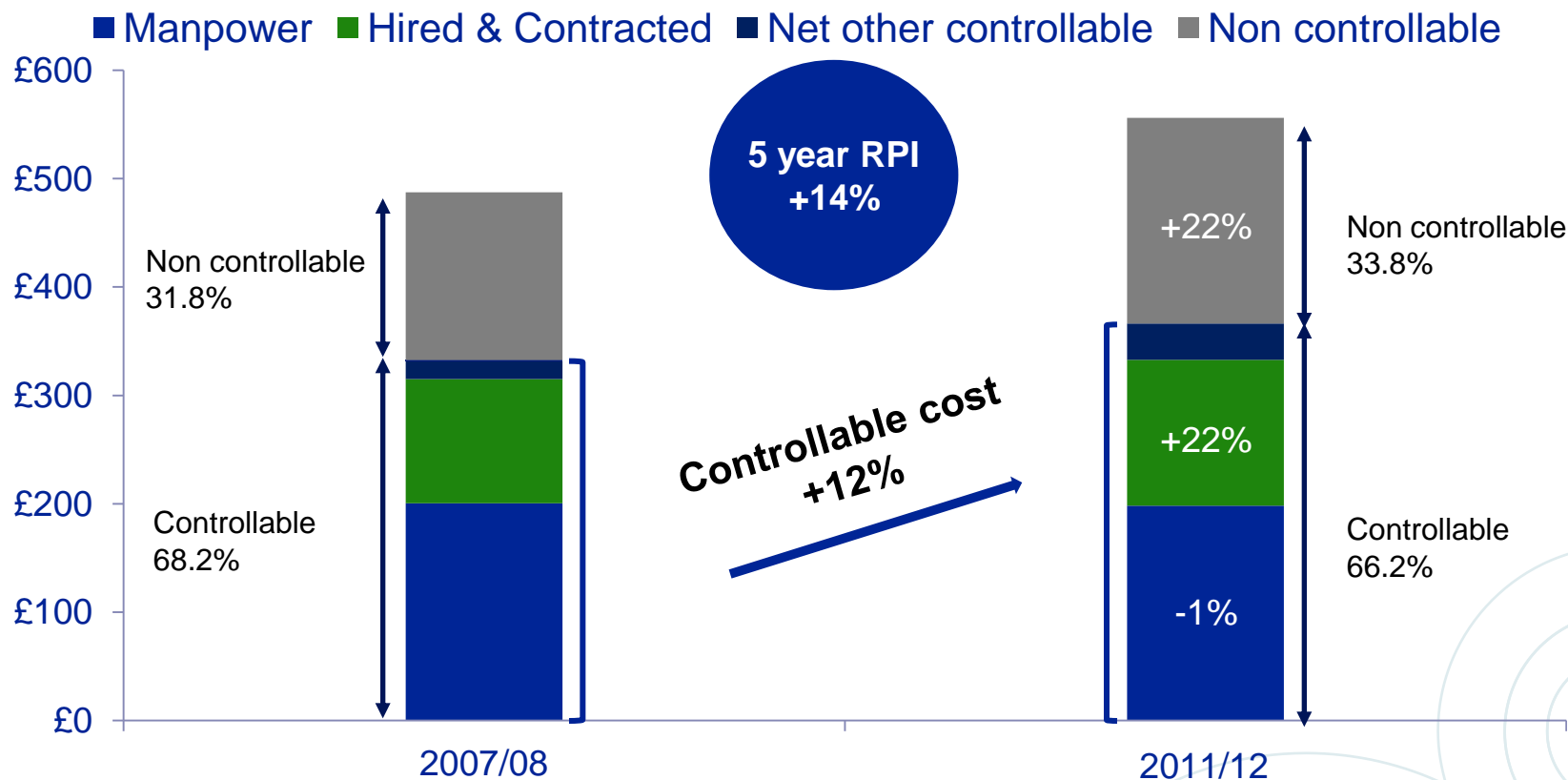


### Lost Time Incidents per 100,000 hrs worked



# Operational expenditure

## 5 year view



- Controllable costs risen by only 12% from 2007/08 to 2011/12
  - Manpower costs fell by 1%
- Non controllable costs risen significantly above inflation
  - Driven primarily by power, bad debts and service charges

# Areas of focus – Productivity

SEVERN

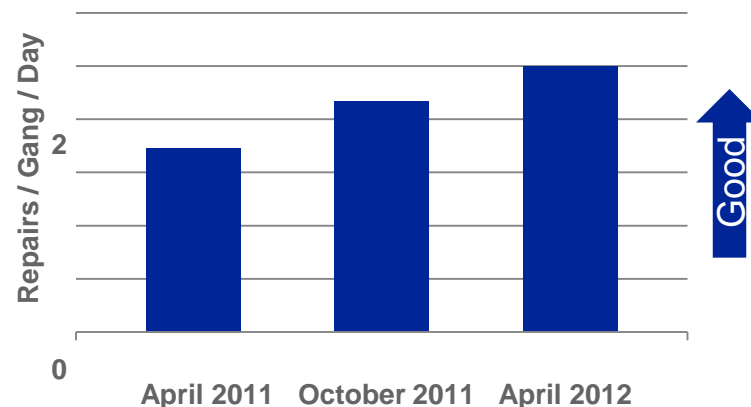
TRENT

WATER

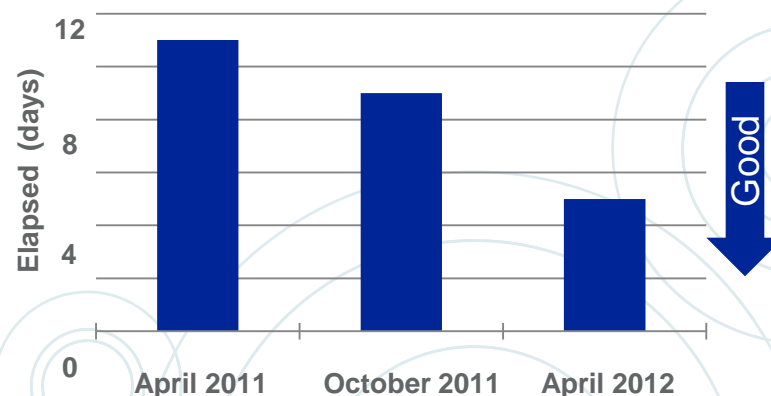
## Example Leakage

- Delivered productivity improvements in finding and fixing leaks
- Repair productivity approaching target levels
- Also innovating with leakage detection on plastic pipes and new repair techniques
- Significantly reduced time to get a leak inspected, assessed and repaired
- Proportion of work carried out right first time has also improved

**Repair productivity 2011/12**



**Visible leak repair times 2011/12**



# Areas of focus going forward

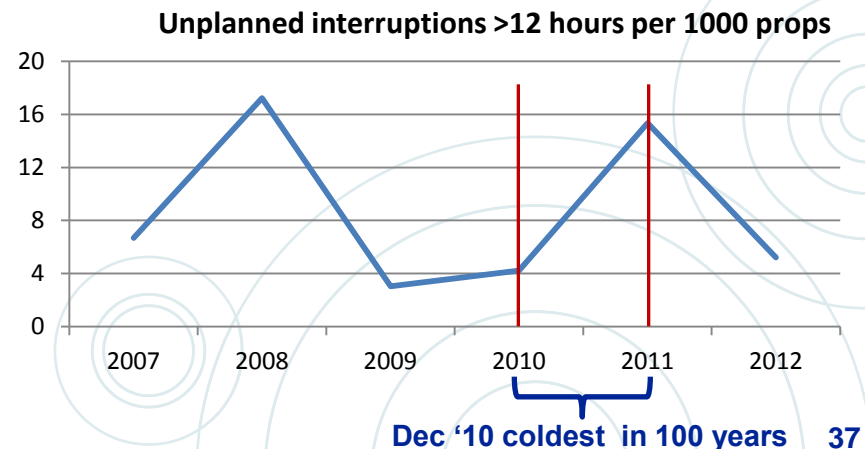
## Serviceability

Serviceability	2008/09	2009/10	2010/11	2011/12e	
Water below ground	Stable	Marginal	Marginal	Marginal	focus area
Water above ground	Stable	Stable	Stable	Stable	✓
Waste below ground	Stable	Stable	Stable	Stable	✓
Waste above ground	Stable	Stable	Stable	Stable	✓

Water below ground serviceability is assessed by:

- ✓ Mains bursts
- ✓ Poor pressure
- Interruptions > 12 hours is driving marginal assessment

**This year saw significant improvements in interruptions > 12 hours we expect to return to stable serviceability in 2012 / 13**



# Capital Investment Programme

## Additional £150m over the remainder of AMP5 to deliver stable serviceability

- Reducing unplanned interruptions
- Improving performance of water treatment works
- Reducing pollution incidents
- Reducing number of sewage treatment works failing consents
- Continue to increase the flexibility of our network for future water trading
- Provide additional RCV growth



**Targeted section of trunk main renewal**

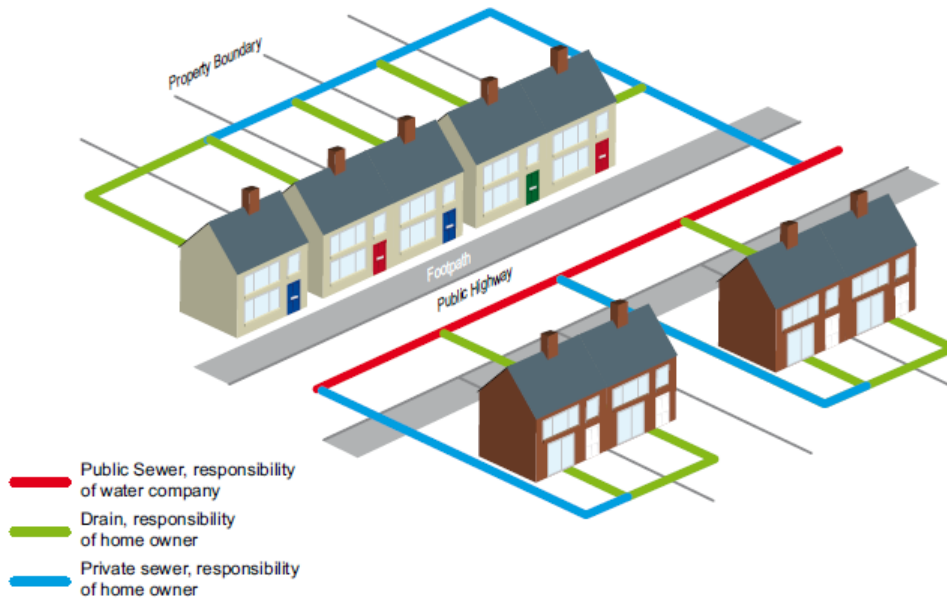


**New Thru-bore hydrants fitted without interrupting supply**

# Private Drains and Sewers (PDaS) Overview

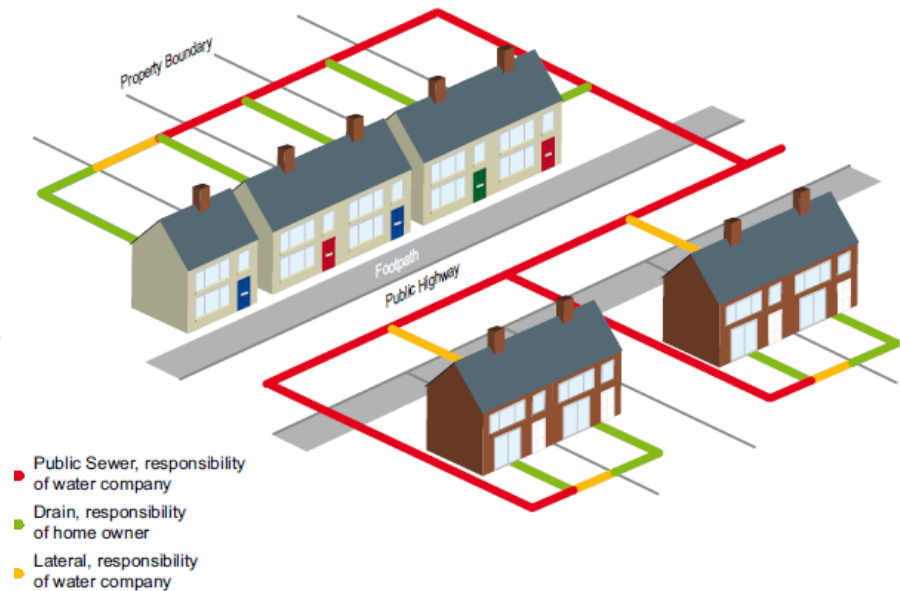
## Pre 1 October 2011

- Home owners are responsible for everything up to the main sewer, including the connection



## Post 1 October 2011

- All sewers transfer
- All laterals and drains outside property boundaries transfer - BUT
- Home owners are still responsible for the private drains within their boundary.





# Severn Trent Water – RCV

£m	2010/11	2011/12	2012/13	2013/14	2014/15
Per Determination*	6,216	6,244	6,280	6,341	6,385
<b>Actual / Estimated Outturn**</b>	<b>6,814</b>	<b>7,089</b>	<b>7,267</b>	<b>7,523</b>	<b>7,786</b>
Ofwat Actual/Projected Outturn***	6,814	7,089	7,130	7,199	7,249

\* 2007/08 prices

\*\* At year-end actual/estimated prices

\*\*\* Year end at 2011/12 prices. Source Ofwat



# Net finance costs

## Year ended 31 March 2012

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	Income statement charge £m	Capitalised interest £m	Gross interest incurred £m
"Cash" interest	178.4	8.1	186.5
Pension debit/(credit)	(3.0)	-	(3.0)
RPI interest and amortised fees	53.6	2.4	56.0
	229.0	10.5	239.5

# Net debt

At 31 March 2012

2010/11 £m	2011/12 £m	Movement in the period £m
315.2 Cash and cash equivalents	295.1	(20.1)
(23.9) Borrowings - current liabilities	(89.3)	(65.4)
(4,320.5) Borrowings - non-current liabilities	(4,309.5)	11.0
160.4 Cross currency swaps hedging debt	135.9	(24.5)
(3,868.8) Net debt	(3,967.8)	(99.0)

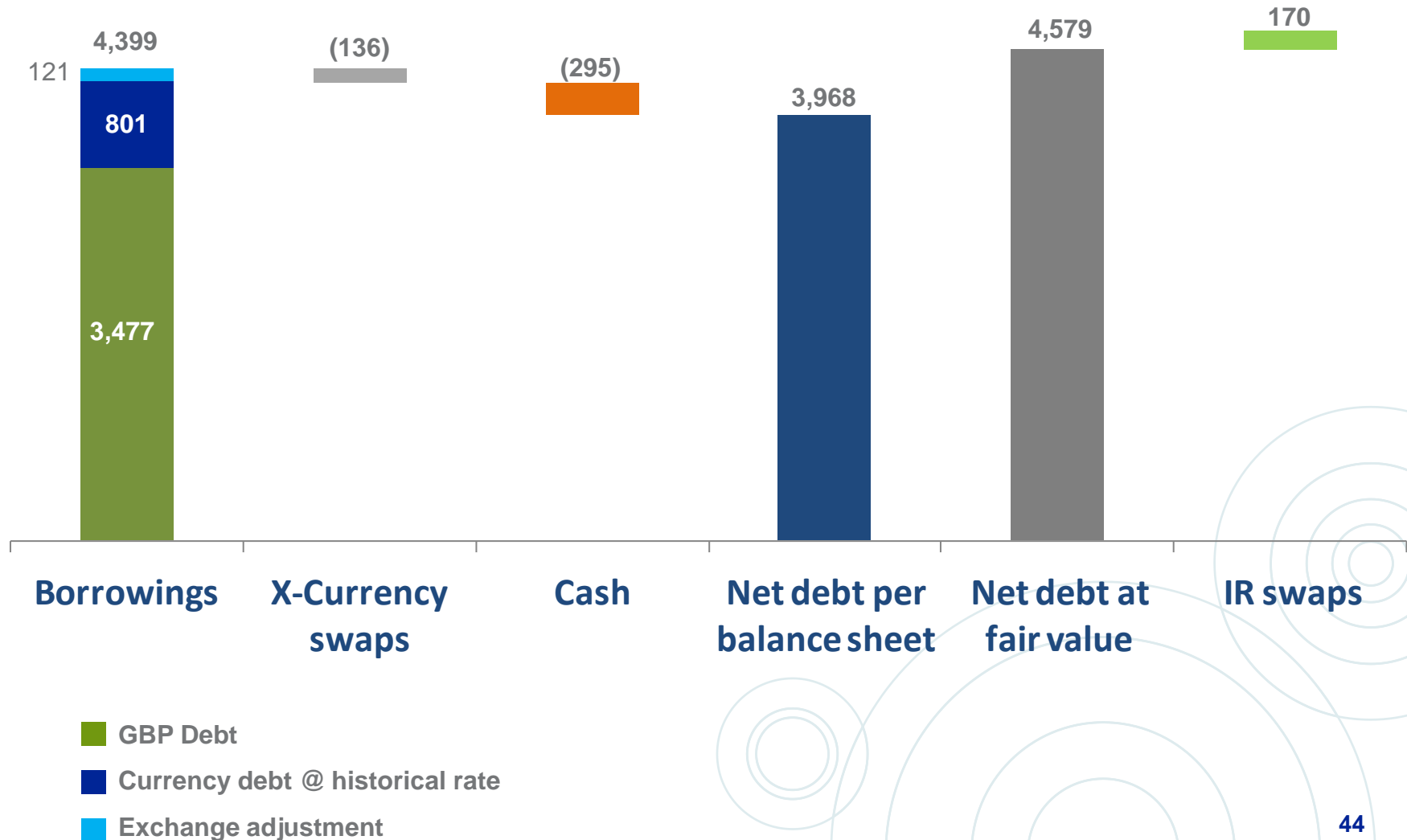
# Fair value of net debt

## At 31 March 2012

2010/11 £m	2011/12 £m	Movement in the period £m
(836.8) Bank loans	(858.3)	(21.5)
(3,597.6) Other loans	(3,936.2)	(338.6)
(237.4) Obligations under finance leases	(215.4)	22.0
(4,671.8)	(5,009.9)	(338.1)
315.2 Net cash and cash equivalents	294.7	(20.5)
160.4 Cross currency swaps	135.9	(24.5)
(4,196.2)	(4,579.3)	(383.1)
(3,868.8) Net debt (previous slide)	(3,967.8)	(99.0)
327.4 <b>Difference</b>	611.5	284.1

# Analysis of borrowings, net debt and swaps

## At 31 March 2012



# What are the risks?

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- **Economy**

- double dip recession, increasing unemployment, rising bad debt
- we have improved collection of debt less than 12 months (>12 months more difficult)
- focus on customer payment plans

- **Inflation**

- negative inflation harmful to the business model (lower revenue, RCV falls, gearing increases)

- **Weather / flooding**

- impact of climate change
- building increased resilience in the network – prudent investment

- **Funding**

- Bond markets open, stable credit rating, successful issue and tender completed

- **Delivery of efficiency / change programmes**

- **Industry change**

- actively engaged in debate with all stakeholders
- transfer of private drains and sewers