United Utilities

Credit Investor Update

Autumn 2019

Coniston Water

Contents

UU overview

Where we operate

Regulated UK water and wastewater business

Around 3 million household and 200,000 non-household customer premises

Regional population of around 7.2 million people in the North West of England

Investment proposition

Why invest in United Utilities?

- **Clear vision** to be the best UK water and wastewater company
- Management team with **extensive** commercial, operational and regulatory experience
- Track record of **regulatory outperformance** – exceeded our 2010-15 targets and on track to outperform again in 2015-20
- Wholesale revenue and asset base **linked to RPI inflation** through to at least 2020
- **Clarity on allowed returns** through to 2020
- **Systems Thinking approach** is the most sophisticated in the sector and provides a real competitive advantage
- **Sustainable improvements** in operational performance and customer service
- **Low cost of debt** locked in and **robust capital structure** with a stable A3 credit rating
- Dividend policy target **annual growth of at least RPI inflation** through to 2020

Our vision is to be the best UK water and wastewater company

Deliver long-term shareholder value by providing:

- The best service to customers
- At the lowest sustainable cost
- In a responsible manner

Shareholder value driven by regulatory outperformance:

- Totex
- Operational
- Financing

Capital structure

Robust and sustainable

- Aim to at least retain **A3 and BBB+** credit ratings for UUW with Moody's and S&P
- **Moody's** has an **A3 rating** with a **Stable** outlook
- **S&P** has an **A- rating** with a **Negative** outlook
- **Fitch** has an **A- rating** with a **Stable** outlook
- Target gearing range of **55% to 65%** supports robust capital structure
- Financing headroom **well into 2021**
- Average term to maturity of debt portfolio of just under **20 years**

Dividends

2015-20 policy targets sustainable growth

2017/18
full year
dividend of
39.73 pence per
ordinary share

2018/19
full year
dividend of
41.28 pence per
ordinary share

Increase of 3.9%
in line with
2015-20 RPI
growth dividend
policy

Recognise importance of income to shareholders

Target growth of at least RPI each year to 2020, from 2014/15 base

RPI based on November from prior year, mirrors RPI in price limits

Consistent with growth in regulatory capital value

Behaving responsibly

Leading on corporate governance

- Approach to **affordability and vulnerability** setting new benchmarks
- **Sharing outperformance** with customers – c£600m over AMP5 and AMP6
- Ofwat **self-assured** for reporting – only company to have achieved this three years running
- **Early adopters** of new standards – recognition through **awards**
- Leading position on **pensions** – maintained a consistent surplus on an IFRS basis, and eliminated deficit on both a funding and self-sufficiency basis
- Securing long-term **operational and financial resilience**

External recognition for best practice

Awards and accreditations reflecting leading performance

A good corporate citizen

Customer

- ServiceMark with Distinction — Accredited from Aug '18 to Aug '21 — The Institute of Customer Service
- Shaw Trust Accessible
- CICM Quality Q Accredited
- The WOW! Awards

Governance

- PwC's Building Public Trust Awards 2018 — Winner of Reporting in Financial Services in the FTSE 350 — Celebrating openness
- A4S
- Member of Dow Jones Sustainability Indices — In Collaboration with RobecoSAM
- FTSE4Good

Environment

- SAM Sustainability Award Industry mover 2019
- CDP — Disclosure Insight Action
- Environment Agency — 3* Company
- Euronext Vigeo Eiris Indices UK 20

Our people

- Britain's Healthiest Workplace
- The Workplace Wellbeing Charter
- 2018 RoSPA Gold Medal Award
- CIPS Corporate Ethics — 0604 — Valid to 13/05/2020

Operational performance

Going from strength to strength

Delivering against our targets year on year

- Consistently **improving customer satisfaction**
- Early investment **delivering performance** against tough targets
- **Resilient** through extreme weather
- **Leakage target met** for 13 consecutive years
- **Fast-track** PR19 business plan, awarded **highest grades in sector**

- Expect to be eligible for AMP6 **SIM reward of around £16m**
- **£19m wholesale ODI reward** for 2018/19, **£30m** cumulative AMP6 reward expected
- **£100m totex outperformance** against FD scope
- **£100m additional investment** for AMP7 flying start; total AMP6 reinvestment of **£350m**
- Fast-track reward; **£24m additional revenue** in AMP7, **greater clarity** with a year to prepare

Systems Thinking Capability Model

Maturity level characteristics

Traditional approach
Silo thinking

Customer identified disruption

Operational / discrete view of asset status

Disconnected performance monitoring

Event led human driven analytics

1 Early adoption
Systems Thinking

Tracked customer experience

Centralised view of discrete production line status

Manual data analysis with human dependant decisions supported by data and technology

2 Designated delivery
Systems Thinking

Joined up customer experience

Central production line view at a catchment scale

Human response to systemised data

Technology enabled, standardised analytics and insight

3 Regionally connected
Systems Thinking

Pre-emptive customer relationship

Centralised view of full system performance

System response with human validation of data led insight

Technology driven analytics and insight

4 Machine managed
Systems Thinking

Collaborative customer relationship

Centralised, predictive control at a system scale

Dynamic plans based on dynamic system data

Machine-led system analytics and system management

5 Artificially Intelligent
Systems Thinking

Connected customer relationship

Machine led system control (A.I.)

Regionally and nationally connected data and insight

Machine learned system analytics with connected insight

Systems Thinking Capability Maturity

Operational Monitoring Example

1 2 3 4 5

Maturity level 1
Event led human driven analytics

Operational Monitoring of Water Quality
(in full operation)

115 resources
£3.4m opex p.a.

Maturity level 2
Centralised view of discrete production line status

Remote Operational Monitoring of Water Quality Performance

July 2018:
25 resources
£0.8m opex p.a.

Maturity level 3
Technology enabled, standardised analytics and insight

Machine led remote operational monitoring of water quality performance

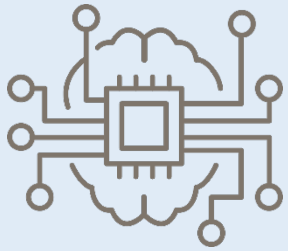
2019:
6 resources
£0.2m opex p.a.

Maturity level 4
Machine led system analytics and system management

Predictive machine led remote operational monitoring of water quality performance

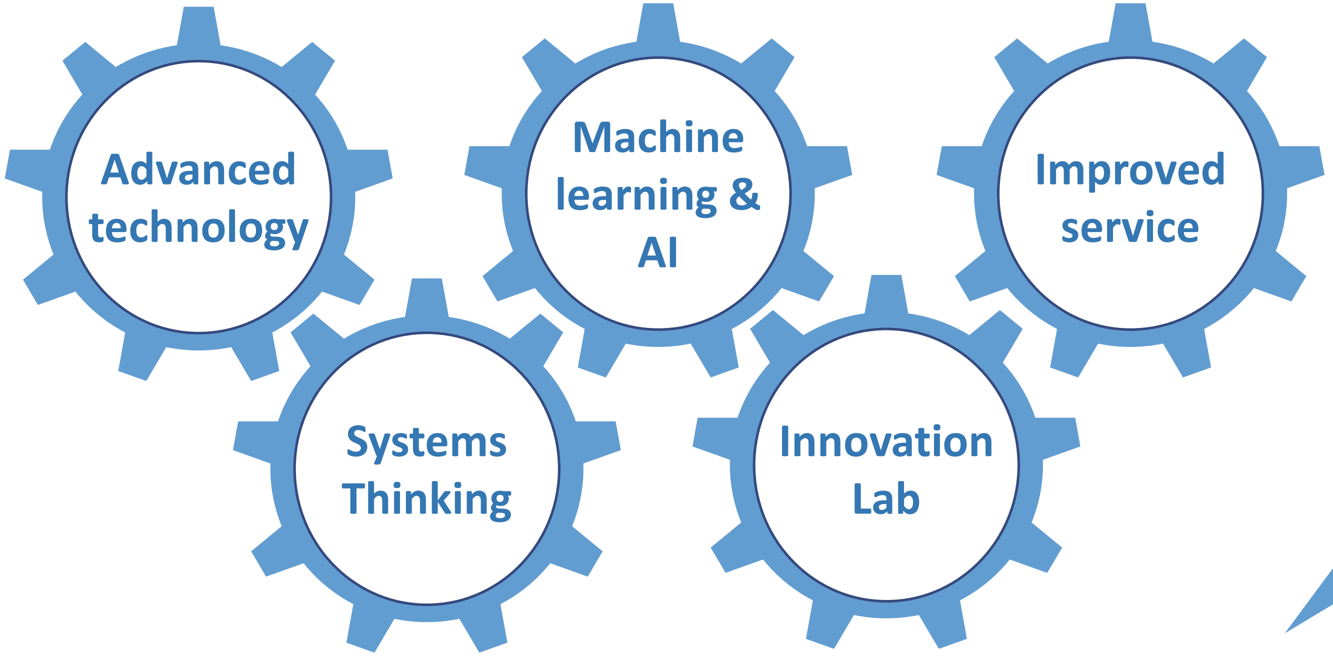
2020

Maturity level 5
Machine led system control (A.I.)



Sector's most embedded innovation culture

Use of technology delivering efficiencies and improved service



"Out of all the water company business plans we have assessed, United Utilities' plan has the best evidence of an embedded culture of innovation."

Ofwat: DD, April 2019

Alternative supply vehicles

Restoring water to 95% of customers within 3 hours

1 million litres of water on wheels

Restoring water to **95% of customers**, within **3 hours**, **24/7**

Centrally planned, **co-ordinated** and **controlled**

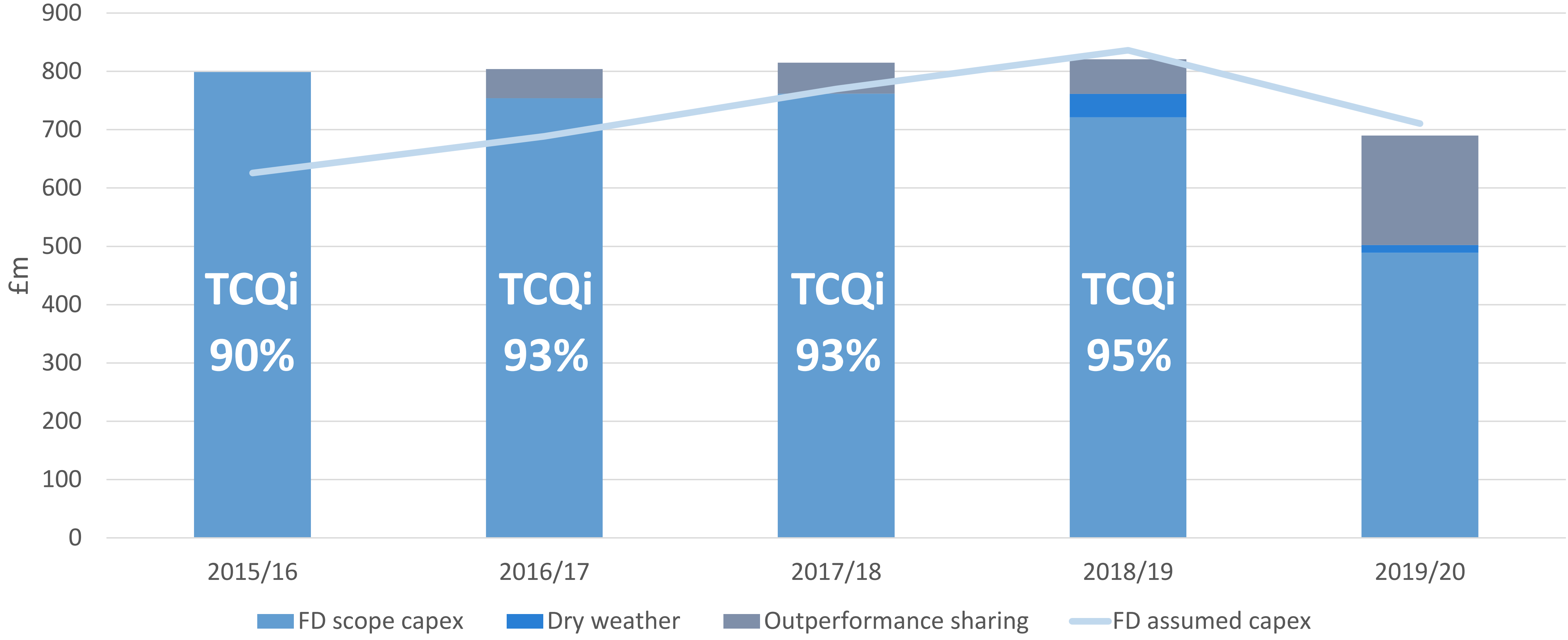
Better response to big bursts and in the **right areas**

Vital for **customer service**, and **customer minutes lost ODI**

The largest fleet of "water on wheels", providing temporary supply of water during planned and unplanned interruptions

Net regulatory capital spend profile

A further £821m invested in 2018/19

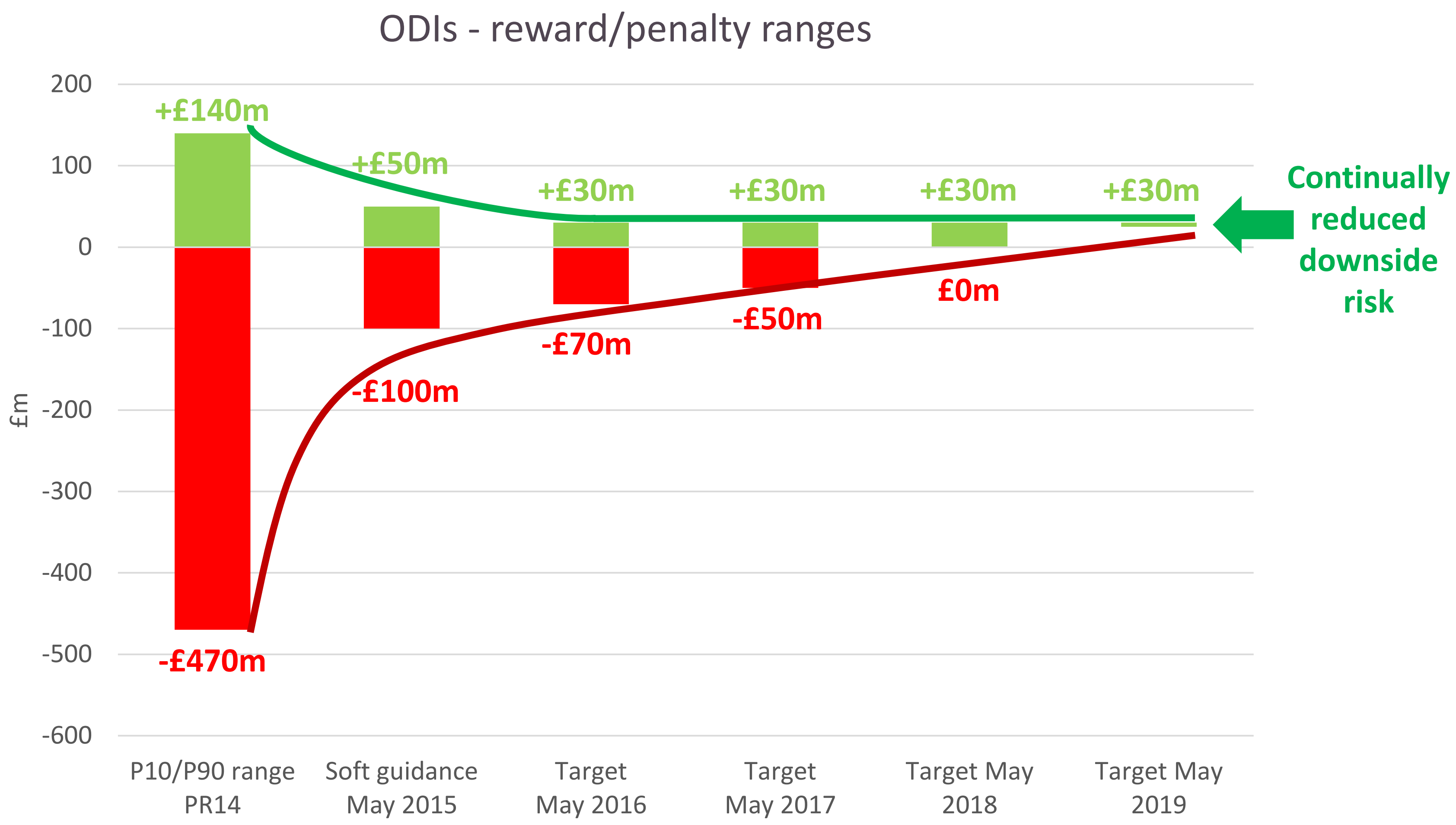


The UU AMP6 investment programme on this chart does not constitute a forecast and is subject to change

Outcome delivery incentives

AMP6 ODIs

Continued solid improvement in operational performance – now on track to deliver around £30 million cumulative reward for the period



Outcome Delivery Incentives (ODIs)

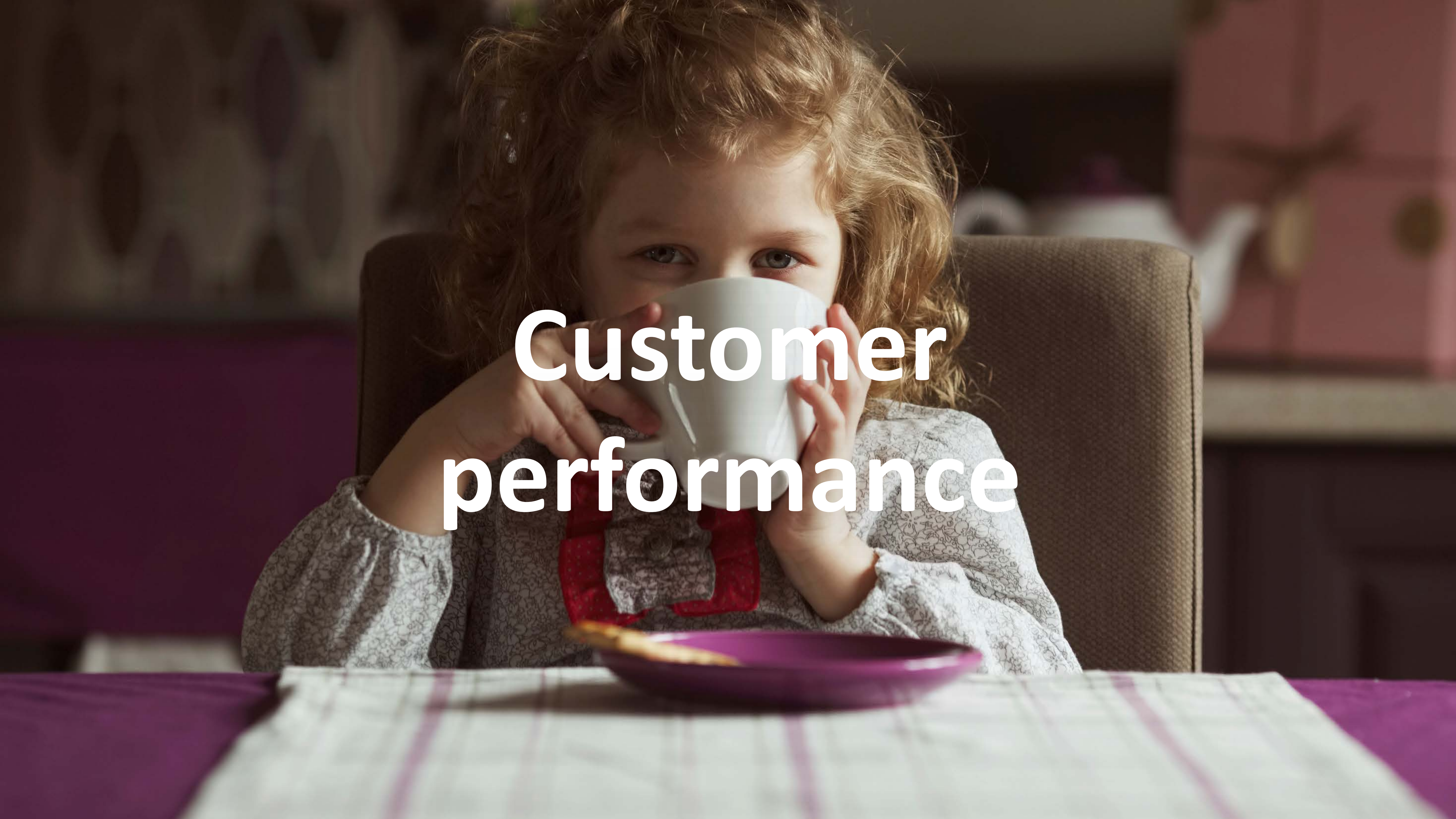
A good year earning a £19m reward

	Reward / (Penalty) (£m) 1 year 2018-19	4 years 2015-19
Private sewers service index	7.4	29.5
Wastewater category 3 pollution incidents	3.3	13.1
Thirlmere transfer to West Cumbria	0.0	0.0
Total leakage at or below target	0.0	9.1
Reliable water service index	0.0	(23.9)
Average minutes supply lost per property	11.3	5.3
Water quality service index	(3.6)	(10.6)
Other 12 wholesale ODIs	0.8	(1.1)
Total wholesale ODIs	19.2	21.4

Good all round performance at the **top of our estimates**

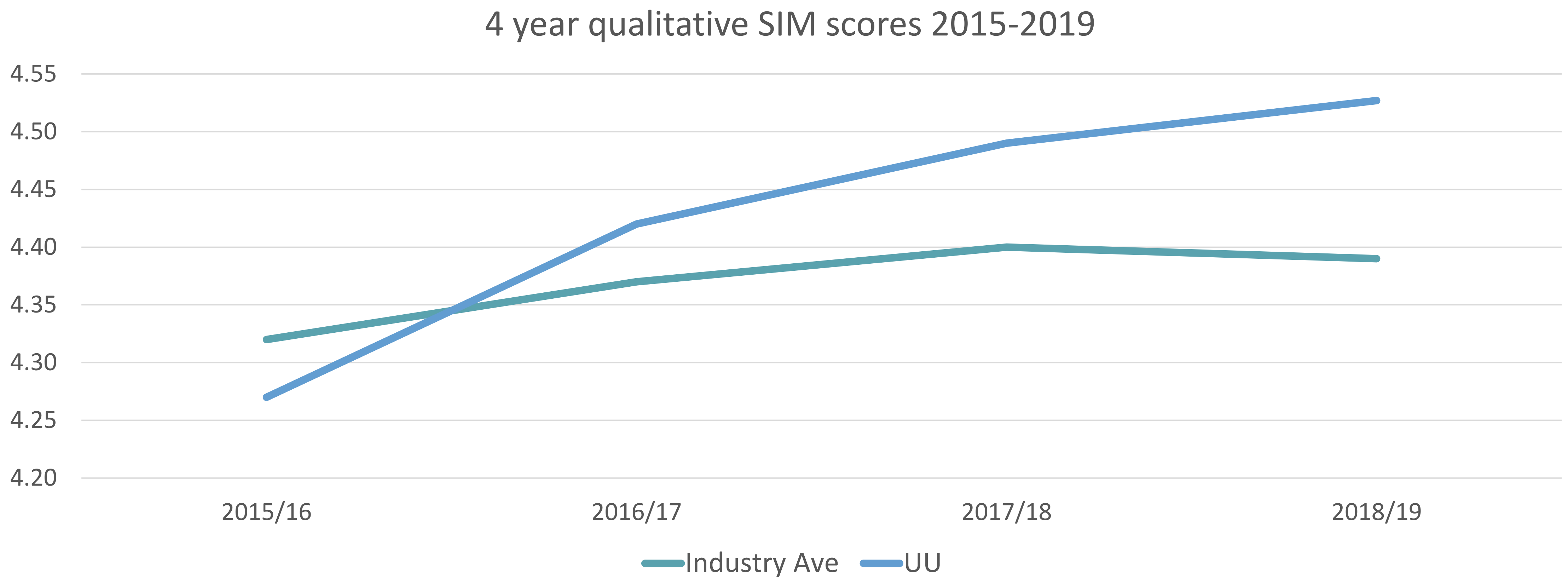
£19m net reward for 2018/19

£30m net reward expected for AMP6


Customer
performance

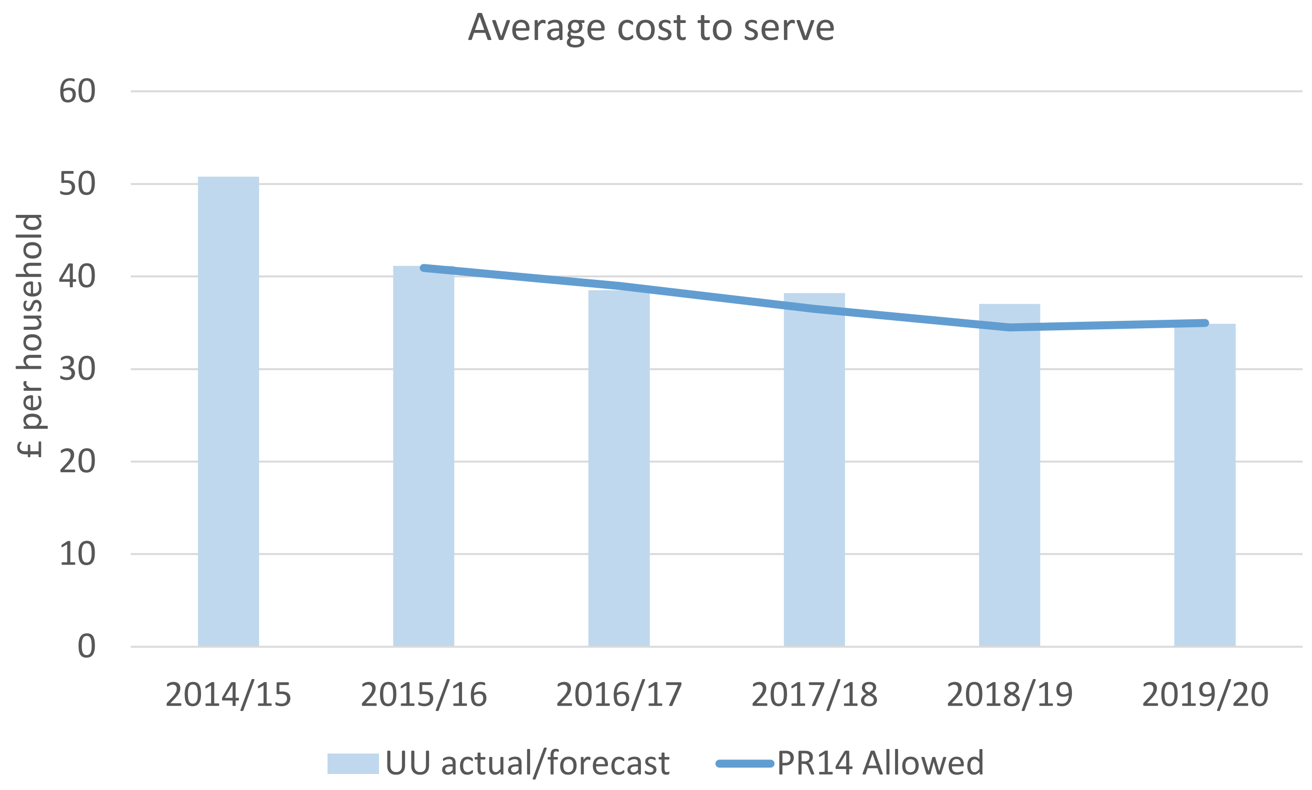
Sector beating SIM improvement

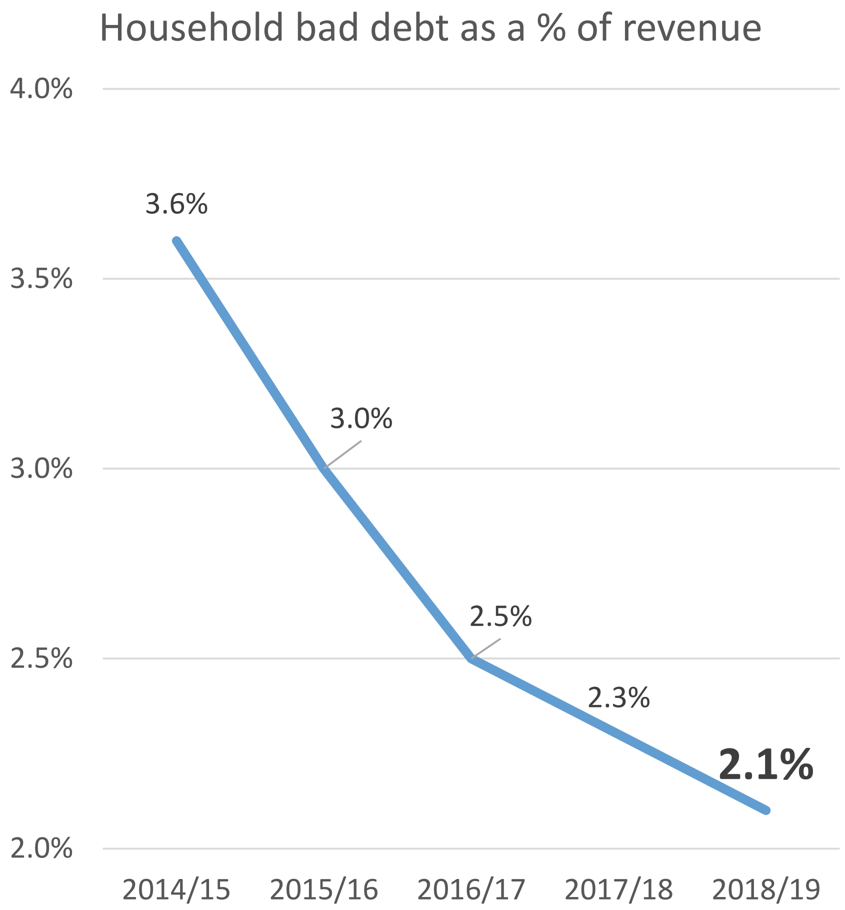
One of the leading companies



Good service costs less

Driving down bad debt and cost to serve whilst improving customer service





Financial resilience

Credit rating summary

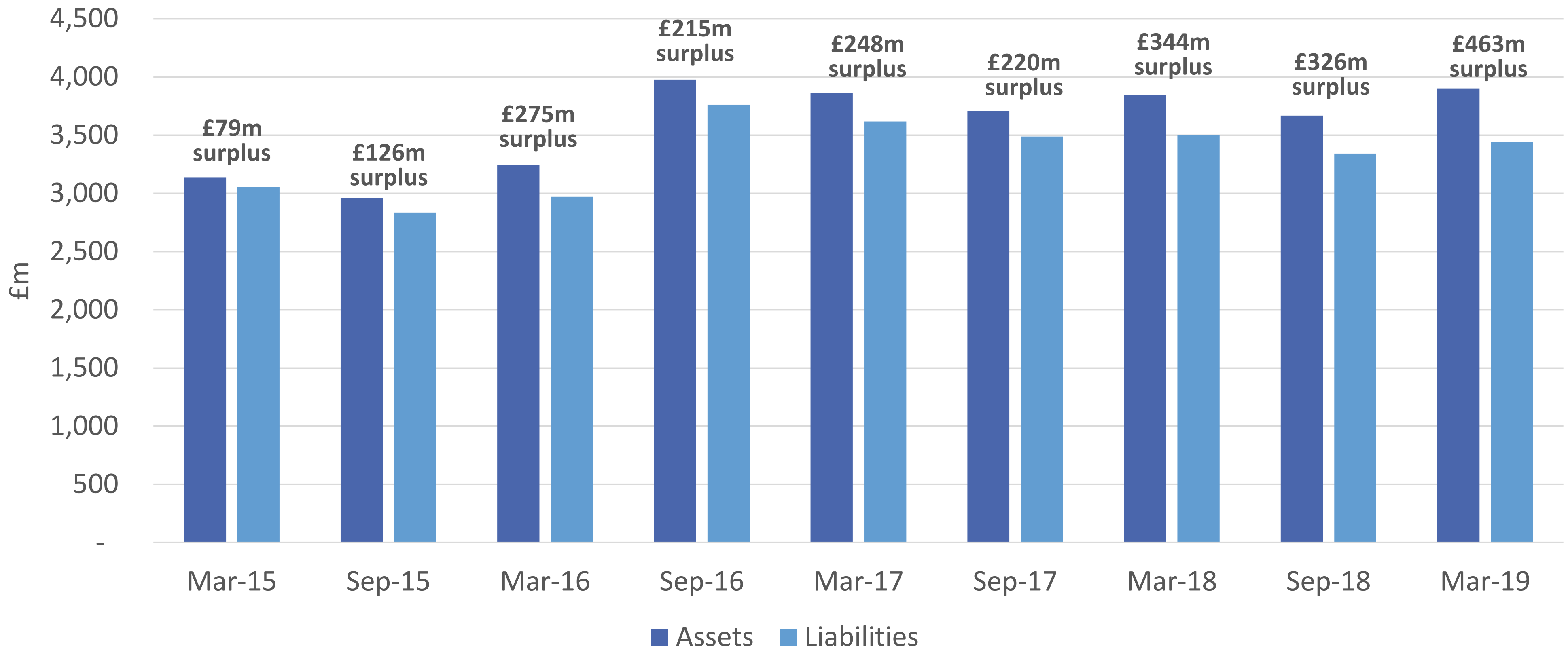
Aim to at least retain credit ratings for UUW of Moody's A3 and S&P BBB+ to support efficient access to debt capital markets

Moody's	S&P	Fitch
UUW[1] rated A3	UUW[1] rated A-[4]	UUW[1] rated[2] A-
UU PLC rated Baa1	UU PLC rated BBB[4]	UU PLC rated[2] A-
A3 threshold: net debt to RCV ratio <65%	A- threshold: adjusted FFO to debt 11-13%	A- threshold: net debt to RCV ratio <65%
A3 threshold: adjusted interest cover >1.7x	BBB+ threshold: adjusted FFO to debt 9-11%	A- threshold: PMICR[3] >1.6x

[1] Any notes issued by UUW's financing subsidiary United Utilities Water Finance PLC (UUWF) are expected to be rated in line with UUW's credit rating
[2] Fitch rating for senior unsecured debt, issuer default rating is one notch lower
[3] Post maintenance interest cover ratio
[4] S&P placed UU's ratings on negative outlook on 9 August 2019

IFRS pension surplus

Fully hedged for inflation and interest rates



Low risk corporate bonds and gilts

Interest rate risk fully hedged in the external market

Inflation risk fully hedged in the external market (IFM replaced)

Pensions – the importance of self-sufficiency

United Utilities' pensions are fully funded on a self-sufficiency basis

Basis of surplus / deficit	Objective	Typical discount rate applied to liabilities	United Utilities
IFRS	Intercompany comparison (full disclosure of assumptions)	Gilts +70/+110	£484m surplus
Funding	Stepping stone to self-sufficiency	?	£nil
Self-sufficiency (aka LTFT)	Minimal reliance on company	Gilts +0/+50	£nil

Responsible stewardship mitigating risk for all stakeholders

References: https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/understanding-db-_scheme-funding.ashx
https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-annual-funding-statement-2019.ashx
https://www.financialdirector.co.uk/2019/04/10/what-do-ltfts-mean-for-sponsors-of-defined-benefit-pension-schemes/

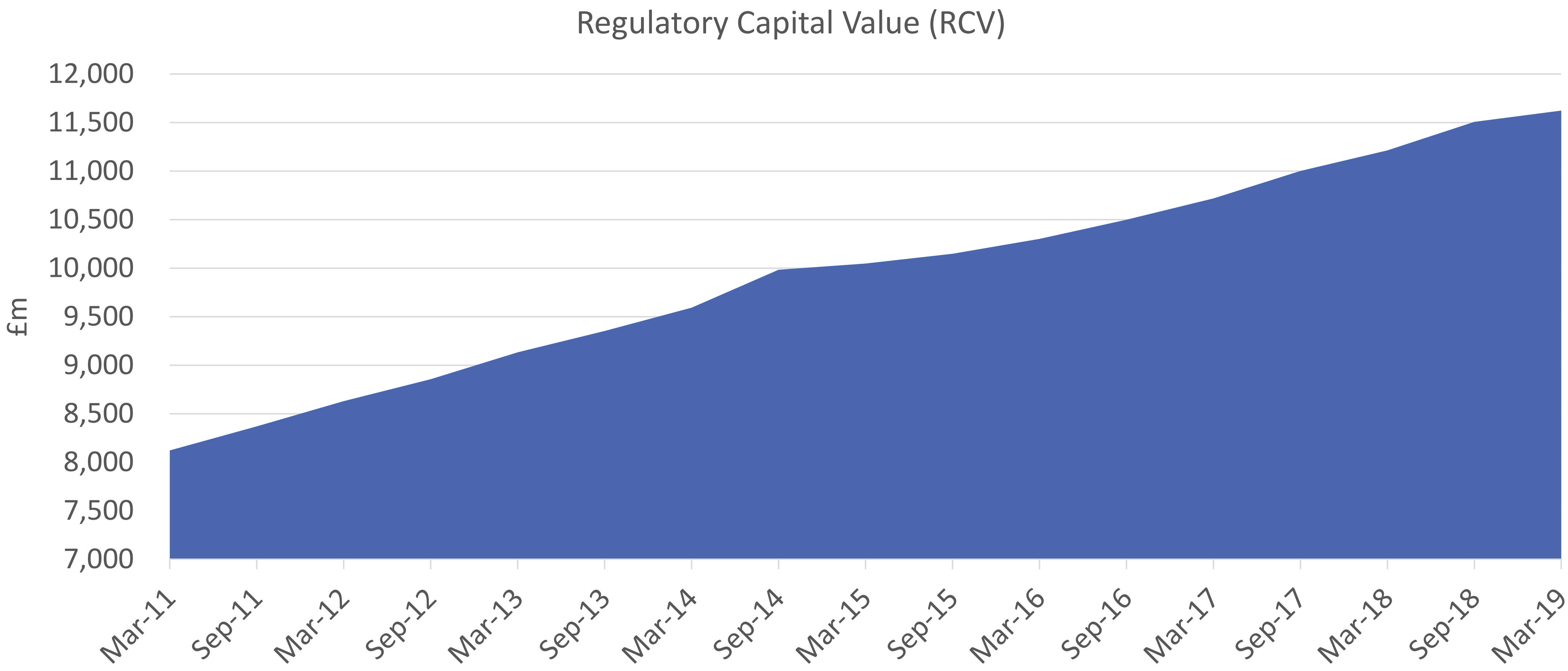
Pensions – the "Financial Director" view

Long-Term Funding Targets (LTFTs)

- In its 2019 Annual Funding Statement, the Pensions Regulator (TPR) announced an expectation that trustees and sponsors of all UK defined benefit pension schemes should agree a Long-Term Funding Target (LTFT)
- Setting a LTFT will require trustees and sponsors to agree a proposed solution to their legacy pension liabilities based on current market practices. This will be a choice between:
  - Buying out the scheme's liabilities with an insurance provider; or
  - Funding and administering the scheme on a low-risk basis (often referred to as "self-sufficiency")
- In this new regulatory environment, it is expected that sponsors will increase higher contributions to get their schemes 'back on track' more quickly if a scheme's downside risks crystallise
- Sponsors to improve transparency over size of pension funding requirements and risks. To go beyond mandatory accounting disclosures to include:
  - A measure of the scheme's deficit on a 'low-risk' basis;
  - Details of all current funding requirements; and
  - A measure of investment risk

Reference: https://www.financialdirector.co.uk/2019/04/10/what-do-ltfts-mean-for-sponsors-of-defined-benefit-pension-schemes/

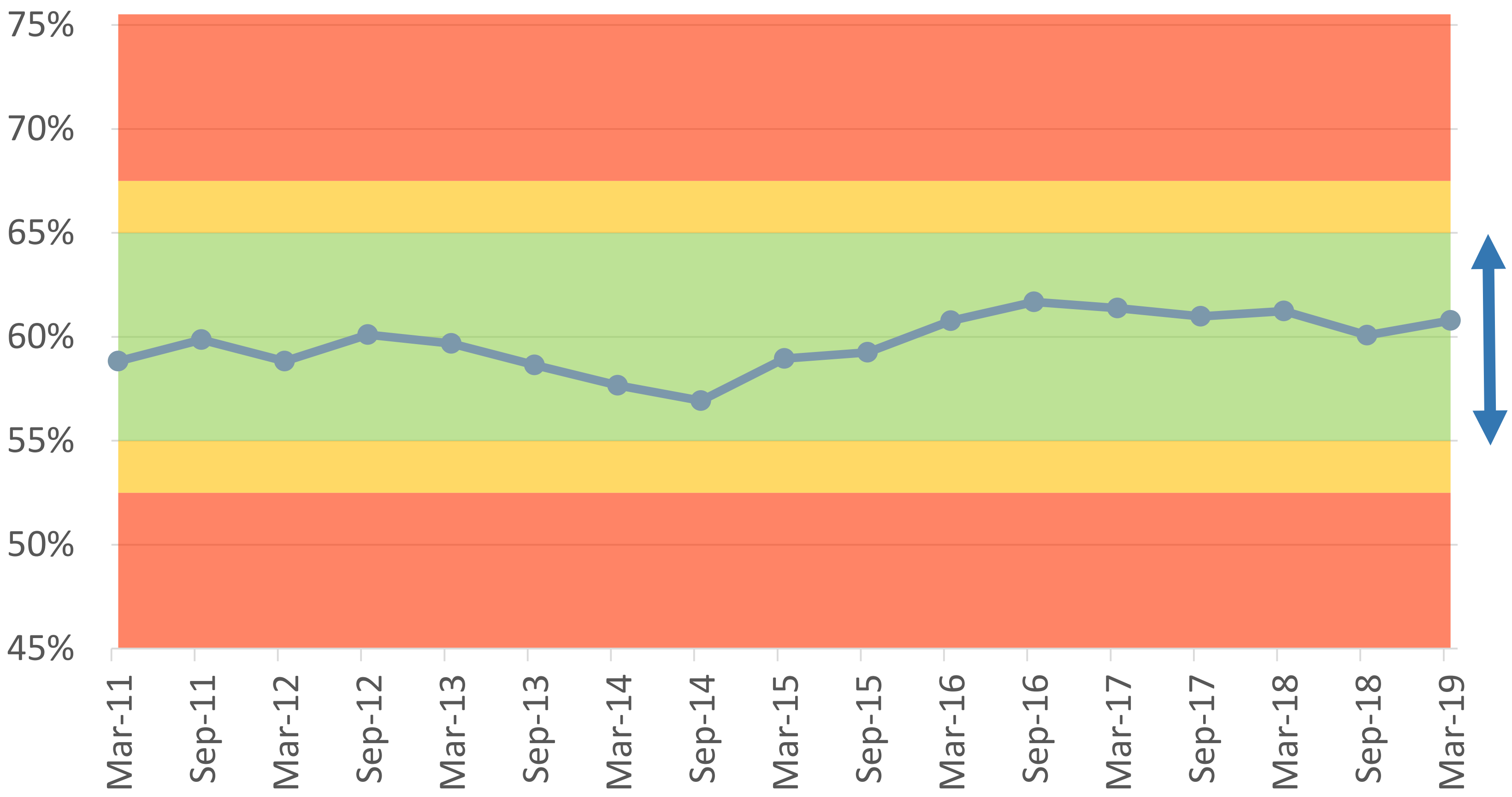
Regulatory capital value (RCV)



United Utilities Water's regulatory capital value (based on shadow RCV for AMP6, adjusted for actual spend) and presented in outturn prices. Shadow RCV at 31 March 2019 = £11,624m.

RCV gearing

RCV gearing supports robust capital structure



RCV gearing within our target range, supporting a solid A3 credit rating

Financing and hedging

Financing position 31 March 2019

AMP6 financing requirement fully funded with headroom out to the end of 2020

Index-linked

£711m RPI-linked raised previously

£165m CPI-linked raised previously

£100m CPI-linked bank loan with 10-year maturity in April 2019

£100m RPI/CPI swaps in April 2019

Nominal

£1,483m raised previously

HKD320m private placement raising **£32m** with 7-year maturity

£100m additional tap of 2025 public bond taking total to £450m

£250m public bond issue with 12-year maturity

Committed bank facilities

New £50m committed bank facilities signed for 5-year term

£100m committed bank facilities renewed for initial 5-year term

£50m committed bank facilities extended a year to 2024

Cost of debt and hedging

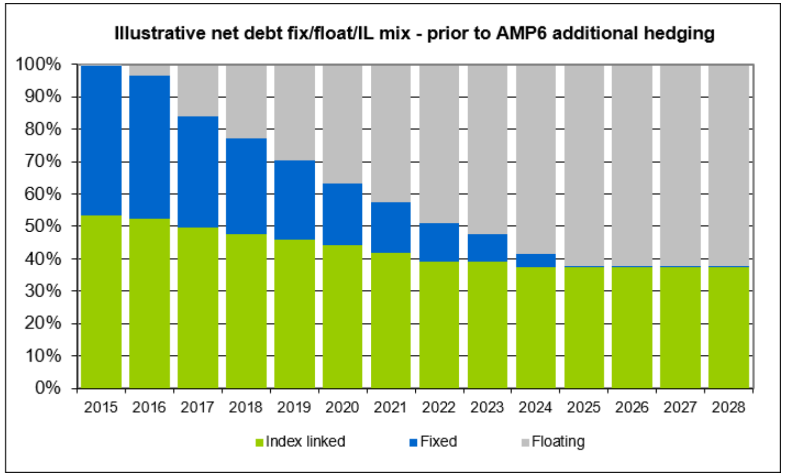
Delivering significant financing outperformance

Inflation hedging	Index-linked debt
c50% of net debt maintained in **index-linked** form	**c£3.8bn** index-linked Average cost of **1.3% real**
Interest rate hedging	**Nominal debt**
Maintain a **fixed rate, 10 year reducing balance** on nominal debt	**c£3.3bn** nominal debt Fixed for 2015-20 at an average rate of **3.2% nominal**

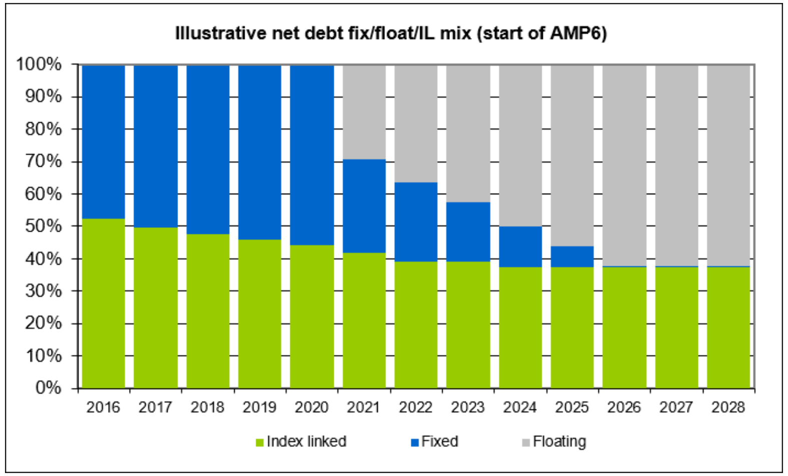
Risk reduction – Interest rate hedging policy

Aims to minimise regulatory risk

- AMP6 cost of debt set through PR14 process
- UU keeps index-linked debt un-swapped as a good match for the RCV which is also RPI-linked to 2020 and then 50% RPI-linked and 50% CPIH-linked with post-2020 new additions linked to CPIH
- During FY14/15 UU substantively fixed underlying rates on nominal floating rate debt for AMP6, whilst continuing with 10-year reducing balance policy post 2020
- 10-year reducing balance policy will continue post-2020, but we will not substantively fix at the start of AMP7 due to debt indexation on new debt
- Manages uncertainty regarding Ofwat's approach to setting the cost of debt at future price reviews



10-yr rolling interest rate profile
Lock in rolling 10-year average interest rate on nominal debt



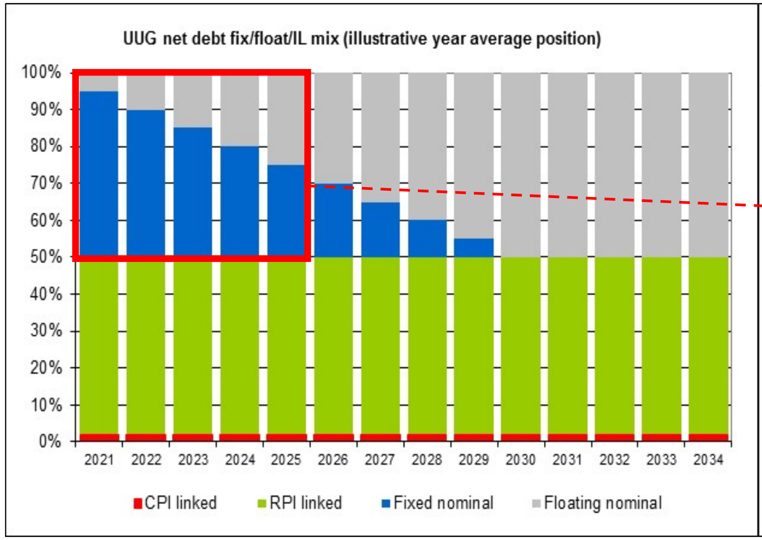
Post additional AMP6 hedging
Substantively fixed rates for whole of AMP6 then revert to reducing balance fixing on nominal debt

Revised interest rate hedging policy AMP7

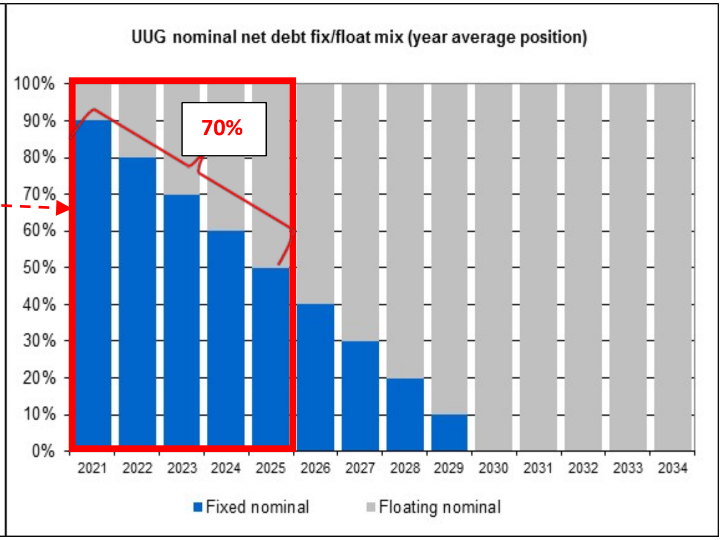
Aims to minimise regulatory risk

- Ofwat PR19 methodology changes:
  - 50% of AMP7 opening RCV linked to RPI and 50% linked to CPIH with post-2020 new additions linked to CPIH
  - Cost of debt allowance will be fixed for the embedded portion (80%) with indexation applied for the new debt portion (20%)
- UU hedging policies review:
  - UU aims to maintain around half of its net debt in index-linked form
  - Will look to issue in CPI/CPIH-linked form and/or swap existing RPI-linked where efficient to do so
  - UU keeps index-linked debt un-swapped as a partial inflation hedge for the RCV
  - 10-year reducing balance policy on nominal debt continues, but we will not substantively fix at the start of AMP7 to better align with the debt indexation mechanism

Start of AMP7 illustrative hedging profile

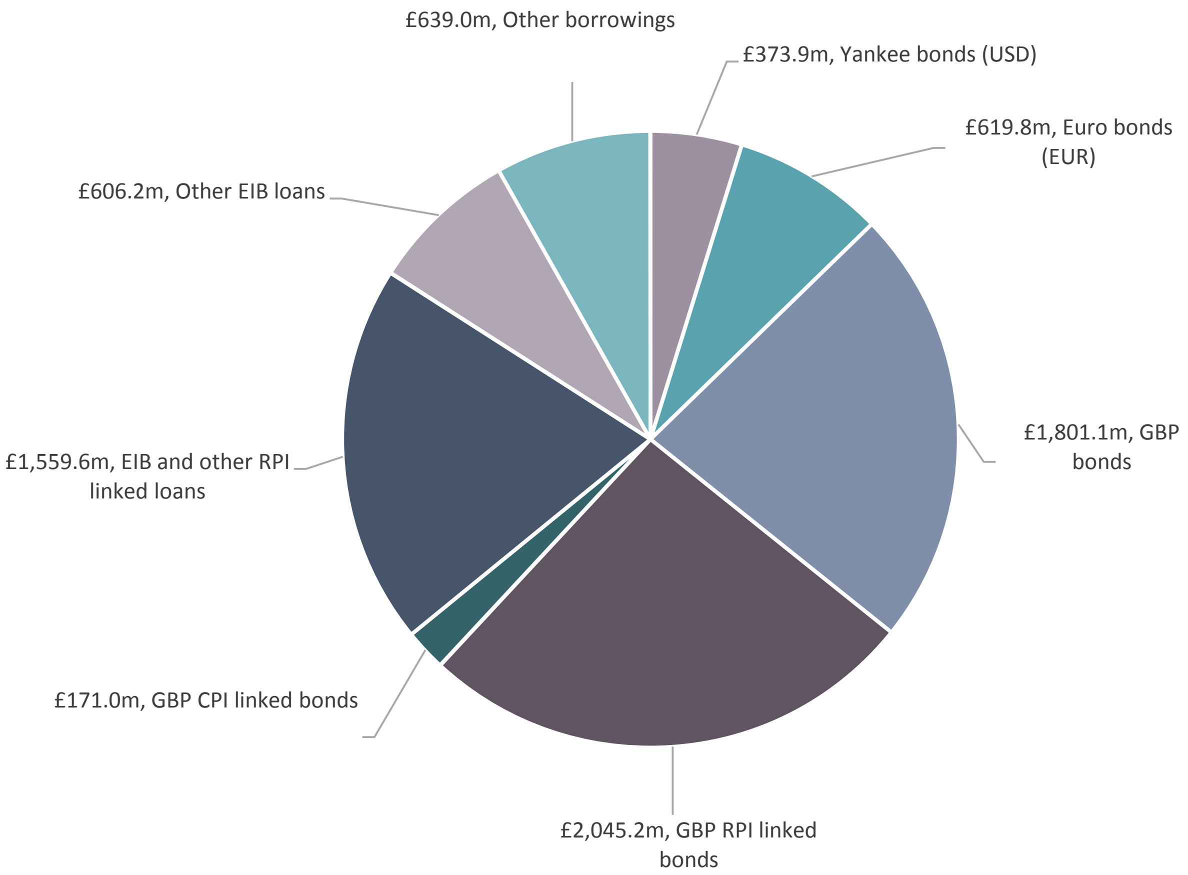


c70% of nominal debt is fixed at the start of AMP7



Financing and liquidity

Gross debt = £7,815.8m



Headroom / prefunding = £357.4m

	£m
Cash and short-term deposits	339.3
Medium-term committed bank facilities[1]	700.0
Short-term debt	(166.7)
Term debt maturing within one year	(515.2)
Total headroom / prefunding	**357.4**

[1] Excludes £100m of facilities maturing within one year

Debt structure

United Utilities Group PLC

United Utilities PLC
Baa1 stable; BBB negative outlook; A- stable[4]

Yankees:
- $400m in 28s

United Utilities Water Limited
A3 stable; A- negative outlook; A- stable[4]
Ring-fenced and regulated by Ofwat

Euro MTNs:
- €500m in 20s
- £375m in 22s
- £300m in 27s
- £50m in 32s[1]
- £200m in 35s
- £100m in 35s[1]
- £35m in 37s[1]
- £70m in 39s[1]
- £100m in 40s[1]
- £50m in 41s[1]
- £100m in 42s[1]
- £20m in 43s[1]
- £50m in 46s[1]
- £50m in 49s[1]
- £510m in 56s[1]
- £150m in 57s[1]

Other debt:
- EIB index-linked loans £1,015m[1]
- Other index-linked loans £300m[1]
- Other EIB loans £606m
- Short-term loans £52m
- ¥10bn dual currency loan
- Other sterling loans £127m

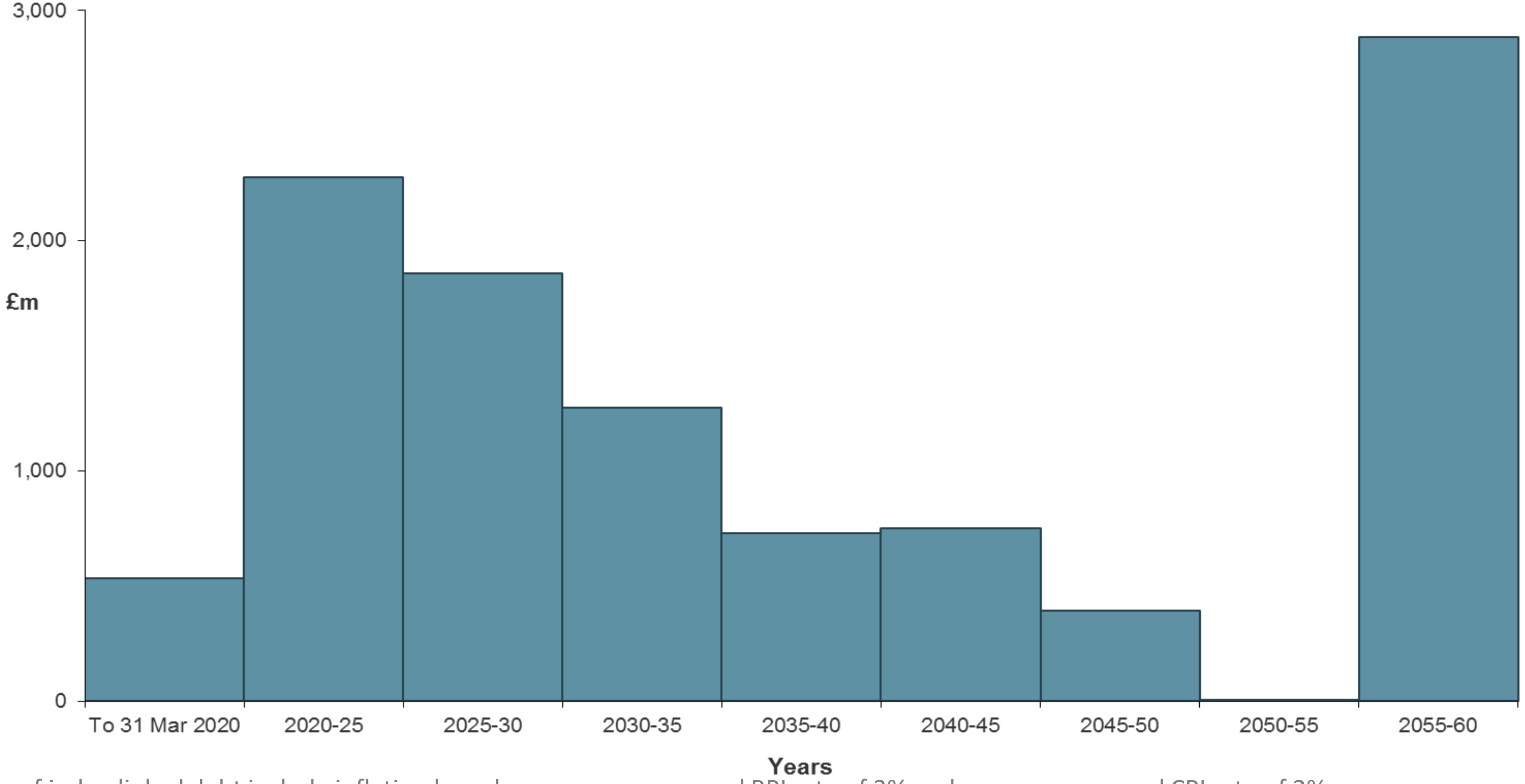
United Utilities Water Finance PLC[3]
Guaranteed by United Utilities Water Ltd

Euro MTNs:
- £25m in 25s[1]
- £450m in 25s
- HK$739m in 26s
- HK$320m in 26s
- HK$830m in 27s
- €52m in 27s
- £20m in 28s[1]
- £35m in 30s[1]
- €30m in 30s
- €30m in 31s
- £250m in 31s
- HK$600m in 31s
- £38m in 31s[1]
- £20m in 31s[2]
- €26m in 32s
- €28m in 32s
- €30m in 33s
- £27m in 36s[1]
- £29m in 36s[1]
- £20m in 36s[2]
- £60m in 37s[2]
- £32m in 48s[2]
- £33m in 57s[2]

[1] RPI linked finance
[2] CPI linked finance
[3] United Utilities Water Finance PLC (UUWF) is a financing subsidiary of United Utilities Water Limited (UUW) established to issue new listed debt on behalf of UUW. Notes issued by UUWF are unconditionally and irrevocably guaranteed by UUW and are rated in line with UUW's credit ratings
[4] Senior unsecured debt ratings published by Moody's; Standard & Poor's; Fitch respectively

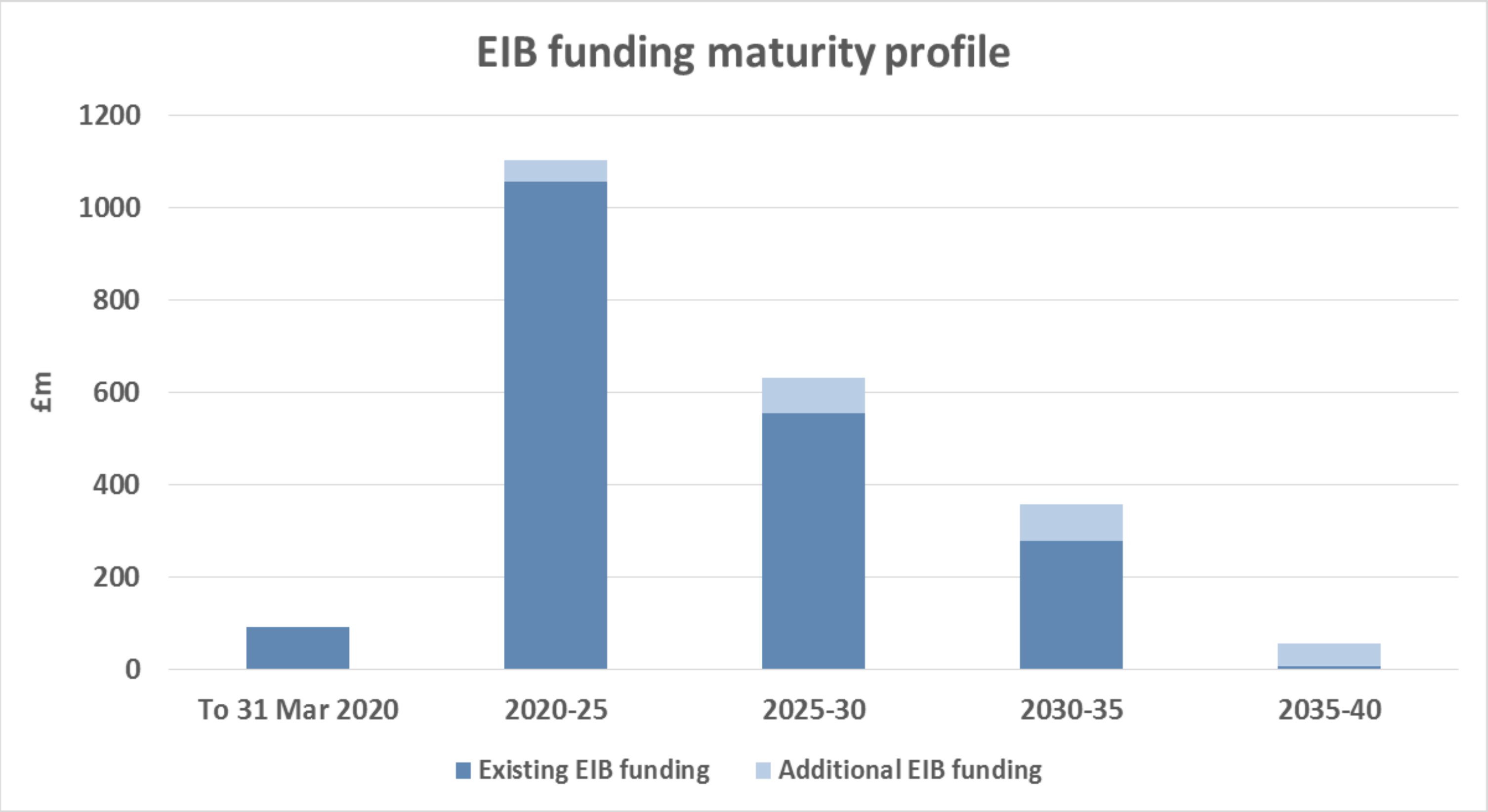
Term debt maturity profile

Average term to maturity of just under 20 years



[1] Future repayments of index-linked debt include inflation based on an average annual RPI rate of 3% and an average annual CPI rate of 2%

EIB funding maturity profile



<u>Notes</u>

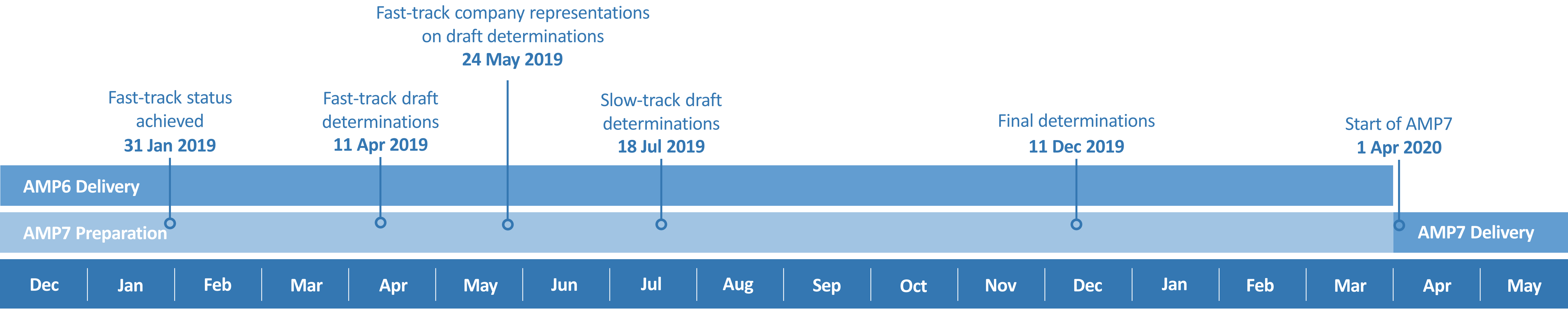
Future repayments of EIB RPI linked debt include inflation based on an average annual RPI rate of 3%.

Dark blue areas represent EIB loans currently drawn and outstanding.

Light blue areas represent a further £250m AMP6 loan assuming this will be signed and drawn in FY2019/20 (being the second tranche of a £500m AMP6 funding package approved by EIB in 2016). It is assumed that this loan will be drawn down in floating rate tranches on an amortising repayment basis with an average loan life of approximately 10-years.

Economic regulation – PR19

PR19 timetable



Ofwat's PR19
July 2019 update

Weighted average cost of capital 2020-25

- Indicative WACC of 2.19%[1]
- Industry average WACC based on notional company with 60% gearing
- Debt indexation to apply for new debt now assumed to be 20% of total debt
- CPIH to be adopted for the indexation of future price controls

[1] Appointee business (vanilla, real RPI)

Calculation of vanilla, real RPI WACC

Cost of debt

1.34%

Cost of equity

3.46%

Gearing

60%

Appointee WACC

2.19%

Retail margin adjustment 0.11%

Wholesale WACC 2.08%

Strong value

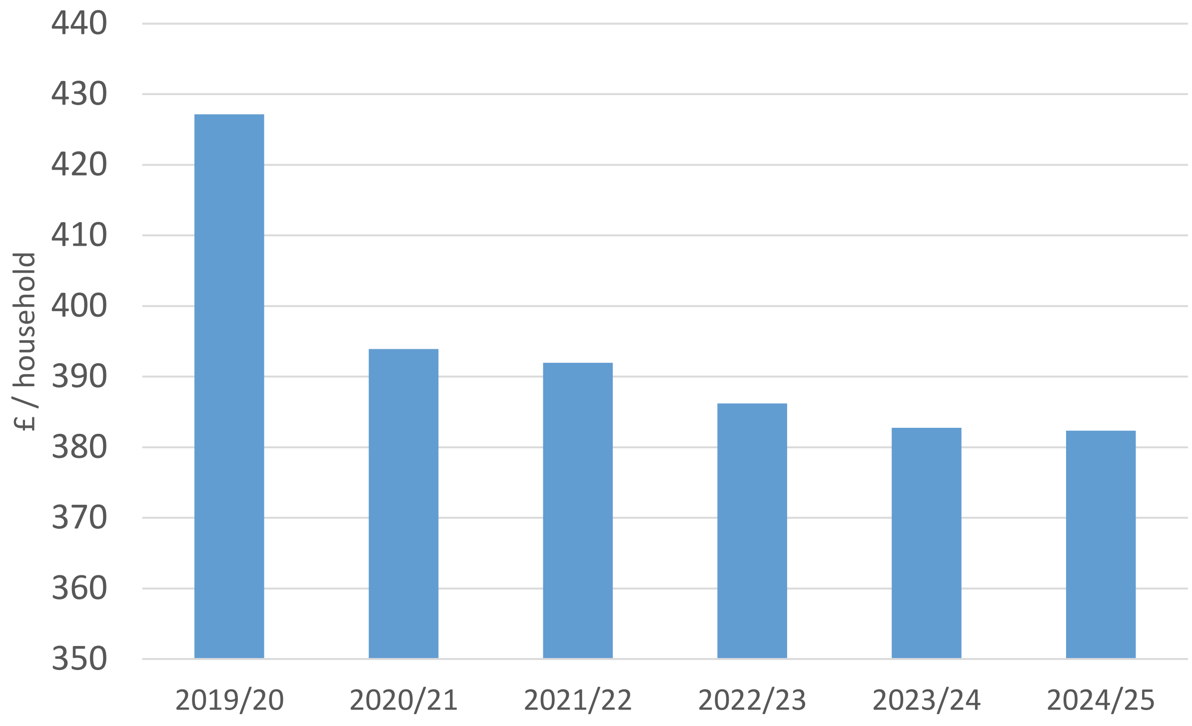
Customers can expect to see improvement in services across the board whilst average bills in our September 2018 business plan are expected to fall by 10.5% in real terms between 2020 and 2025

£382 2024/25 AVERAGE REAL CUSTOMER BILL

£45 AVERAGE REAL BILL REDUCTION

10.5% REAL REDUCTION FROM 2019/20

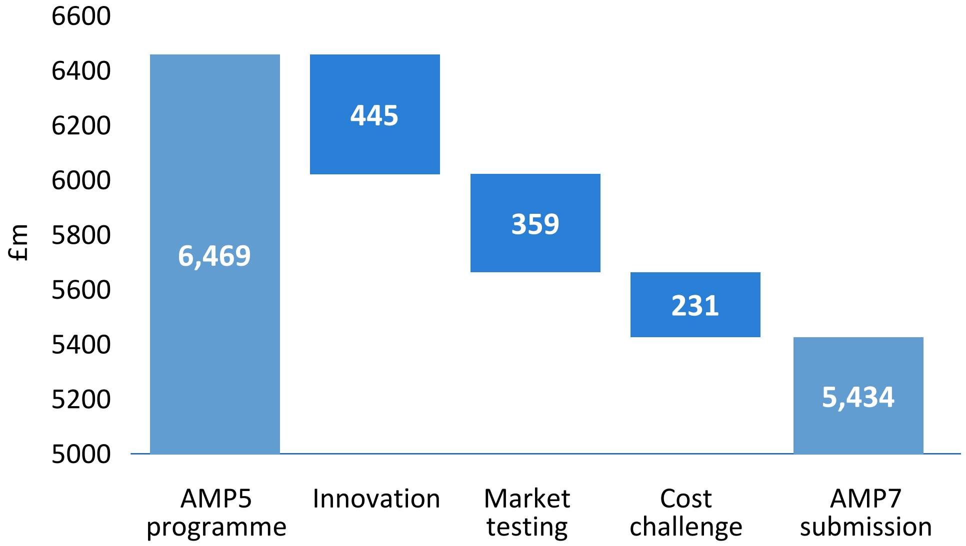
Average household dual bill (real)[1]

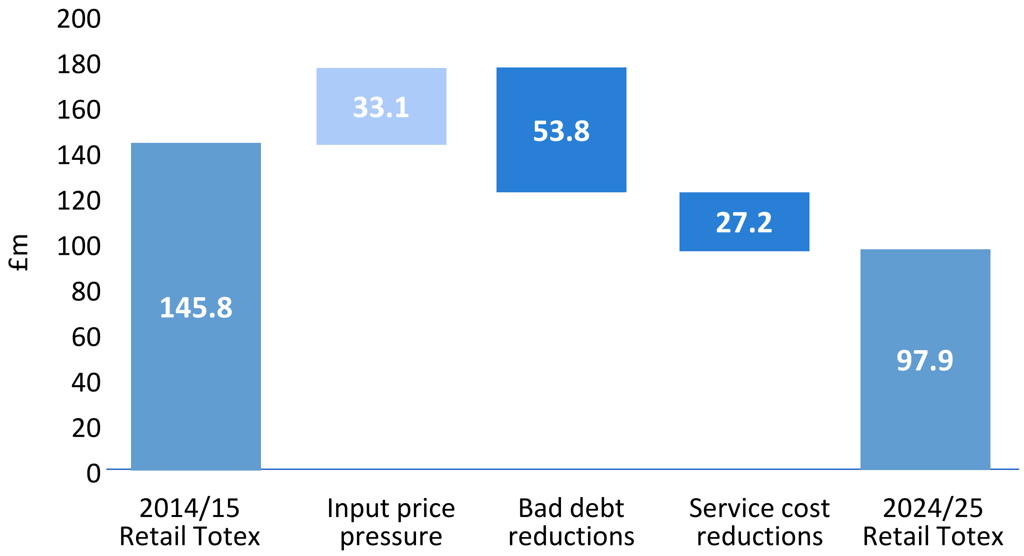


[1] 2017/18 price base

Efficiency in wholesale, efficiency in retail

September 2018 business plan submission – stepped up to the efficiency challenge ahead of AMP7



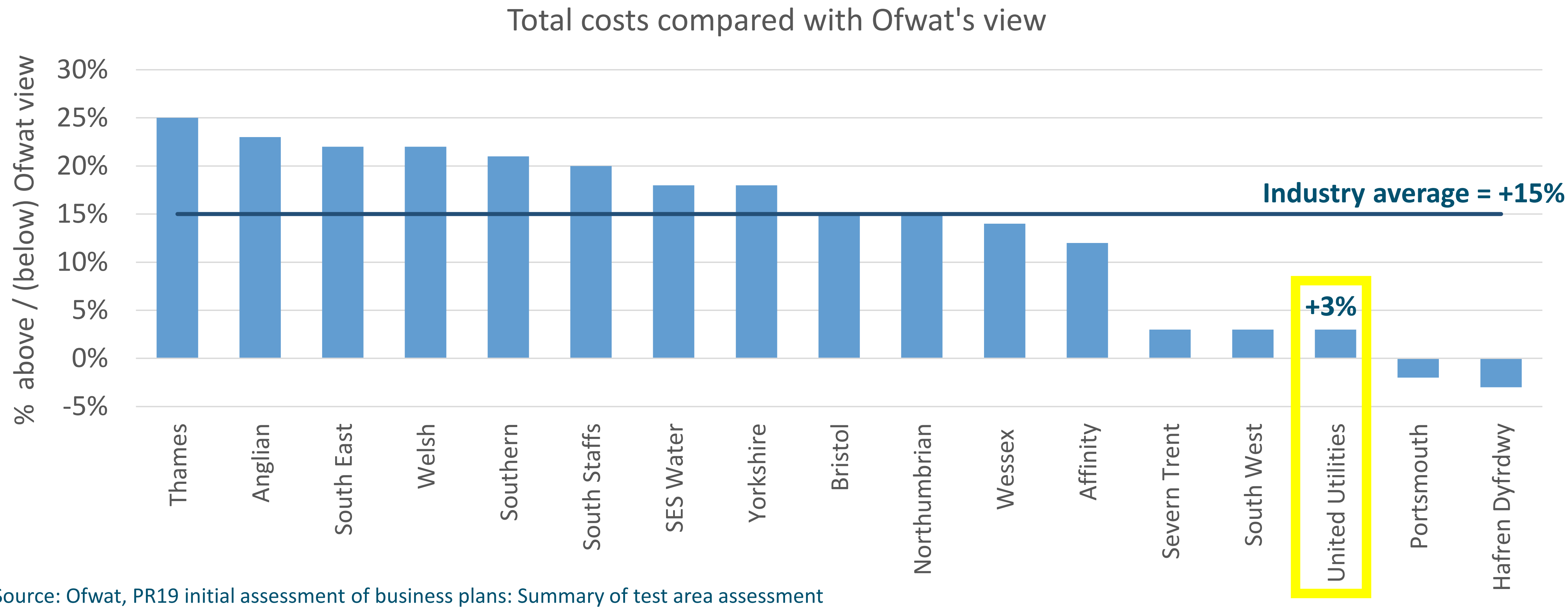


Innovation, market testing and cost challenge leading to **£1bn reduction in wholesale totex**

Overall **retail costs down by one third**; **bad debt down by half** by end of AMP7 vs start of AMP6

Efficient costs

Significant improvement in efficiency



Source: Ofwat, PR19 initial assessment of business plans: Summary of test area assessment

A fast-track company

Leading on a forward looking basis

A = High quality, ambitious and innovative plan with evidence that overall is sufficient and convincing.

B = High quality plan, not sufficiently ambitious and innovative to be exceptional with evidence that overall is sufficient and convincing.

C = Concerns with the plan: Plan falls short of high quality and/or evidence is insufficient and/or unconvincing in some areas.

D = Substantial concerns with the plan: Plan falls significantly short of required quality and/or little or no evidence, or no convincing evidence.

	Water and sewerage companies											Water only companies					
Test Area	Anglian Water	Dwr Cymru	Hafren Dyfrdwy	Northumbrian Water	Severn Trent Water	South West Water	Southern Water	Thames Water	United Utilities Water	Wessex Water	Yorkshire Water	Affinity Water	Bristol Water	Portsmouth Water	South East Water	South Staffs Water	SES Water
Engaging customers	A	B	C	B	B	B	C	C	B	B	B	C	B	C	C	B	C
Addressing affordability and vulnerability	B	B	D	B	B	B	B	C	A	B	C	C	C	C	B	C	B
Delivering outcomes for customers	B	C	D	C	C	B	C	C	C	C	C	C	C	C	B	C	C
Securing long-term resilience	C	C	D	C	C	B	D	D	B	C	C	D	C	C	C	D	C
Targeted controls, markets and innovation	B	C	C	C	C	C	C	C	B	B	B	C	C	C	B	C	C
Securing cost efficiency	D	D	B	C	B	B	D	D	B	C	C	C	C	B	C	C	D
Aligning risk and return*	C	C	D	B	C	B	C	C	C	D	C	D	C	C	C	C	C
Accounting for past delivery*	B	C	D	C	B	D	D	D	B	B	B	C	D	C	D	B	B
Securing confidence and assurance	D	A	C	C	B	C	C	C	B	C	C	C	C	C	B	C	D

* Highest possible assessment for these test areas was B

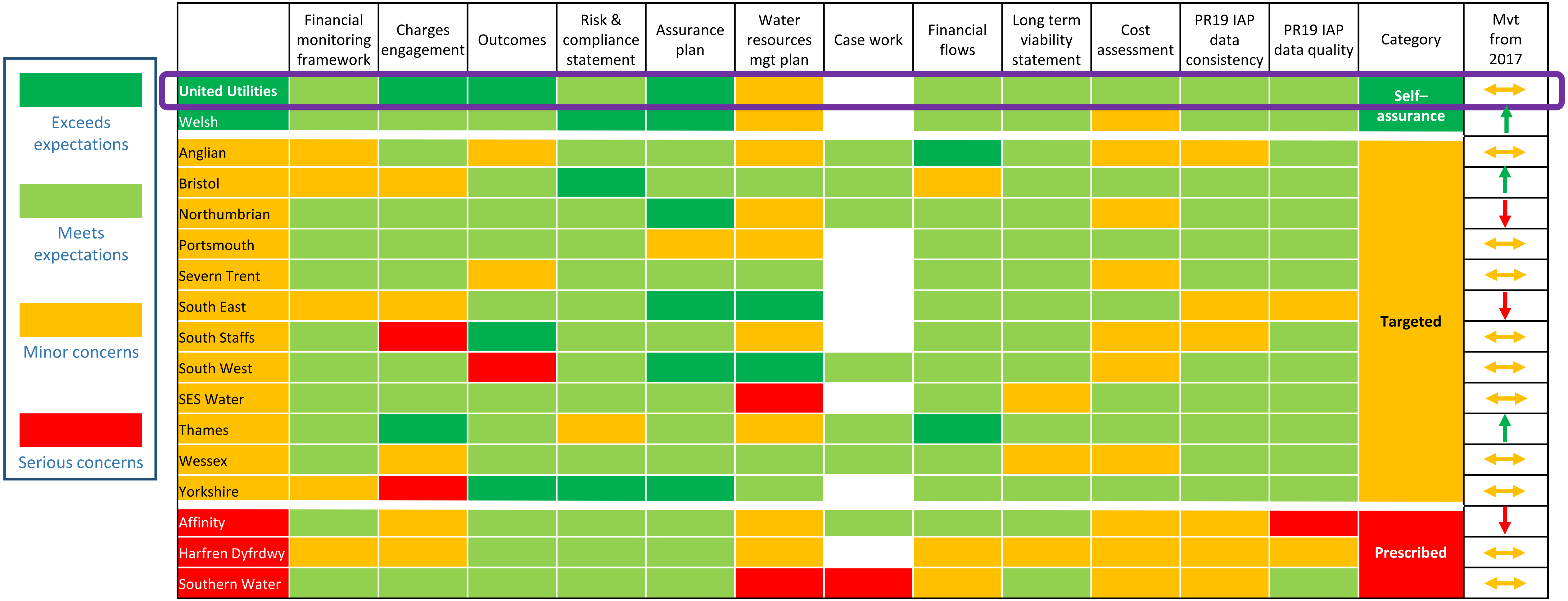
Source: Ofwat, PR19 Initial assessment of plans: Summary of test area assessment

Highlights – Ofwat's Initial Assessment of Plans

Industry leading in many areas

Trust and confidence in reporting

Awarded top self-assurance status for third consecutive year



Supporting information

Financial performance

Reported income statement

Year ended 31 March £m	2019	2018
Revenue	**1,818.5**	**1,735.8**
Operating expenses	(790.4)	(722.6)
EBITDA	**1,028.1**	**1,013.2**
Depreciation and amortisation	(393.2)	(376.8)
Operating profit	**634.9**	**636.4**
Investment income and finance expense	(205.4)	(206.6)
Share of profits of joint ventures	6.7	2.3
Profit before tax	**436.2**	**432.1**
Tax	(72.8)	(77.5)
Profit after tax	**363.4**	**354.6**
Basic earnings per share (pence)	**53.3**	**52.0**
Total dividend per ordinary share (pence)	**41.28**	**39.73**

Underlying income statement

Year ended 31 March £m	2019	2018	Movement
Revenue	**1,818.5**	**1,735.8**	**82.7**
Operating expenses	(575.9)	(566.8)	
Infrastructure renewals expenditure	(164.6)	(147.1)	
EBITDA	**1,078.0**	**1,021.9**	
Depreciation and amortisation	(393.2)	(376.8)	
Operating profit	**684.8**	**645.1**	**39.7**
Net finance expense	(231.2)	(277.2)	
Share of profits of joint ventures	6.7	2.3	
Profit before tax	**460.3**	**370.2**	**90.1**
Tax	(81.6)	(65.3)	
Profit after tax	**378.7**	**304.9**	**73.8**
Earnings per share (pence)	**55.5**	**44.7**	
Total dividend per ordinary share (pence)	**41.28**	**39.73**	

Revenue analysis

Year ended 31 March £m	2019	2018
Wholesale water charges	767	719
Wholesale wastewater charges	906	876
Household retail charges	105	111
Other appointed revenue	6	6
UU Water appointed	**1,784**	**1,712**
UU Water non-appointed	14	5
Non-UU Water	21	19
Revenue	**1,819**	**1,736**

Underlying operating costs

Year ended 31 March £m	2019	2018	Movement
Revenue	**1,818.5**	**1,735.8**	**82.7**
Employee costs	(154.4)	(147.0)	(7.4)
Hired and contracted services	(96.2)	(95.4)	(0.8)
Property rates	(94.7)	(90.5)	(4.2)
Materials	(72.9)	(66.7)	(6.2)
Power	(70.0)	(70.4)	0.4
Regulatory fees	(32.5)	(29.7)	(2.8)
Bad debts	(26.5)	(20.8)	(5.7)
Cost of properties disposed	(4.7)	(9.8)	5.1
Settlement of commercial claims	9.9	-	9.9
Other expenses	(33.9)	(36.5)	2.6
	(575.9)	**(566.8)**	**(9.1)**
Infrastructure renewals expenditure (IRE)	(164.6)	(147.1)	(17.5)
Depreciation and amortisation	(393.2)	(376.8)	(16.4)
Total underlying operating expenses	**(1,133.7)**	**(1,090.7)**	**(43.0)**
Underlying operating profit	**684.8**	**645.1**	
Adjustments:			
Dry weather event	(36.1)	-	
GMP equalisation	(6.6)	-	
Flooding incidents (net of insurance proceeds)	-	(1.7)	
Non-household retail market reform[1]	-	(1.0)	
Restructuring costs	(7.2)	(6.0)	
Reported operating profit	**634.9**	**636.4**	

[1] Relates to market reform restructuring costs incurred preparing the business for open competition in the non-household retail market

Dry weather event costs

Year ended 31 March £m	2019	2020
Capex	29.6	13.0
IRE	10.5	-
Opex	25.6	-
Totex	**65.7**	**13.0**

£36m of costs recognised as an adjusting item for the year to 31 March 2019

Finance expense

Year ended 31 March £m	2019	2018
Investment income	17.1	12.0
Finance expense	(222.5)	(218.6)
	(205.4)	**(206.6)**
Less net fair value gains on debt and derivative instruments	(9.5)	(47.3)
Adjustments for interest on derivatives and debt under fair value option	30.6	23.5
Adjustment for net pension interest income	(9.5)	(7.1)
Adjustment for capitalised borrowing costs	(37.4)	(39.7)
Underlying net finance expense	**(231.2)**	**(277.2)**
Average notional net debt	**6,907**	**6,614**
Average underlying interest rate	**3.3%**	**4.2%**
Effective interest rate on index-linked debt	3.9%	5.0%
Effective interest rate on other debt	2.7%	3.1%

Finance expense: index-linked debt

Year ended 31 March £m	2019	2018
Cash interest on index-linked debt	(48.8)	(47.8)
RPI adjustment to index-linked debt principal – 3 month lag[1]	(71.1)	(107.8)
CPI adjustment to index-linked debt principal – 3 month lag[2]	(3.1)	(3.7)
RPI adjustment to index-linked debt principal – 8 month lag[3]	(24.1)	(26.3)
Finance expense on index-linked debt	**(147.1)**	**(185.6)**
Interest on other debt (including fair value option debt and derivatives)	(84.1)	(91.6)
Underlying net finance expense	**(231.2)**	**(277.2)**

- **Cash interest payment of £49m on c£3.8bn of index-linked debt**
- **Decrease in indexation charge mainly due to lower RPI, particularly on 3 month lagged debt**
- **RPI impact on RCV exceeds RPI impact on debt principal**

[1] Affected by movement in RPI between January 2018 and January 2019
[2] Affected by movement in CPI between January 2018 and January 2019
[3] Affected by movement in RPI between July 2017 and July 2018

Profit before tax reconciliation

Year ended 31 March £m	2019	2018
Operating profit	634.9	636.4
Investment income and finance expense	(205.4)	(206.6)
Share of profits of joint ventures	6.7	2.3
Reported profit before tax	**436.2**	**432.1**
Adjustments:		
Flooding incidents in Dec 15 (net of insurance proceeds recognised)	-	1.7
Non-household retail market reform[1]	-	1.0
Dry weather event	36.1	-
GMP equalisation	6.6	-
Restructuring costs	7.2	6.0
Net fair value gains on debt and derivative instruments	(9.5)	(47.3)
Interest on derivatives and debt under fair value option	30.6	23.5
Net pension interest income	(9.5)	(7.1)
Capitalised borrowing costs	(37.4)	(39.7)
Underlying profit before tax	**460.3**	**370.2**

[1] Relates to market reform restructuring costs incurred preparing the business for open competition in the non-household retail market

Profit after tax reconciliation

Year ended 31 March £m	2019	2018
Reported profit after tax	**363.4**	**354.6**
Adjustments:		
Flooding incidents in Dec 15 (net of insurance proceeds recognised)	-	1.7
Non-household retail market reform[1]	-	1.0
Dry weather event	36.1	-
GMP equalisation	6.6	-
Restructuring costs	7.2	6.0
Net fair value gains on debt and derivative instruments	(9.5)	(47.3)
Interest on derivatives and debt under fair value option	30.6	23.5
Net pension interest income	(9.5)	(7.1)
Capitalised borrowing costs	(37.4)	(39.7)
Agreement of prior years' tax matters	(4.2)	0.4
Tax in respect of adjustments to underlying profit before tax	(4.6)	11.8
Underlying profit after tax	**378.7**	**304.9**
Basic earnings per share (pence)	**53.3**	**52.0**
Underlying earnings per share (pence)	**55.5**	**44.7**

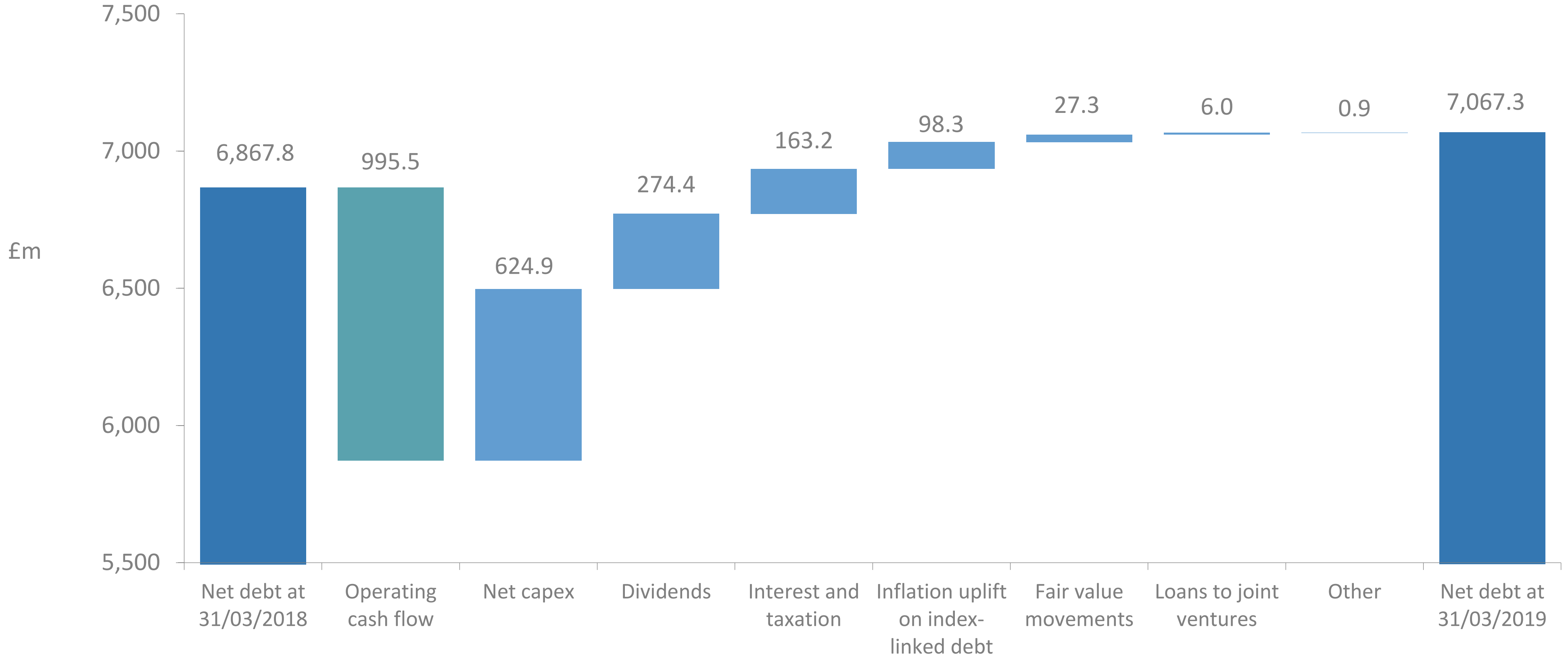
[1] Relates to market reform restructuring costs incurred preparing the business for open competition in the non-household retail market

Financial position

At 31 March £m	2019	2018	Movement
Property, plant and equipment	11,153.4	10,790.5	362.9
Retirement benefit surplus	483.9	344.2	
Other non-current assets	441.3	421.1	
Cash	339.3	510.0	(170.7)
Other current assets	280.8	302.2	
Total derivative assets	489.1	635.5	(146.4)
Total assets	**13,187.8**	**13,003.5**	
Gross borrowings	(7,815.8)	(7,912.3)	96.5
Other non-current liabilities	(1,843.3)	(1,741.5)	
Other current liabilities	(338.0)	(297.8)	
Total derivative liabilities	(79.9)	(101.0)	21.1
Total liabilities	**(10,077.0)**	**(10,052.6)**	
TOTAL NET ASSETS	**3,110.8**	**2,950.9**	
Share capital	499.8	499.8	
Share premium	2.9	2.9	
Retained earnings	2,269.8	2,120.3	149.5
Other reserves	338.3	327.9	
SHAREHOLDERS' EQUITY	**3,110.8**	**2,950.9**	
NET DEBT[1]	**(7,067.3)**	**(6,867.8)**	**(199.5)**

[1] Net debt includes cash, borrowings and derivatives (slide 62)

Movement in net debt



Derivative analysis

At 31 March £m	2019	2018
Derivatives hedging debt	479.6	585.5
Derivatives hedging interest rates	(69.9)	(50.1)
Derivatives hedging commodity prices	(0.5)	(0.9)
Total derivative assets and liabilities (slide 60)	**409.2**	**534.5**

- Derivatives hedging debt; hedge our non index-linked debt into sterling, floating interest rate debt. Typically these are designated in fair value hedge accounting relationships
- Derivatives hedging interest rates; fix our sterling interest rate exposure on a 10 year rolling average basis. This is supplemented by fixing substantially all remaining floating exposure across the future regulatory period around the time of the price control determination
- Derivatives hedging commodity prices; fix a proportion of our future electricity prices in line with our policy
- Derivatives are included within net debt to eliminate, to a certain extent, the fair value recognised in borrowings and thereby present a more representative net debt figure
- Further details of our group hedging strategy can be found in the Group financial statements

Cash flow statement

Year ended 31 March £m	2019	2018
Net cash generated from operating activities	832.3	815.6
Net cash used in investing activities	(627.7)	(723.2)
Net cash (used in) / generated from financing activities	(377.4)	184.7
Net movement in cash	**(172.8)**	**277.1**

Impact of RPI inflation

Short-term timing differences – for 2018/19 year end

Regulated revenue	Dividend policy	Regulatory capital value (RCV)	Index-linked debt[3]
Price limits are based on the movement in RPI[1] inflation between November 2016 and November 2017 (i.e. 3.9%)	Dividends for the 2018/19 financial year are also based on the movement in RPI[1] inflation between November 2016 and November 2017 (i.e. 3.9%) to mirror the inflationary uplift in price limits	Opening RCV is inflated by the movement in RPI[1] inflation between March 2018 and March 2019 Plus RCV additions (from totex) during the year, gives 31 March 2019 RCV (which is used for year-end gearing calculation)	RPI 3 month lag – adjustment to principal is based on the movement in RPI[1] inflation between January 2018 and January 2019 RPI 8 month lag – adjustment to principal is based on the movement in RPI[1] inflation between July 2017 and July 2018 CPI 3 month lag – adjustment to principal is based on the movement in CPI[2] inflation between January 2018 and January 2019

[1] Retail Prices Index (RPI)
[2] Consumer Price Index (CPI)
[3] Indexation of principal is calculated based on monthly movements in RPI / CPI

Economic regulation – PR14

Ofwat's legal duties

Primary	Secondary
• Ensure companies properly carry out their functions	• Promoting economy and efficiency
• Ensure companies can finance their functions	• Contributing to the achievement of sustainable development
• Protect interests of consumers, wherever appropriate by promoting effective competition	• Ensure Ofwat gives no undue preference[1]
• Secure the long-term resilience of water and sewerage systems[1]	

[1] added as part of the Water Act 2014

Regulatory capital value

Market capitalisation
(shortly after flotation)

+

Pre 2015: Capital investment
2015-20: RCV additions (from totex)

-

Pre 2015: Capital charges
2015-20: RCV run-off

+/-

Inflation adjustment

=

Regulatory capital value (RCV)

Plus other adjustments at each price control

Ofwat's PR14 final determination

Weighted average cost of capital 2015-20

Debt	Equity
Real pre tax 2.59%[1]	Real post tax 5.65%

Notional gearing 62.5%

WACC

Appointee business (vanilla, real) 3.74%[2,3]

Includes retail margin allowance of 0.14%

Wholesale business (vanilla, real) 3.60%[2]

[1] Assumes ratio of 75% embedded debt / 25% new debt. Cost of embedded debt = 2.75% & cost of new debt = 2.1%.

[2] Quoted ratios for non-enhanced companies. Enhanced companies received a slightly higher appointee WACC of 3.85%/ wholesale WACC of 3.70%

[3] 2010-15 WACC (vanilla, real) of 5.1%; derived from pre-tax debt of 3.6%, post-tax equity of 7.1% and a notional gearing of 57.5%

Ofwat's final determination – December 2014

Allowed revenues

£m	2015-16	2016-17	2017-18	2018-19	2019-20	AMP6 total
Wholesale water (2012/13 prices)	654	660	666	672	679	3,331
Wholesale wastewater (2012/13 prices)	775	783	792	800	804	3,954
Wholesale revenue (2012/13 prices)	**1,429**	**1,443**	**1,458**	**1,472**	**1,483**	**7,285**
Retail household (nominal prices)	132	128	121	116	119	616
Retail Non-household (nominal prices)	36	37	37	38	38	186
Retail revenue (nominal prices)	**168**	**165**	**158**	**154**	**157**	**802**
Total revenue (variable price base)*	**1,597**	**1,608**	**1,616**	**1,626**	**1,640**	**8,087**

* Not consistent with statutory accounting / IFRS revenues

Ofwat's final determination – December 2014

Wholesale price controls

Wholesale totex FD threshold of £5,328m[1] (2012/13 prices)	Wholesale totex in revenue calculation of £5,296m[2] (2012/13 prices)	Wholesale 'pay as you go' ratios: water = 66%, wastewater = 50%	Allowed wholesale revenue of £7,285m (2012/13 prices)	Nominal growth in the RCV of c£1.5bn (c15%) across AMP6 2015-20
£188m below UU October proposal of £5,516m but £427m higher than DD, reflecting additional totex exclusions accepted	Split: £2,356m water and £2,940m wastewater	'Pay as you go' ratio flexed in line with allowed totex	Split: £3,331m water and £3,954m wastewater	Comprising c£0.2bn real growth and c£1.3bn RPI uplift (assuming 2.5% p.a. RPI)

[1] Includes pension deficit repair allowances
[2] Combines Ofwat's estimates of efficient costs with the companies' forecasts in the ratio 75:25. Excludes pension deficit repair allowances

Ofwat's final determination – December 2014

Retail price controls

Allowed retail household revenue of £616m (nominal prices)

£20m p.a. special factor claim[1] relating to income deprivation allowed

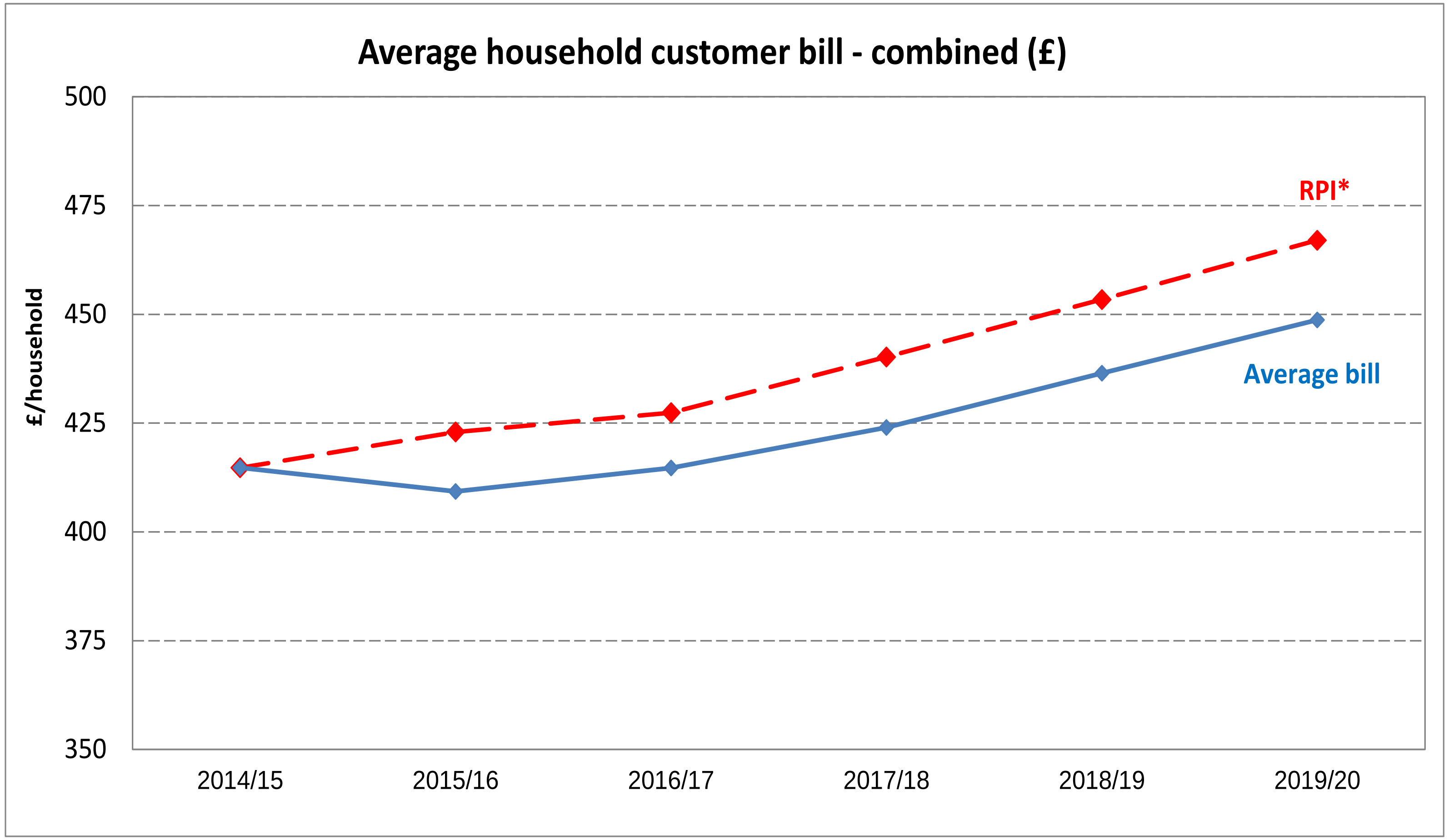
Allowed retail non-household revenue of £186m (nominal prices)

No inflationary increases allowed on retail price controls

[1] Reflects impact of the extreme levels of deprivation in the North West on our costs, and includes bad debt and associated costs

Ofwat's final determination – December 2014

Average household bills



*Assumes 3% p.a. RPI inflation from 2017/18 to 2019/20

Cautionary statement

This presentation contains certain forward-looking statements with respect to the operations, performance and financial condition of the group. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this presentation and the company undertakes no obligation to update these forward-looking statements. Nothing in this presentation should be construed as a profit forecast.

Certain regulatory performance data contained in this presentation is subject to regulatory audit.