# Group Overview, Business Model and Investment Case

SEVERN TRENT

**LSE:** SVT
**ADR:** Listed on OTCQX – STRNY

**Severn Trent Plc is a FTSE 100 company focused on water and waste water. It has two businesses, Severn Trent Water and Severn Trent Services:**

## SEVERN TRENT WATER

3rd largest regulated water utility business in England and Wales.

5 year regulatory cycle (AMP periods) – current period 2010/11 to 2014/15.

Asset base – "RCV" (regulatory capital value) – £7.6bn @ March '14.

Inflation linked business model.

Independent, transparent regulation.

Demonstrated ability to outperform, delivering a £150m special dividend payment in 2012.

Sector leading performance on renewable energy.

Thought leadership on sector reforms.

## SEVERN TRENT SERVICES

Exposure to higher growth, unregulated markets.

2 activities – Products (purification and disinfection), Operating Services.

Leveraging core expertise – focus on water.

Fundamental growth drivers – climate change, population growth, security of supply, rising environmental standards & legislation, poor quality infrastructure.

Capital light model.

Short term challenging, long term opportunity.

### Group Financial Summary

Revenue (£m)

| | |
|---|---|
| 2013/14 | £1,857 |
| 2012/13 | £1,832 |
| 2011/12 | £1,771 |
| 2010/11 | £1,711 |

Adjusted basic earnings per share (p)[1,2]

| | |
|---|---|
| 2013/14 | 88.4 |
| 2012/13 | 92.6 |
| 2011/12 | 88.9 |
| 2010/11 | 105.6 |

Profit before interest, tax and exceptionals (£m)[2]

| | |
|---|---|
| 2013/14 | £517 |
| 2012/13 | £495 |
| 2011/12 | £504 |
| 2010/11 | £519 |

Dividend per share (p)

| | |
|---|---|
| 2013/14 | 80.4 |
| 2012/13 | 75.9 |
| 2011/12 | 70.1 |
| 2010/11 | 65.1 |

[1] Before exceptional items, gains/losses on financial instruments and deferred tax.
[2] 2012/13 restated due to adoption of 1AS19 revised. Earlier periods have not been restated, so are not directly comparable

# Our Investment Proposition

- **Severn Trent Water is a regulated, low risk UK utility with inflation linked assets and revenues.**
- **Severn Trent Water has a growing asset base, from sustainable, efficient, long term investments in essential assets, on which it earns a regulated return.**
- **Severn Trent Services provides exposure to higher growth, unregulated markets, while still leveraging our core expertise of water and waste water.**
- **We have a proven ability to generate shareholder value through both an inflation linked dividend and capital growth.**
- **We are committed to a dividend policy of RPI+3% to March 2015 and delivered a total shareholder return** of 93% between 1 April 2010 and 31 March 2014, significantly outperforming our peers and the FTSE 100.**
- **We have a focus on "continuous improvement" and a track record of delivery, publishing key performance indicators annually since 2007.**
- **We strive to maintain the right balance between our customers, investors, people and the environment.**
- **We are thought leaders on regulatory reform through our "Changing Course" publications and are well placed to benefit from upcoming changes to the regulatory framework.**

**FY 13/14 dividend = 80.4p, +6% y-o-y, 4.4% yield***

**FY 14/15 dividend = 84.9p, +5.6% y-o-y, currently 4.7% yield***

* 1,820p, close on 13/03/14

** Assumes reinvestment of dividends paid.

# Severn Trent Water – delivering sustainable returns through efficient, long term investments

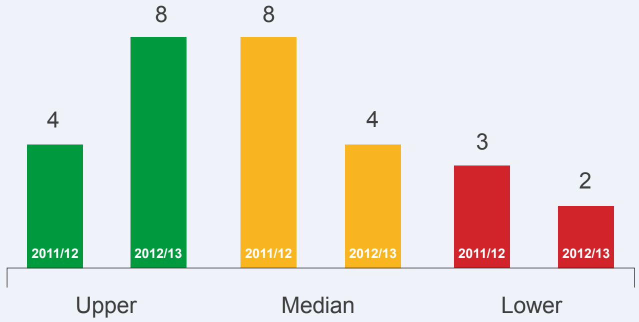
**Severn Trent Water is one of the largest of the 10 Water and Sewerage Companies in England and Wales. We cover an area of 21,000km². We:**

- supply water to 8m people and sewerage services to c. 9m people
- supply 1.8bn litres water per day
- treat 1.4bn litres waste water per day

**Our physical assets include:**

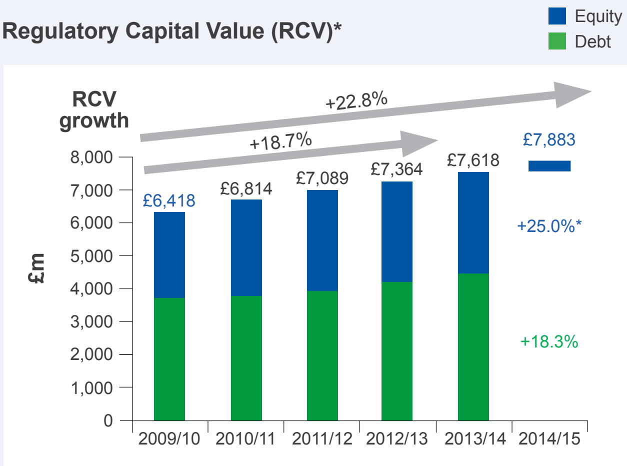
- 47,000 kilometres of water mains
- 156 water treatment works
- 92,000 kilometres of sewers
  - Including 37,000km of private drains and sewers adopted October 2011
- 1,019 sewage treatment works

**Focus on continuous improvement:**
Ofwat KPI benchmark performance




Ofwat dropped water pollution as a KPI between 2011/12 and 2012/13

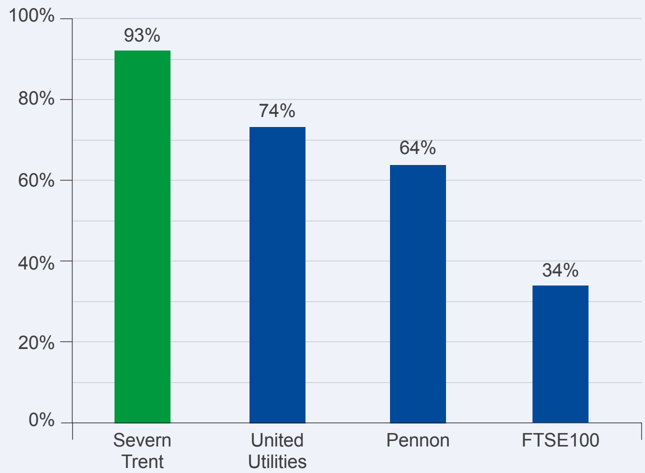
**Regulatory Capital Value (RCV)***



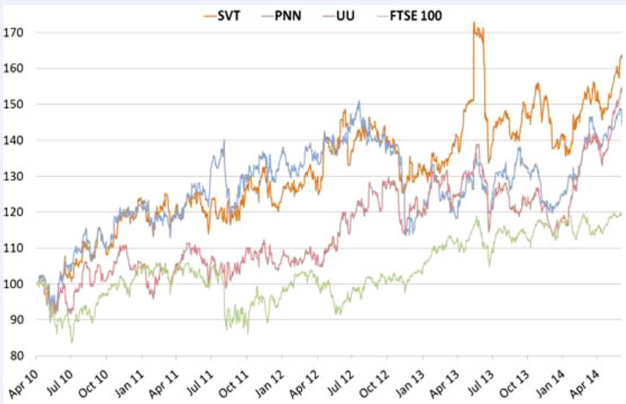

Based on year end RPI forecast of 2.8% for 2014/15. For RCV values see: www.ofwat.gov.uk/regulations/prs_web_rcvupdates

* Adjusted for special dividend

**Severn Trent Plc.**
**Total Shareholder Returns: 2010/11 – 2013/14**




**Share price relative – AMP5 to date:**




**Final determination AMP5 2010/11 – 2014/15:**

| | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | Average |
|---|---|---|---|---|---|---|
| K-factors (real price change) | -1.0 | 0 | 0 | -1.0 | -1.1 | -0.6 |
| Ofwat RPI forecast | -1.0% | 2.0% | 3.0% | 2.7% | 2.5% | 1.8% |
| Actual / forecast RPI | 0.3% | 4.7% | 5.2% | 3.0% | 2.6% | 3.2% |

**AMP5 Performance so far**

- Outperforming price review (final determination)
- Opex for AMP5 expected to be c. £30m below level allowed by regulator
- Power hedging gives a benefit of c. £25 million over AMP5 vs. cost allowed by regulator
- Financing outperformance c. £100m over AMP5

## Price review 2014 (AMP6 2015/16 – 2019/20)

**Significant changes from current framework:**

- Outcome delivery incentives (ODIs) – financial penalties and rewards for specific operational performance
- Totex (total expenditure) – no differentiation between capital and operational expenditure
- Wholesale / retail split – separate price controls for wholesale (water and waste) and for retail (non-household and household)
- From 2017 non-household retail market opens to full competition

**Continuity:**

- 100% of RCV in wholesale
- Allowed return on asset base (RCV)
- Customer bills and RCV linked to RPI

**Review timetable:**

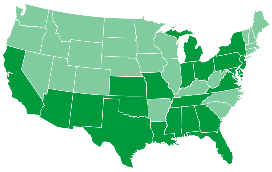
- December 2013 – Business Plan submitted
- January 2014 – Ofwat guidance on risk and reward (returns) published
- April 2014 – Plan ratings published (Severn Trent "Standard")
- 27 June 2014 – Revised plan submission
- 29 August 2014 – Draft determination
- 12 December 2014 – Final determination

## Severn Trent Services – focus on water and waste water in unregulated markets

SEVERN TRENT SERVICES

**Non-regulated global water technologies and services business. 2 key activities: Products & Operating Services.**

- Headquartered in Fort Washington, PA, USA. Global workforce around 3,100.
- 20 offices around the world and sales into 115 countries
- Short term challenging, long term opportunity



| | Market Drivers |
|---|---|
| **Financial Constraints** | Rising capital requirements<br>Weak municipal finances<br>Increased regulation / legislation<br>Increased energy prices |
| **Water scarcity** | Climate change<br>Population growth<br>Security concerns |
| **Lack of expertise** | Ageing infrastructure / poor assets<br>Ageing workforce in developed countries<br>Developing economies |

Revenue (£m)


PBIT* (£m)


* before exceptionals

| | Building the system – Products | Operating Other People's Assets – Operating Services |
|---|---|---|
| **What we do** | High value add technologies focused on water purification<br>Critical parts of a new build project<br>Well established brands (ClorTec® (disinfection), TETRA® (filtration), BALPURE® (marine)) with proven install base<br>Expert at assembling and packaging | Operate plants and systems for municipalities, including over 400 contracts in the USA<br>25 year Ministry of Defence contract in UK<br>Expertise differentiates us<br>Leverage off STW best practice<br>Medium scale projects<br>Bring global expertise to local customers<br>Long term stable revenues |
| **What we don't do** | Commodity components (e.g. pumps, screens)<br>We are not a full scale manufacturer<br>End-to-end solutions | Risky countries<br>Mega contracts<br>Plant / building construction<br>Solely Repair & Maintenance |

## Renewable Energy

Severn Trent's non-regulated business generates renewable energy from wind turbines and the anaerobic digestion (AD) of crops and we are now expanding into the food waste AD market. We plan to investigate the development of other technologies including photovoltaics (PV) and biomass combustion.

# We are a low risk business
## (for more information see our 2014 Annual Report)

| Risk Factor | Notes |
|---|---|
| **Legal/Regulatory** | There are risks associated with our ability to effectively anticipate and/or influence future developments in the UK water industry. At present, Severn Trent is an active participant in the debate, delivering thought leadership. We will continue to engage with our peers, Ofwat and other regulators, UK Government departments and other stakeholders to influence the direction of regulatory policy where possible. Currently, there is also risk around the outcomes of our AMP6 plan, submitted to Ofwat but not yet finalised. Additionally, there are risks associated with potential non compliance with the numerous and increasingly demanding environmental obligations. |
| **Customer Perception** | Our ability to improve and maintain levels of customer service remains a principal risk. There is also a risk we may be unable to respond effectively to the opening of the business retail market to competition. Programmes of work across all parts of our business are underway to mange this risk. |
| **Financial/Economic** | The current economic climate still poses a risk to the ability to obtain funding for the group at commercially attractive rates. There are also risks around our ability to effectively manage counterparty risk and fund pensions promises sustainably. In the current economic climate, there are risks to our strategic growth objective for Severn Trent Services. The risk of negative inflation and its impact on the regulatory model also remains. |
| **Operational** | These are risks associated with our daily operations, including asset failure, process compliance and key systems which may in turn impact our ability to serve our customers or to meet our regulatory targets. There are also risks around the delivery of our capital programme, our efficiency improvement programmes and delivery of our financial targets in both Severn Trent Water and Severn Trent Services. |

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**Our AMP6 Business Plan**
www.severntrent.com/futures/our-2020-plan/

**Changing Course**
www.severntrent.com/future/policy-regulation/

**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