United Utilities Group PLC
3 September 2018

UNITED UTILITIES PR19 BUSINESS PLAN SUBMISSION

United Utilities Water Limited has today submitted its business plan covering the 2020-25 period.

Highlights of the proposal

- 10.5% reduction in real terms in average bills between 2020 and 2025
- Balanced outcome delivery incentive (ODI) package with range of outcomes estimated at plus or minus 2% of return on regulated equity across AMP7, equivalent to around +/-£410m
- Reduction of over £1bn in expenditure compared with AMP5
- Bold strategy of innovation with further advancements in Systems Thinking capability
- Delivering a major water resilience scheme with estimated construction costs of over £750m in AMP7 and AMP8 to be directly procured for customers in Manchester and the Pennines
- Adopting an RPI-stripped appointee cost of capital of 2.4% consistent with Ofwat's early view
- Leading the industry in operational, corporate and financial resilience

Steve Mogford, Chief Executive Officer, said:

"Our business plan sets out our ambition to build on our achievements in AMP6 and deliver a better quality, more reliable water and wastewater service for customers in the North West of England to 2025 and beyond. We are cutting bills such that they will be lower in real terms in 2025 than they were 15 years ago, whilst also delivering higher standards of service, increasing resilience, delivering innovation and investing for the long-term.

"We exit AMP6 as a high performing, responsible company and have submitted a plan for AMP7 that delivers for customers, aligned with the key PR19 themes. Our plan represents the next step towards our vision to be the best UK water and wastewater company and has benefited from extensive engagement with customers and other stakeholders in our region. We are excited about what it means for AMP7 and beyond and we are confident that this is a very high quality and ambitious plan, rich in content, with a compelling proposition of bill reductions and service improvements."

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Our full PR19 business plan can be accessed at the following link:
https://www.unitedutilities.com/nwmatters

We will be hosting a webcast presentation for investors and analysts starting at 10.00am on Tuesday 4 September 2018. The webcast can be accessed at the following link:
https://www.investis-live.com/united-utilities/5af40966cc5d470e00698687/hrsz

The presentation can also be accessed via a live audio-only call facility by dialling:
UK toll: +44 (0) 20 3936 2999
Access code: 427874

This announcement and the associated presentation will be available at:
https://www.unitedutilities.com/corporate/investors/

The webcast will be available on demand from Wednesday 5 September 2018 at the following link:
https://www.unitedutilities.com/corporate/investors/financial-news/latest-financial-news/

Customer bills

We are proposing a 10.5 per cent reduction in real terms in average customer bills over the five years to 2025. This represents an average reduction of £45 per customer in real terms from 2019/20 to 2024/25 and, assuming 2 per cent per annum CPIH inflation, we expect our bills to fall by an average of £5 per customer in nominal terms over the period.

Delivering this for our customers will also mean that average bills will be around 14 per cent lower in real terms in 2025 than they were 15 years ago in 2010, whilst service standards and environmental quality continue a path of significant improvement. This is a strong value for money proposition, which research shows over 80 per cent of our customers support, and which we are committed to deliver.

This reduction in customer bills is achieved despite the additional cost of an average of £12 per customer to deliver new environmental and other service enhancements, and a further £0.52 average per customer for the completion of the first phase of the Manchester and Pennines Resilience project.

The table below shows a reconciliation between the expected average bills in 2019/20 and 2024/25 and details the actions to achieve the bill reduction in our business plan:

	£
Expected 2019/20 average customer bill (2017/18 prices)	**427**
Additional cost of delivering new environmental obligations and service enhancements	12
Embracing Ofwat's AMP7 WACC guidance, including the resulting impact on tax	(21)
Lower base costs to maintain services, including reduced recovery of pension deficit payments	
- wholesale	(13)
- residential retail	(8)
Lower pay-as-you-go (PAYG) advancement compared with PR14 to maintain financeability	(3)
Increases in customer numbers	(9)
Other items (including AMP6 reconciliation, PR14 CIS adjustment, and revenue re-profiling)	(3)
Expected 2024/25 average customer bill (2017/18 prices)	**382**

Service and outcome delivery incentives (ODIs)

We have designed a package of performance commitments, targets and incentives that covers all aspects of service and environmental performance that are important to customers and stakeholders and that incentivises innovation in our operations. We have adopted the common performance commitments proposed by Ofwat and have developed a comprehensive set of bespoke commitments, reflecting the results of our customer research. These include significant reductions in leakage, sewer flooding, and supply interruptions, as well as further developments in our industry leading pollution performance and integrated catchment management approach.

We have significantly reduced leakage over the last 25 years and have met our leakage target for over a decade. Our regional supply-demand surplus has historically meant that there has not been a strong water resource driver to reduce leakage beyond the sustainable economic level, however we recognise there are wider benefits to leakage reductions and have therefore set a target to deliver a 15 per cent reduction by the end of AMP7. This target is stretching, but one that we think we have a good opportunity of achieving.

We support the wider application of financial incentives to performance commitments and have applied financial incentives to almost all our measures, with most subject to both outperformance payments for stretching performance and underperformance penalties. We have reviewed our overall outcome delivery incentive (ODI) package to ensure that there is an appropriate balance of risk and return. We have estimated the potential upside and downside – or the P10 / P90 range – of our proposed ODIs, with the total range over the five-year period being plus or minus 2 per cent of return on regulated equity (RoRE), and this equates to roughly plus or minus £410 million across AMP7.

The table below shows a breakdown of our roughly symmetrical P10 / P90 range for AMP7 ODIs grouped by impact:

	Penalty £m	**Reward £m**
Water quality	(37)	66
Water reliability	(107)	94
Environment	(102)	114
Supporting customers	(48)	48
Sewer flooding	(114)	87
Gap / vacant sites	(2)	7
Total P10 / P90 range	**(410)**	**416**

Delivering long-term resilience

In many ways, we are already leading the way for the industry in the areas of operational, corporate and financial resilience and our plan sets out how we intend to raise the bar even further. Our Systems Thinking approach is significantly improving the reliability of our systems and, in AMP6, we have already committed to reinvest £250 million of outperformance to improve resilience and enhance our capability to maintain services in AMP7 and beyond.

Our plan proposes one significant resilience project that sits outside of the core total expenditure budget to ensure the resilience of potable water supplies to populations in Manchester and the Pennines. These populations are served by the Haweswater Aqueduct for which we are proposing a major scheme, with strong customer support, to deliver replacement tunnels across AMP7 and AMP8 using a direct procurement approach, as this is most likely to be the best value solution.

Total expenditure (totex)

Our AMP7 wholesale cost proposals are £5.4 billion (2017/18 prices), and are therefore lower than our AMP6 final determination of £6.2bn (2017/18 prices) and over £1 billion lower than our AMP5 final determination of £6.5bn (2017/18 prices). These significant savings are achieved through innovations applied in AMP6 and planned for AMP7, market testing our cost base and a better challenge of needs both internally and externally with our quality regulators.

The table below shows a reconciliation between the wholesale total expenditure (totex) programme in AMP5 and that in our AMP7 business plan submission:

	£m	**%**
AMP5 programme (2017/18 prices)	**6,469**	**100%**
Innovations applied in AMP6 and planned for AMP7	(445)	(7%)
Application of industry leading market testing framework to 100% of cost base	(359)	(6%)
Better challenge of cost needs internally and with quality regulators	(231)	(3%)
AMP7 submission (2017/18 prices)	**5,434**	**84%**

The table below shows a reconciliation between the residential retail totex in 2014/15 and that in 2024/25 of our AMP7 business plan submission:

	£m	**%**
2014/15 residential retail totex (in nominal terms)	**145.8**	**100%**
Input price pressure	33.1	23%
Bad debt reductions	(53.8)	(37%)
Service cost reductions	(27.2)	(19%)
2024/25 residential retail totex (in nominal terms)	**97.9**	**67%**

Innovation

Fundamental throughout our plan is a bold strategy of innovation, drawing on new initiatives, learning and inspiration from beyond the UK water sector. We are committed to our long-term strategy to embrace Systems Thinking in how we run our services, as we believe this provides the right platform to deliver best quality service at the lowest sustainable cost. We are already benefiting from historical investment in capability and infrastructure and, in AMP7, we propose incentives through a Systems Thinking ODI for additional innovation and adoption of technology to create a clearly charted step change in capability. This mechanism provides scope for flexible acceleration in adopting new technology so it can improve service delivery to customers faster.

Responsible approach to sharing outperformance and dividends

In AMP5 and AMP6 we have voluntarily reinvested over half a billion pounds of outperformance back into the business, sharing the benefit with customers. We have also made substantial contributions towards customer affordability schemes out of shareholder funds. In AMP7, we are going further by pre-committing to a guaranteed rate of benefit sharing with customers through our CommUnity Share initiative, linked to responsible approaches to gearing and dividend distributions.

We have built headroom through AMP6 to put ourselves in the best position going into AMP7, and are putting forward the best business plan that gives us a good opportunity to deliver for our shareholders as well as our customers through continued performance improvements. We recognise the importance of dividends to our shareholders, however our United Utilities Group PLC dividend policy will not be decided by the Board and announced until we have received our final determination.

Return on capital

We have adopted an RPI-stripped appointee WACC of 2.4 per cent real, consistent with the 'early view' position set out by Ofwat in its methodology statement. In adopting Ofwat's early view WACC guidance for the plan, we are committing to a plan that delivers the best affordability for customers on an efficiently financed basis.

The table below shows how this WACC is broken down:

AMP7 (RPI real)	**Ofwat 'early view'**
Overall cost of debt (RPI real)	1.33%
Cost of equity (RPI real)	4.01%
Gearing	60.0%
Appointed vanilla WACC (RPI real)	**2.4%**
Impact of 1% household retail margin	(0.1)%
Wholesale vanilla WACC (RPI real)	**2.3%**
RPI CPIH wedge	1.0%
Wholesale vanilla WACC (CPIH real)	**3.3%**

Although we have assessed that certain sub-elements of the appointee cost of capital are, on an individual basis, set at the very low end of (or even below) an acceptable range, we have been able to adopt the Ofwat early view WACC on an overall basis, as part of the risk and return balance and price control package set out in our full business plan document. This includes a small adjustment to the PAYG ratios that we have used to mitigate financeability constraints by keeping FFO to debt ratios above the minimum threshold during AMP7 on a notional company basis.

We have applied PAYG rates broadly consistent with operating costs (which includes infrastructure renewals expenditure) as a proportion of totex for each price control. However, in order to support the financeability of our plan on a notional company basis, it has also been necessary to advance revenues by increasing PAYG above the "natural" rate by 1.9 per cent of AMP7 totex (c£102m, or 1.2 per cent of AMP7 revenue). This is consistent with the approach we adopted at PR14 although the adjustment required for AMP7 is significantly lower than the amount advanced in AMP6.

To mitigate the impact of this on customer bills, we have also re-profiled revenues to 'flatten' the profile of key ratios over 2020-25, and hence minimise the required level of PAYG advancement.

The table below shows the impact of these adjustments on average customer bills:

£ (2017/18 prices)	2020/21	2021/22	2022/23	2023/24	2024/25
Average household bill pre PAYG advancement and revenue re-profiling	382.39	381.53	380.88	379.03	379.94
Impact of revenue re-profiling	4.75	3.68	(1.06)	(3.62)	(4.24)
Impact of PAYG lever	6.78	6.76	6.37	7.33	6.64
Final proposed bill profile (including Manchester and Pennines Resilience project)	393.92	391.96	386.19	382.74	382.33

These adjustments are necessary to ensure that our plan achieves adequate ratio values on a notional company basis consistent with achieving, as a minimum, Baa1/BBB+ credit ratings with Moody's and Standard & Poor's, to ensure that our plan is adequately financeable and resilient. Financeability on an actual company basis has been assessed based on maintaining, as a minimum, A3/BBB+ credit ratings, underpinning efficient access to the debt capital markets through the economic cycle. The bill impacts of these adjustments are relatively modest, and still enable us to propose a substantial reduction in bills in real terms over AMP7 as part of our business plan, which has received high levels of customer support.

The following table shows the PAYG ratios for the wholesale business in each year of AMP7 and for 2020-25 in total:

Wholesale total	2020/21	2021/22	2022/23	2023/24	2024/25	2020-25
Totex £m (2017/18 prices)	1,073.7	1,072.8	1,017.7	1,172.0	1,097.6	**5,433.9**
"Natural" PAYG rate %	58.6%	59.5%	62.9%	54.6%	58.9%	**58.8%**
Adjustments to PAYG rate %	1.9%	1.9%	1.9%	1.9%	1.9%	**1.9%**
Total PAYG rate %	60.5%	61.4%	64.8%	56.4%	60.8%	**60.7%**
RCV run-off rate (in line with 'natural' rate)	4.5%	4.5%	4.5%	4.6%	4.6%	**4.5%**

Key financials

The table below identifies the costs included within the building blocks of the allowed revenue:

£m (2017/18 prices)	2020/21	2021/22	2022/23	2023/24	2024/25
PAYG (operating costs and IRE)	649.6	658.5	659.5	661.5	667.7
Depreciation determined by RCV run-off and post-2020 depreciation	530.8	523.2	523.9	528.9	529.9
Return on RCV	316.1	316.3	315.4	315.9	317.4
Residential retail costs	91.7	90.2	87.9	86.6	84.9
Retail margin – residential	11.7	11.8	11.7	11.7	11.7
Wholesale current taxation	36.4	40.6	43.4	42.3	47.3
Other adjustments	19.4	16.2	1.9	(6.0)	(6.0)
Allowed revenue	**1,655.8**	**1,656.6**	**1,643.7**	**1,640.9**	**1,652.8**
K factor	n/a	0.05%	(0.78%)	(0.17%)	0.73%
Average household bill (excluding Manchester and Pennines Resilience project) (£)	393.92	391.96	386.19	382.74	381.81
Average household bill (including Manchester and Pennines Resilience project) (£)	393.92	391.96	386.19	382.74	382.33
Capital expenditure and RCV					
Capital expenditure	453.7	437.0	379.9	535.2	452.2
RCV – year-end (nominal)	11,923.4	12,101.1	12,216.1	12,495.3	12,684.6

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Classification – PR19 Business Plan