# Half Yearly Report 2008/09

Pennon Group Plc

27 November 2008

www.pennon-group.co.uk

# Pennon Group Plc ("Pennon Group")
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# Pennon Group Plc
## *2008/09 H1 Financial Highlights*

- Underlying operating profit[(1)] up 9.8% to £136.8m
  - SWW up 3.9% to £101.8m
  - Viridor up 22.1% to £33.1m
- Underlying profit before tax[(1)] up 3.2% to £86.8m
- Underlying earnings per share[(2)] up 2.7% to 18.7p
- Dividend
  - Interim dividend per share up 8.0% to 6.75p
  - Continued dividend policy of 3% per annum real increases to 2009/10
- Group well funded with cash balances of £306m at 30 September
- £100m additional funding facility from the EIB for SWW secured in November
- Group businesses well positioned in the current economic slow-down

*[(1)] Before restructuring costs and intangibles amortisation*
*[(2)] Before restructuring costs (net of tax), intangibles amortisation and deferred tax*

## Pennon Group Plc
### *2008/09 H1 Operational and Business Highlights*

**South West Water:**

- On target to deliver 2005 – 2010 Regulatory Contract
- Strong growth in Regulatory Capital Value 2005 – 2010, due to reach £2.7bn by end of K4
- OFWAT K4 operating cost efficiency target achieved 18 months early
- Leakage performance maintained in 2007/08 – amongst the very best in the industry
- Capital investment of £67.4m
- Draft Business Plan submitted to OFWAT for period 2010-15

# Pennon Group Plc
## *2008/09 H1 Operational and Business Highlights*

**Viridor**:

- Continued strong growth in PBITA
- 14 year, 450kt pa recycling, anaerobic digestion and disposal contracts secured with South London Waste Partnership
- ROC-able power generation output sold forward to March 2010 in May at favourable rates
- Business mix and profits well diversified

Pennon Group Plc

# Pennon Group Plc
## *Summary Financial Results*

| | For the half year ended 30 September 2008 £m | 2007 £m | Change | Full Year 2007/08 £m |
|---|---|---|---|---|
| Group revenue | 503.3 | 435.9 | 15.5% | 875.0 |
| Group operating profit [(1)] | 136.8 | 124.6 | 9.8% | 242.1 |
| Group profit before tax [(1)] | 86.8 | 84.1 | 3.2% | 154.9 |
| Earnings per share [(2)] | 18.7p | 18.2p | 2.7% | 36.9p |
| Dividend per share | 6.75p | 6.25p | 8.0% | 19.81p |

(1) *Underlying - before restructuring costs and intangibles amortisation*

(2) *Underlying - before restructuring costs (net of tax), intangibles amortisation and deferred tax*

# Pennon Group Plc
## *Cash Flow*

| | For the half year ended 30 September | | Full Year |
|---|---|---|---|
| | 2008 | 2007 | 2007/08 |
| | £m | £m | £m |
| Cash inflow from operations | 175.9 | 165.1 | 356.1 |
| Net interest paid | (32.5) | (31.4) | (79.7) |
| Dividends and tax paid | (33.5) | (23.9) | (86.6) |
| Capital expenditure | (120.6) | (111.7) | (218.1) |
| Acquisitions | (3.4) | - | (88.9) |
| Pension prepayment | (11.4) | - | (19.0) |
| Net cash outflow | (25.5) | (1.9) | (136.2) |
| Shares issued | 1.3 | 1.4 | 1.6 |
| Own shares acquired | - | (47.0) | (49.6) |
| Non-cash movements | (22.1) | (9.2) | (22.3) |
| Increase in net borrowings | (46.3) | (56.7) | (206.5) |

# Pennon Group Plc
## *Net Borrowings*

| | As at 30 September | | As at 31 March |
|---|---|---|---|
| | 2008 | 2007 | 2008 |
| | £m | £m | £m |
| Loans and finance leases | | | |
| - over one year | 2,033 | 1,868 | 2,032 |
| - under one year | 83 | 86 | 89 |
| | 2,116 | 1,954 | 2,121 |
| Less: cash and cash equivalents | (306) | (340) | (357) |
| Net borrowings | 1,810 | 1,614 | 1,764 |
| | | | |
| Net gearing (1) | 76% | 73% | 73% |
| SWW debt/RCV | 58% | 60% | 60% |

- **Gearing stable**
- **Significant pre-funding for SWW**

(1) *Net debt / (equity + net debt)*

# Pennon Group Plc

## *Net Debt Analysis as at 30 September 2008*

| | £m |
|---|---|
| Finance leasing | 1,196 |
| Bank bilaterals - RCFs/term loans | 295 |
| EIB | 204 |
| Index linked bond 2057 | 212 |
| Private placements | 200 |
| Other | 9 |
| Total gross debt | 2,116 |
| Less: Cash/liquid investments | (306) |
| Total net debt | 1,810 |

- **Key role of finance leasing**

# Pennon Group Plc

## *Net Interest Payable[1]*

| | For the half year ended 30 September | | Full Year |
|---|---|---|---|
| | 2008 | 2007 | 2007/08 |
| | £m | £m | £m |
| Interest payable | (60.2) | (47.0) | (106.6) |
| Interest receivable | 13.5 | 7.5 | 21.0 |
| Net interest payable | (46.7) | (39.5) | (85.6) |
| Average rate of interest | 5.2% | 5.0% | 5.2% |
| Net interest cover[2] | 2.9x | 3.2x | 2.8x |

- **Effective management of interest rates – SWW 5.0%**

*[1] Excludes pensions net interest and discount unwind on provisions*

*[2] From underlying profit*

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## *Efficient Financing Strategy*

- Funding strategy uses mix of fixed, floating and index linked rate borrowings:
  - Locks in benefit of low interest rates compared to Ofwat assumptions
  - Circa 60% of SWW projected net debt fixed to March 2010
  - Circa 25% of SWW current debt index linked to 2041-2057

- Significant finance leasing with long maturity

- New financing initiatives in 2008/09:
  - £25m 5-10 year finance lease facility for Viridor
  - successful renewal of £55m RCFs for both Plc and SWW
  - £100m 15 year EIB facility secured for SWW

- **Index linked debt: average real rate 1.66%**

- **Debt 'fair value' benefit up from £170m at March 2008 to £188m**

# Pennon Group Plc

## *Fair Value of Non-Current Borrowing*

| | As at 30 September 2008 | | | As at 31 March 2008 | | |
|---|---|---|---|---|---|---|
| | Book Value £m | Fair Value £m | Diff £m | Book Value £m | Fair Value £m | Diff £m |
| Finance Leases | 1,136 | 1,004 | 132 | 1,124 | 992 | 132 |
| Bank bilaterals – RCFs/term loans | 295 | 295 | - | 295 | 295 | - |
| EIB | 190 | 183 | 7 | 202 | 198 | 4 |
| Index-linked bond 2057 | 212 | 162 | 50 | 212 | 178 | 34 |
| Private placements | 200 | 201 | (1) | 199 | 199 | - |
| | 2,033 | 1,845 | 188 | 2,032 | 1,862 | 170 |

- **Debt 'fair value' benefit - £188m**

# Pennon Group Plc
## *Refinancing*

- Cash balances of £306m at 30 September 2008
- Committed undrawn facilities of £218m at 30 September 2008
- New £100m EIB facility secured November 2008
- Committed funding in place for South West Water to at least 2011
- £267m loan repayments required March 2010
- £31m by March 2009
  - £43m April 2009 – December 2009
  - £192m January 2010 – March 2010
- Refinancing of existing facilities expected to be progressed in 2009

# Pennon Group Plc
## *Taxation*

| | For the half year ended 30 September | | Full Year |
| --- | --- | --- | --- |
| | 2008 | 2007 | 2007/08 |
| | £m | £m | £m |
| UK corporation tax[1] | 20.9 | 19.7 | 25.0 |
| Deferred tax | 0.3 | 4.5 | 12.0 |
| Deferred tax arising on abolition of industrial buildings allowances (2007 change of rate) | 29.2 | (22.4) | (21.0) |
| | 50.4 | 1.8 | 16.0 |

- **Mainstream tax charge 25% (H1 2007 - 24%)**

(1) *Includes £1.0m tax relief on restructuring costs (H1 2007 £0.3m)*

# Pennon Group Plc

***Pensions as at 30 September 2008***

- Gross pension deficit of £58m (March 2008 - £26m)

- Pension fund assets £301m
  Pension fund liabilities <u>£359m</u>
  £58m = £42m net of tax

- Net deficit represents less than 3% of current market capitalisation

- Deficit increased from March 2008 due to impact of equities decline on fund assets

# Pennon Group Plc
## *Dividends*

- Interim dividend increased by 8.0% to 6.75p per share
- Progressive dividend policy: 3% real to 2009/10
- DRIP (Dividend Re-Investment Plan) alternative

SOUTH WEST WATER

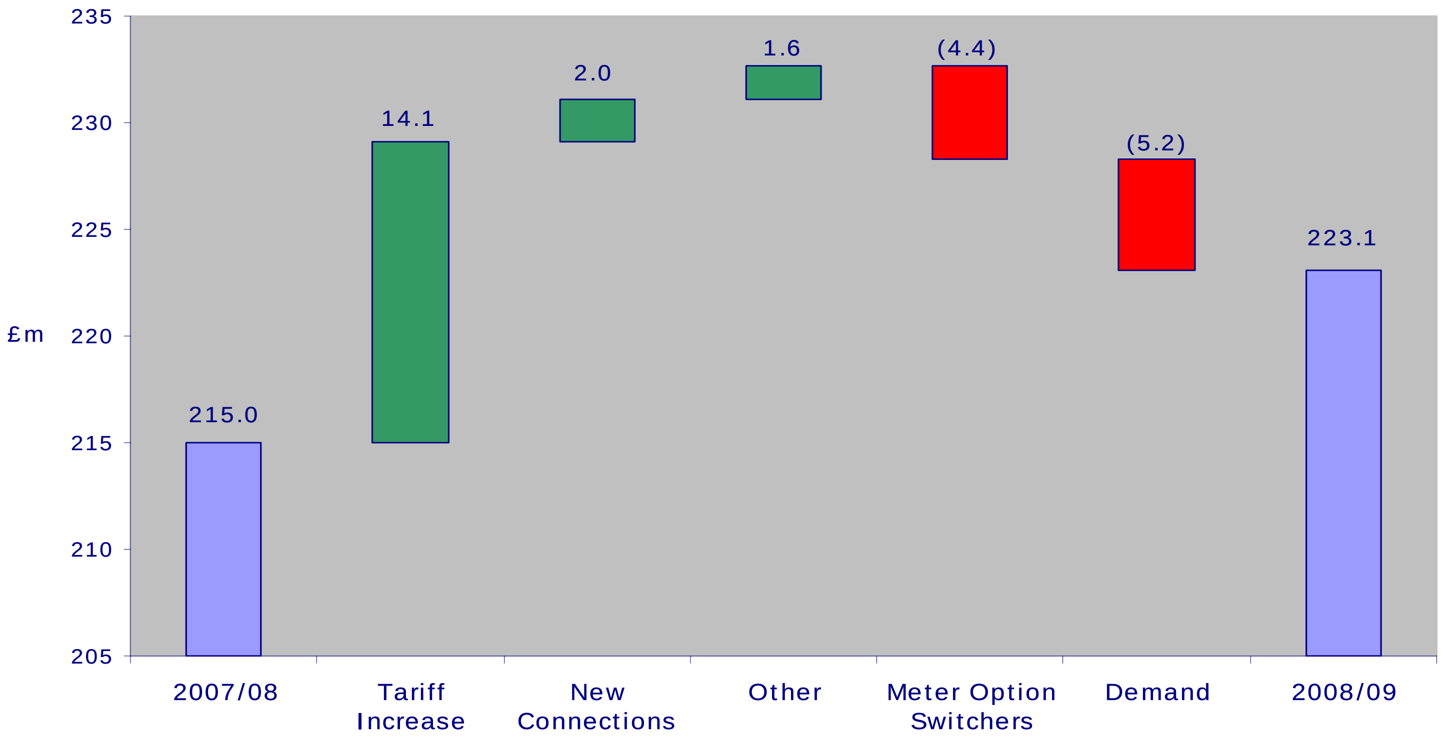
# South West Water
## *Financial Performance Summary*

| | For the half year ended 30 September | | Full Year |
|---|---|---|---|
| | 2008 | 2007 | 2007/08 |
| | £m | £m | £m |
| Revenue | 223.1 | 215.0 | 421.0 |
| Operating profit[(1)] | 101.8 | 98.0 | 185.0 |

- **Revenue up by 3.8%**
- **Operating profit[(1)] up by 3.9%**

*[(1)] Underlying – before restructuring costs*

# South West Water
## *Revenue*




| | |
|---|---|
| • Number of meter switchers | 14,500 |
| • Number of new customers | 4,200 |
| • Domestic customers now metered | 64% |
| • Existing metered customers' volume usage | -4.3% |



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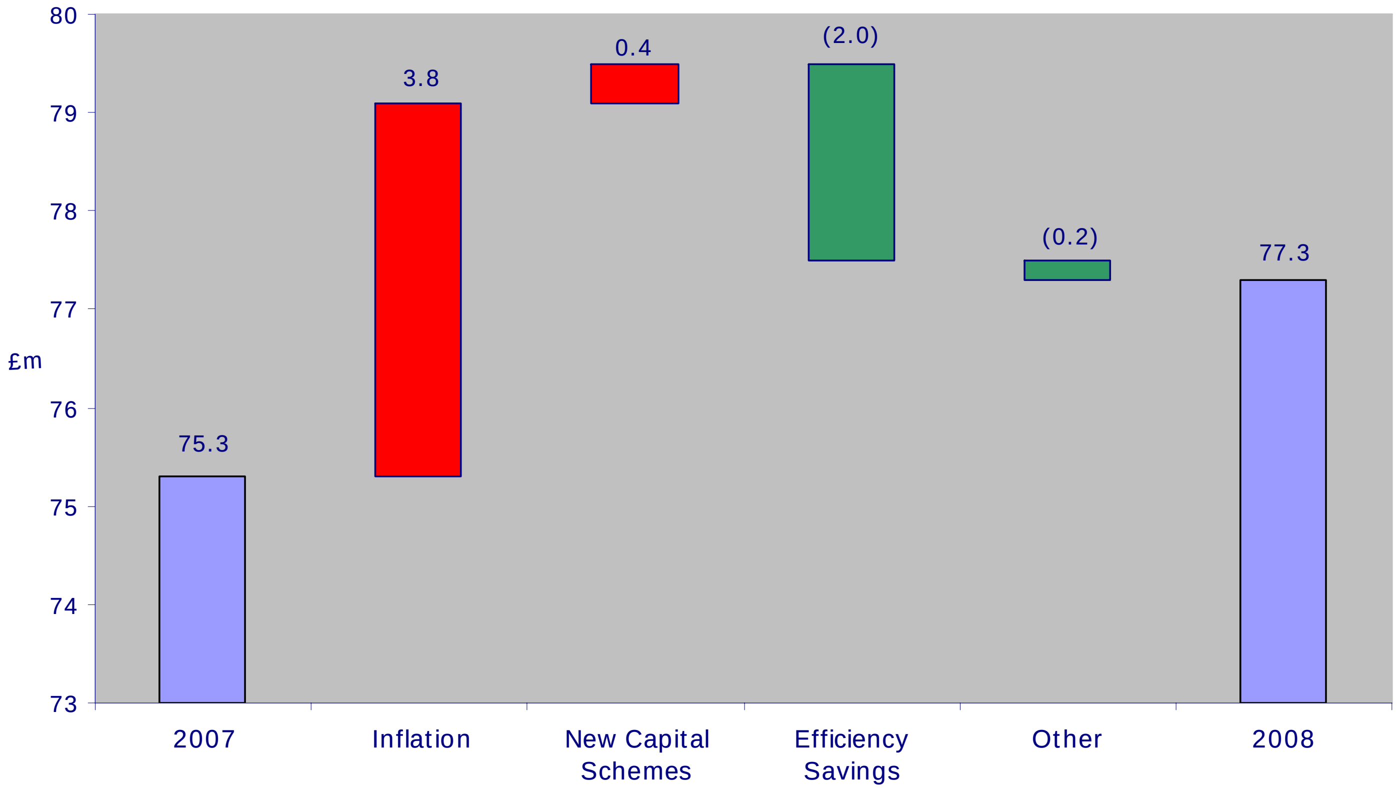
# South West Water
## *Operating Costs*




- Bad debts rising more slowly than tariff increases
- 2008/09 power prices fixed below headline inflation rate



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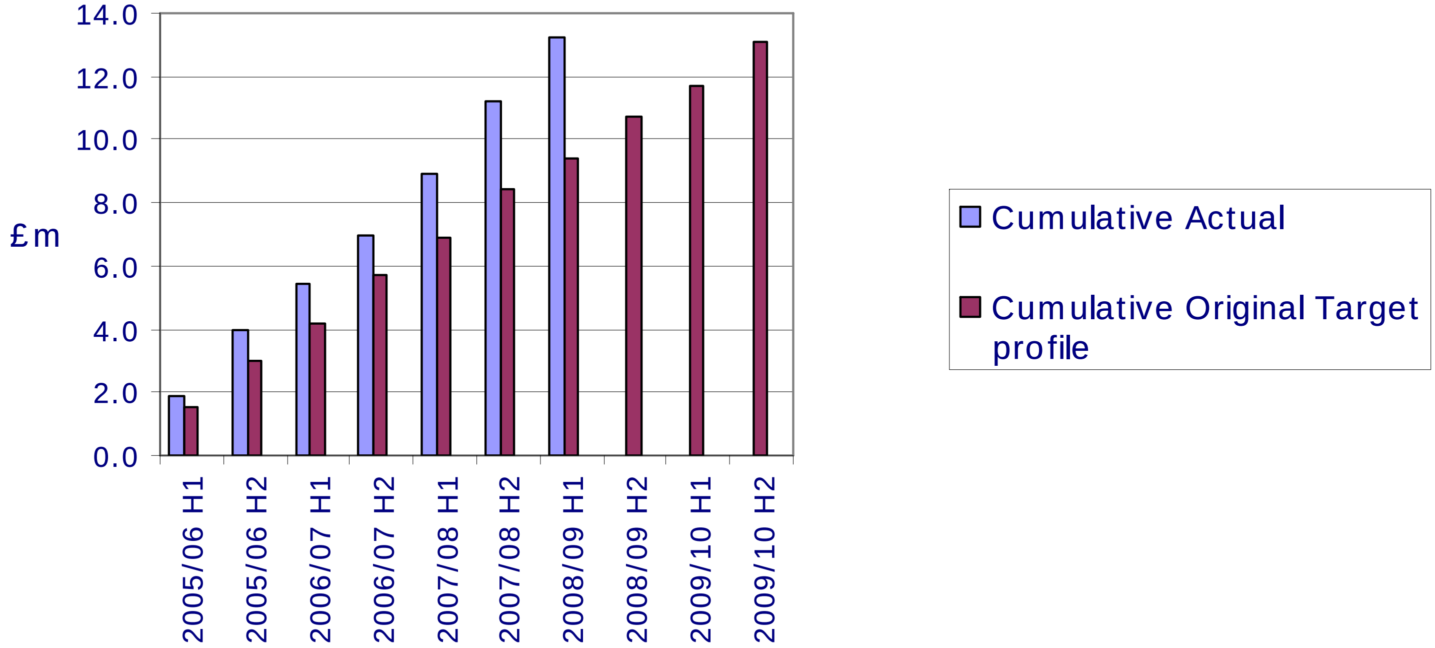
# South West Water

## *K4 Opex Efficiency Achievement versus Target*

Efficiency achievement




- **K4: £13m per annum efficiency savings to date – K4 target already achieved, 18 months early**

# South West Water
## *Capital Programme*

- Capital expenditure half year to 30 September 2008 – £67.4m (H1 2007 - £76.6m)
  - 180km water mains replaced/refurbished (H1 2007 - 261km)
    - reflecting switch to urban areas

- Depreciation charges of £44.0m (2007: £41.7m) reflect the increased asset base

- K4 capital programme on track
  - investment to date £643m[1] (outturn prices)
  - all major projects delivered in line with OFWAT/DWI/EA expectations

- K4 capital programme of £762m[1] (2002/03 price base)
  - **on track to achieve 5% outperformance**

*[1] UK GAAP*

# South West Water
## *Regulatory Capital Value*

| Year End | 2005<br>£m | 2006<br>£m | 2007<br>£m | 2008<br>£m | 2009<br>£m | 2010<br>£m |
|---|---|---|---|---|---|---|
| At 2002/03 prices[1] | 1,847 | 1,929 | 1,994 | 2,042 | 2,095 | 2,136 |
| Actual/expected outturn prices[2] | 1,956 | 2,091 | 2,265 | 2,408 | 2,590 | 2,710 |

- 39% growth in RCV 2005-10 – highest projected percentage increase of any quoted water company
- Growth in RCV significantly exceeding growth in net debt (excluding effect of 2006 capital return)

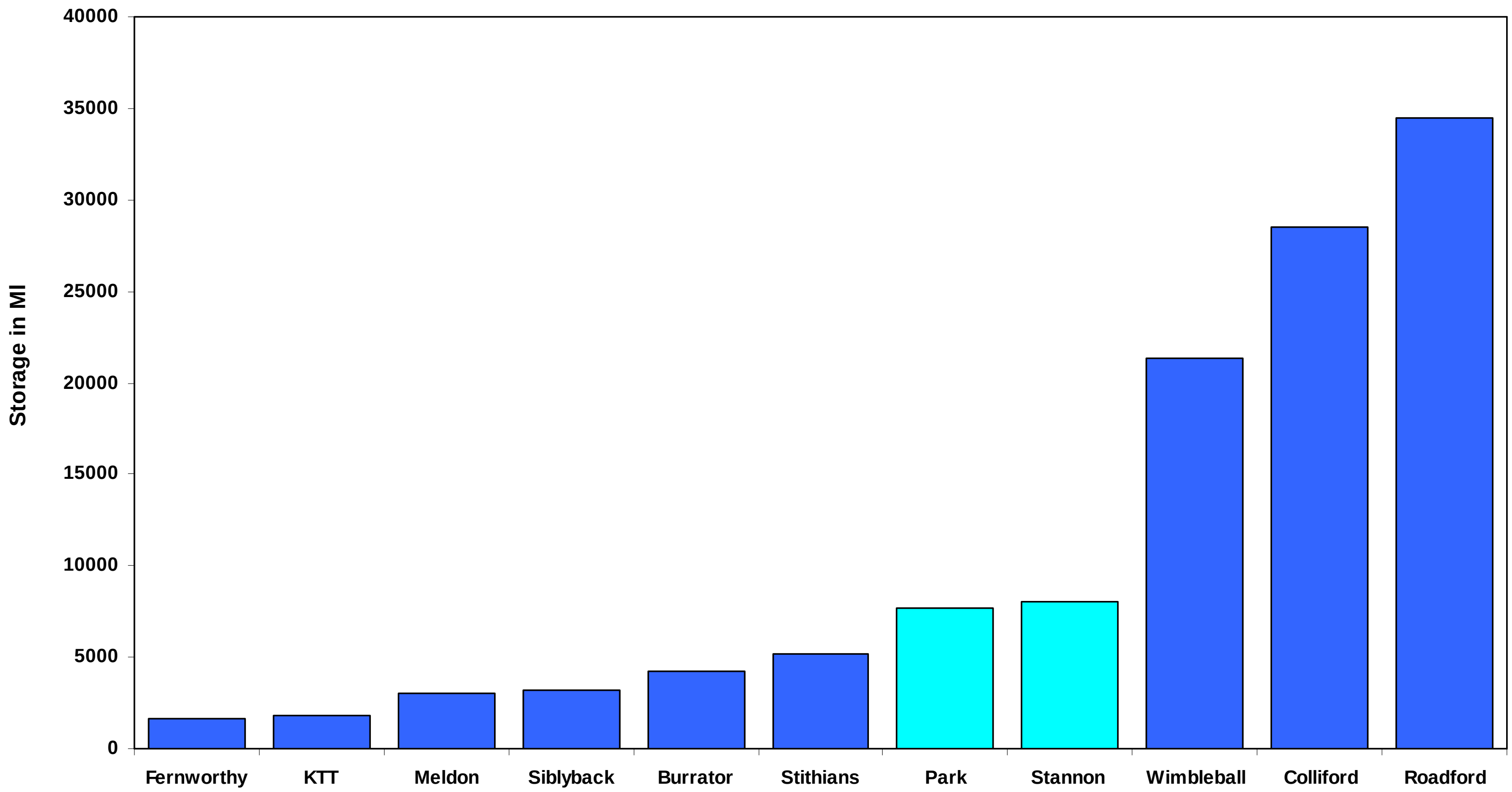
*(1) Source: Ofwat*
*(2) Source: South West Water*

# South West Water

## *Delivering K4: Operational Performance*

- OFWAT K4 efficiency target achieved 18 months early, and targeting outperformance to 2010
- OFWAT leakage target met every year
  - leakage performance maintained in 2007/08; amongst the very best in the industry
- 2007 drinking water quality – highest ever at 99.97%
- 2007/08 waste water quality – all time high
- No hosepipe bans or drought orders – 12th consecutive year
  - Stannon Lake purchased.  Will form region's fourth largest reservoir

# South West Water
## *Reservoir Storage Capacity*



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## South West Water
### *Preparing for PR09 and K5*

- Organisational restructuring
  - delivering efficiencies
  - platform for K5
  - £5m cost expected in 2008/09 (£3.4m spend in H1)
- Customer debt and affordability programmes
  - new debt recovery system
  - new incentivised customer contact/billing contract
  - successful Watercare and Restart programmes to assist vulnerable customers
- Investment in early implementation K5 efficiency platforms, including PUROS project

## South West Water

### *PR09 Draft Business Plan – Highlights*

**A realistic balance between stakeholder requirements:**

- **Customers** – prices as stable as possible
  - average bill increases 1.4% pa above inflation
  - 82% customers metered by 2015
- **Environment** - £813m investment (2007/08 prices)
  - protect and maintain improvements made over the last 20 years
  - further improvements to meet EU Directives
  - start to address Climate Change
  - potential additional >£100m following completion of investigations (subject to IDOK or logging up in 2015):
    - Water Framework Directive
    - Revised Bathing Water Directive
    - Adoption of private sewers
- **Investors** – 4.6% post tax real rate of return
  - efficiently financed asset base

*Further efficiencies planned - 2.3% pa opex efficiencies off base costs from 2010/11*

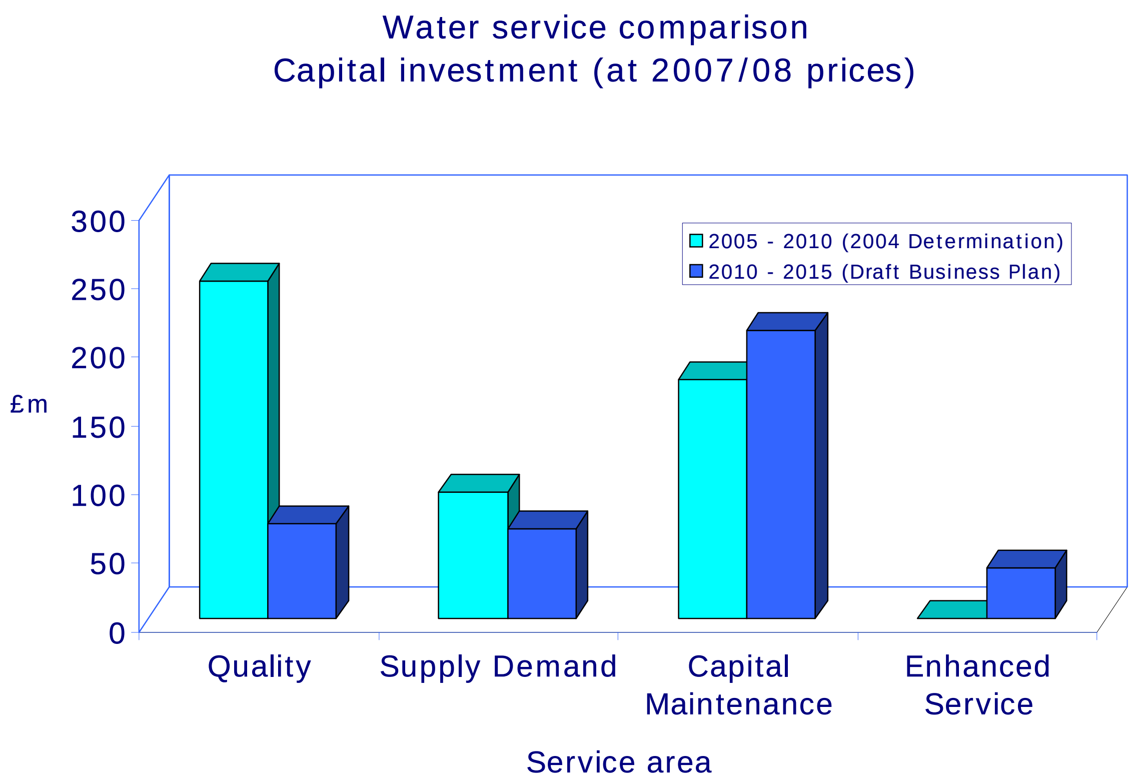
# South West Water

## *PR09 Draft Business Plan – Cost of Capital*

- 4.6% post tax real return
  - cost of equity 7.7% (same as PR04)
  - cost of debt 3.8% real
  - embedded debt c 0.1% benefit
  - gearing 60% debt/RCV
- Returns to be reviewed as market conditions develop, and updated for the Final Business Plan submission in April 2009
- Cost of capital assumes Notified Item protection against key risks including energy costs

# South West Water

## *PR09 Draft Business Plan Water Service Investment*



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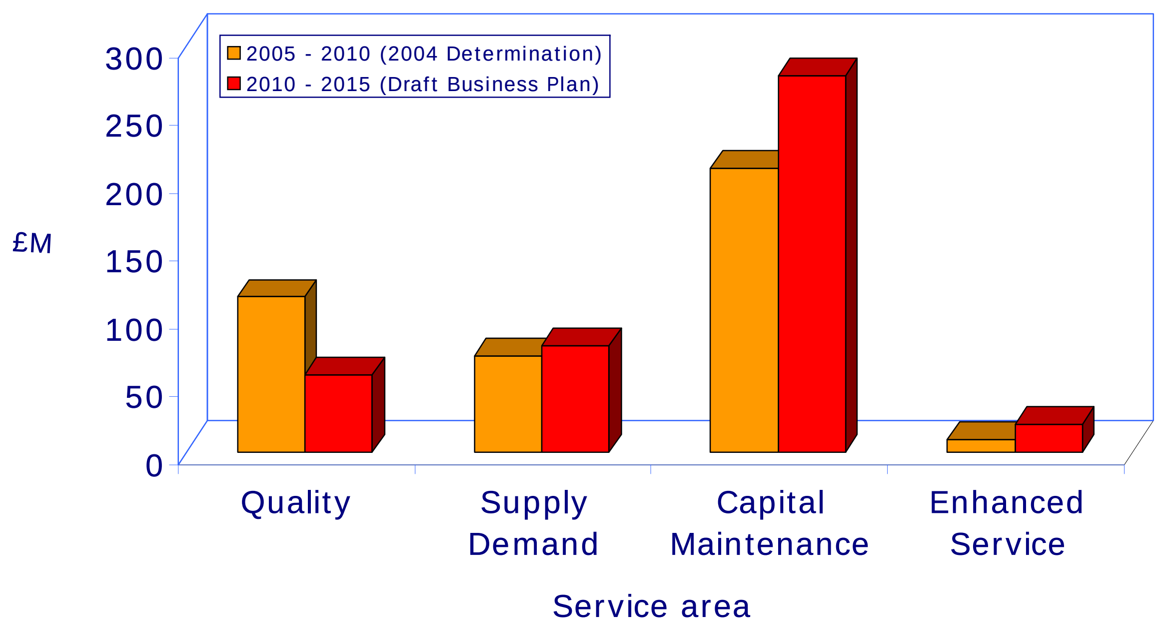
# South West Water

## *PR09 Draft Business Plan Waste Water Investment*

Sewerage service comparison
Capital investment (at 2007/08 prices)



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## South West Water

***Price Review Timetable***

| | |
|---|---|
| 11 August 2008 | Companies submitted draft business plan |
| *19 December 2008* | *OFWAT publish draft capital baseline* |
| *7 April 2009* | *Companies submit final business plan* |
| *23 July 2009* | *Draft price limits published* |
| *26 November 2009* | *Final price limits published* |
| *January 2010* | *Accept price limits or seek Competition Commission referral* |

Viridor

# Viridor
## *Financial Performance Summary*

| | For the half year ended 30 September | | | Full Year |
|---|---|---|---|---|
| | 2008 | 2007 | Change | 2007/08 |
| | £m | £m | % | £m |
| Turnover [1] | 281.1 | 221.3 | 27.0 | 455.1 |
| EBITDA | 55.5 | 49.1 | 13.0 | 101.0 |
| PBITA | 33.1 | 27.1 | 22.1 | 58.1 |

- **Particularly strong growth in turnover, EBITDA and PBITA**

[1] *Including landfill tax*

# Viridor

## *2008/09 Financial Highlights*

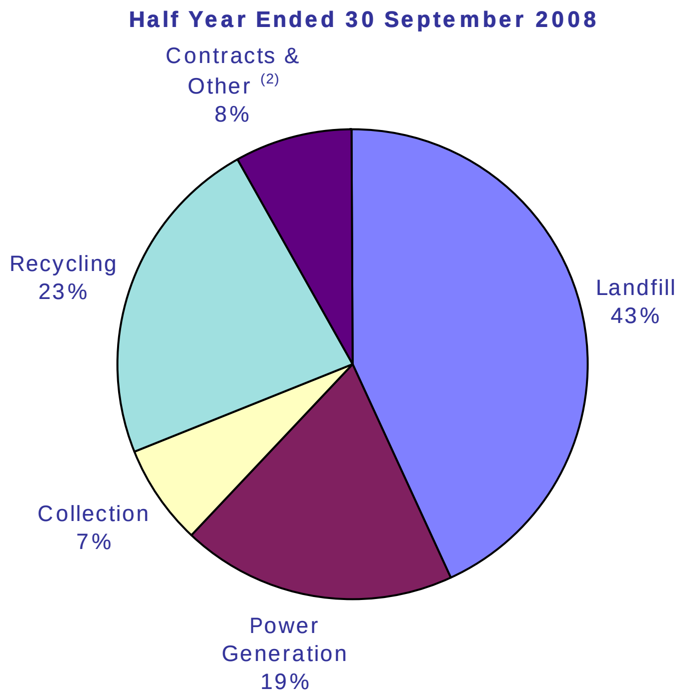
- Revenue increased by £59.8m (27.0%) to £281.1m
  - acquisitions (full 6 month contribution from Grosvenor and Shore) accounted for £33.5m and existing business £11.7m
  - includes increase in landfill tax of £14.6m

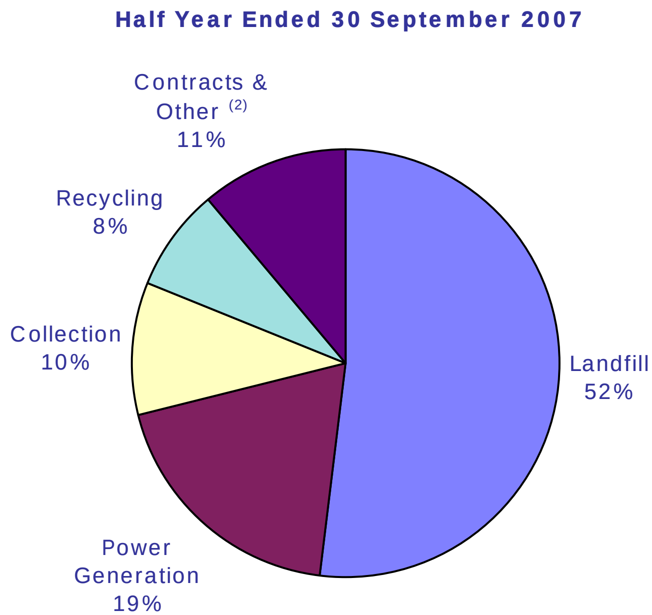
- EBITDA increased by £6.4m (13.0%) to £55.5m

- PBITA increased by £6.0m (22.1%) to £33.1m
  - acquisitions £4.1m
  - existing business £1.9m or 7.0% (9.0% excluding one-offs in 2007/08)
  - particularly power generation and recycling
  - recyclate prices high in H1; now low

- Capex £40.5m (H1 2007 - £32.3m)

# Viridor
## *Profit Contribution by Segment [1]*




- **Business successfully diversified**

*(1) Contribution before intangibles and overheads (incl pensions)*
*(2) "Contracts" include West Sussex PFI, other civic amenity contracts and sludge contracts and "Other" includes asset disposals*



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# Viridor
## *Operational Highlights – Landfill*

- Total volumes decreased by 0.2m tonnes or 6.2% to 2.5m tonnes
  - non-recurring items H1 2007/08
  - increase in domestic and Viridor's own inputs, more than offset by reduced third party industrial and commercial

- Average gate fees increased by 9.1% (to £20.77 per tonne), more than offsetting increased fuel and leachate removal costs
  - margin per tonne increased by c20p per tonne

- Consented landfill capacity fell from 84m cubic metres at 31 March 2008 to 83.6m cubic metres at 30 September 2008 reflecting
  - 3.1m cubic metres usage
  - 2.7m cubic metres planning gains

# Viridor
## *Operational Highlights – Power Generation*

- Total landfill gas power generation increased by 6.6% to 245 GWh reflecting our strategy of maximising output
- Average price grew to £66MWh (H1 2007 - £56MWh)
  - ROC-able electricity output sold forward to March 2010 at May 2008 forward prices
- Total capacity(1) grew 1MW from 84MW at 31 March 2008 (79MW at 30 September 2007) to 85MW at 30 September 2008
- 57% ROCs, 43% NFFO at 30 September 2008

(1) *Excludes 3 MW sub-contract in Suffolk*

# Viridor

## *Operational Highlights – Recycling I*

- Tough UK Government recycling targets
  - 50% of municipal waste by 2020
- Steeply increasing Landfill Tax (£8 per tonne pa) enhances economics of recycling in pure cost terms
- Worldwide long-term requirement for raw materials
  - particularly in Asia/Far East
- Significant short term volatility in recyclate prices (high in first half and now low)
- Underlying opportunity is to recycle/recover materials in UK and sell to mills/users in UK and worldwide
  - half of UK waste paper is reprocessed overseas

# Viridor
## *Operational Highlights – Recycling II*

- Viridor recycles and composts around 1.5m tonnes per annum through
  - 18 Materials Reclamation Facilities (MRFs)
    - 14 municipal waste; 2 electronic waste; 2 glass
  - 72 Household Waste Recycling Centres (HWRCs)
  - 10 composting sites
  - international distribution network

- Viridor revenues are gate fees (currently 40%) plus recyclate sales (60%) across range of products (of which 50% is export)

- H1 contribution grew by 233.3% (66.7% excluding acquisitions)
  - full year growth will be lower

# Viridor
## *Operational Highlights - Contracts and Collection*

- Contracts
  - continued good performance in Somerset PPP and West Sussex PFI
  - feeds recycling

- Collection profits down slightly reflecting high fuel costs and the volume impact of UK economic conditions

# Viridor
## *Renewable Energy Opportunities*

*Waste currently 30% of UK Renewables – scope for significant further growth*

- **Landfill gas**
  - 85 MW (as at 30 September 2008)
- **Lakeside** joint venture with Grundon Waste Management
  - 400kt pa and up to 37MW EfW plant at Colnbrook near Heathrow
  - £160m capex, 86% non-recourse debt with balance split equally between equity providers
  - profit contribution expected in 2009/10
- **Exeter**
  - 60kt pa, 3MW electricity (plus heat)
  - planning permission achieved
- Other possible long-term EfW/CHP sites
  - Trident Park, **Cardiff** (site acquired)
  - **Dunbar** (existing Viridor site; planning application submitted)
  - **Greater Manchester / Ineos Chlor Runcorn** (planning permission achieved September 2008; 750kt pa, 70MW electricity plus heat)
- 7 proposed **Anaerobic Digestion** (AD) plants
  - planning permissions achieved for
    - Beddington (up to 75kt pa and 2MW)
    - Walpole (45kt pa and 1.5MW)
  - 5 further proposed for Greater Manchester (4 have planning permission)

# Viridor
## *PPP/PFI Contracts*

Up to £30bn needs to be invested in municipal waste facilities in UK by 2020 (Source: Institution of Civil Engineers)

- **West Sussex PFI** and **Somerset PPP** already operational
- **South London Waste Partnership** contracts won (September 2008)
  - 450,000 tonnes pa
  - recycling, anaerobic digestion and disposal
  - 14 years
- Viridor/Laing preferred bidder for **Greater Manchester** Waste PFI
  - largest waste PFI contract in the UK
  - main commercial aspects agreed
  - preliminary works underway
  - key planning permissions secured (including strategic waste CHP plant in September 2008)
  - signing delayed by impact of current debt markets but substantial progress has been made
- Viridor continues to bid selectively
  - one of last two for **Oxfordshire** PPP
  - one of last four for **Cheshire** PFI
  - one of last four for **Medway** PPP
  - in the bidding for other contracts
- **Presentation on PPPs/PFIs** at 5.30pm on Wednesday, 3 December
  - contact Jo Finely/Tony Hooper for details

# Viridor
## *Current Economic Conditions*

- Viridor overall well positioned in face of current economic conditions
  - but is not immune
- ROC-able power generation sold forward to 31 March 2010 at mid 2008 prices
- 60% of landfill volumes are domestic plus Viridor's own collection
- Recycling diversified business mix but will be impacted by current low recyclate prices
  - 40% revenues are currently gate fees, 60% recyclate sales
  - broad range of recyclate sold
  - diversified established distribution network (50% export)
  - weakness in sterling reduces impact on Viridor's export business (international prices denominated in dollars)

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# Pennon Group Plc
***Summary***

- Strategy clearly focused on water and sewerage services and waste management
- **South West Water**
  - successfully delivering K4 regulatory contract
  - strong growth in K4 RCV due to reach £2.7bn by March 2010
  - PR09 programme on track: Draft Business Plan published
- **Viridor** delivering strong growth by
  - capitalising on its strong position in landfill waste disposal
  - maximising its landfill gas renewable energy generation
  - exploiting opportunities arising from Government's landfill, recycling and renewable energy targets
- Well funded with efficient long-term financing
- Group businesses well positioned in the current economic slow-down

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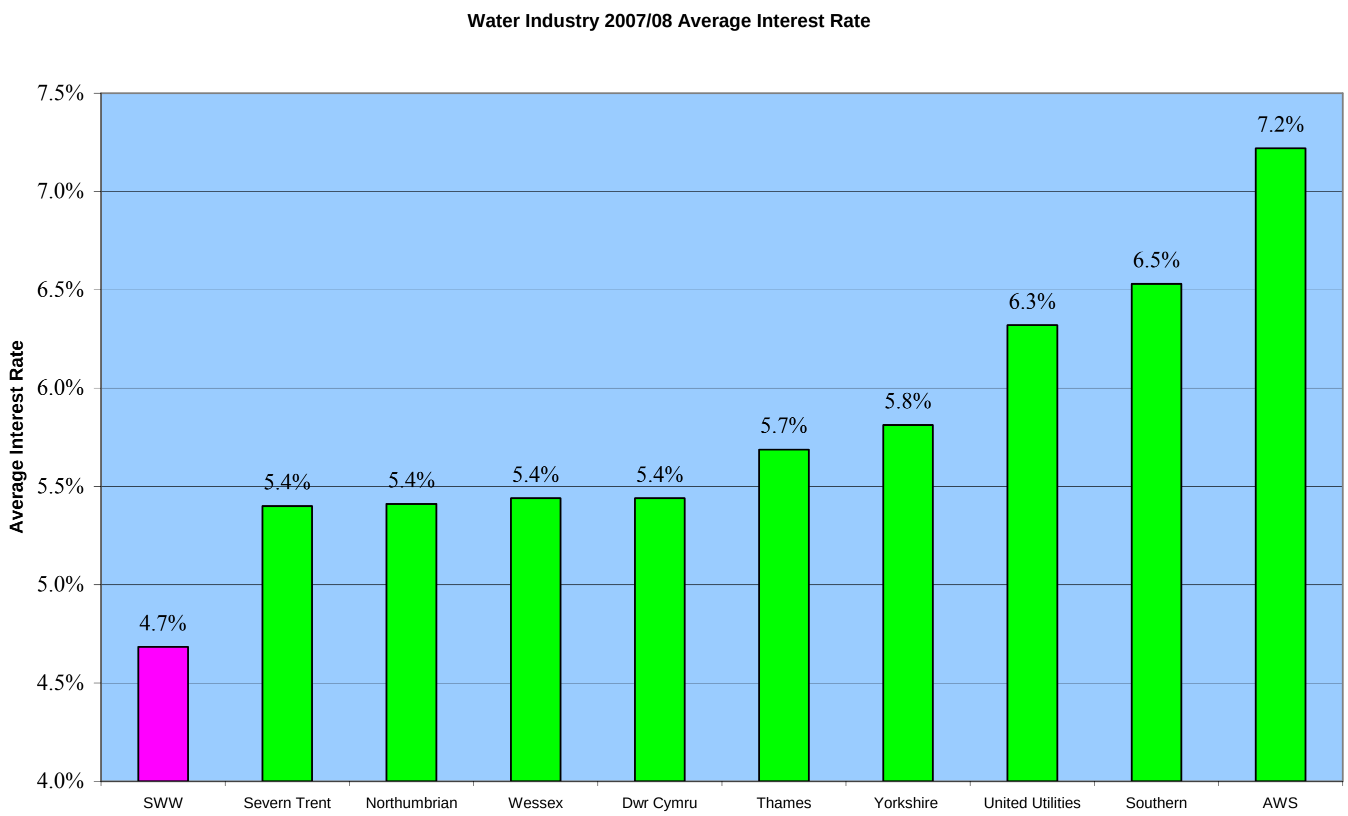
# Water Industry
## *2007/08 Average Interest Rate*




Source: Pennon calculation based on Annual Reports and Regulated Accounts

Basis: Net Interest Payable (excluding pensions net interest/Average Net Debt)

Accounts prepared under IFRS