



**United
Utilities**

United Utilities PLC

Responses to regulatory reviews

14 December 2004

www.unitedutilities.com



John Roberts

Chief Executive

Good afternoon ladies and gentlemen, and thank you for attending this presentation at short notice. With me on the platform is Simon Batey, our Finance Director, and Charlie Cornish, Managing Director of United Utilities Service Delivery.

Other members of our senior management team are also present in the audience.

Agenda

- **Price reviews and dividend policy** **John Roberts**
- **The regulatory contracts** **Charlie Cornish**
- **Summary and questions** **John Roberts**

The agenda for this afternoon is as follows.

I'll start off by focusing on our responses to the price reviews, and, further to these outcomes, our decision on dividend policy for the 2005-10 period.

Charlie will then give you some more details about our regulatory contracts.

In particular, he'll focus on our operating efficiency challenges and capital investment requirements.

I'll then summarise and open the meeting up to Q&A.

After the presentation has finished there'll be an opportunity to talk further over drinks, which will be served next door.

The regulatory contracts overview United Utilities Water

- Average real price increase of 4.5%
 - front-end loaded price profile, with highest increases in the first two years of the review period
 - average household bills up by £53 by 2009/10 in real terms
 - placing our bill fifth highest out of the WaSCs in 2009/10
- £2.9bn* capital investment programme
 - capital maintenance accounts for around half of expenditure
 - rest mainly on environmental and drinking water quality improvements
- Total cumulative operating cost saving of £147m*
 - reflects annual operating efficiency targets of 1.2% for water and 2.0% for wastewater

* outturn prices

Starting with our water business, as you're probably aware, Ofwat granted us an average annual real price increase of 4.5 per cent, over the next five years.

Our price profile is front-end loaded, with the highest increases in the first two years of the review period.

As a result of the price rises, average annual household bills in the North West will increase by £53 in real terms by 2010. That puts our bills right in the middle of the pack compared to other water and sewerage companies, broadly where we're already placed.

The increase in customer bills is primarily being driven by the size of our capital investment programme, which is nearly £3 billion in outturn prices.

Capital maintenance accounts for around half of this expenditure, with the rest being spent mainly on environmental and drinking water quality improvements.

We've also been set demanding operating efficiency targets.

These total to a cumulative cost saving of nearly £150 million, in outturn prices, over the next five years, and reflect annual operating efficiency targets of 1.2 per cent for water and 2 per cent for wastewater.

The regulatory contracts overview United Utilities Electricity

- Real price increase of 8% in 2005/06, followed by constant real prices thereafter
 - largest revenue increase in the industry compared to Ofgem's initial proposals
- £640m* capital investment programme
 - mainly related to maintenance and load related growth
- Efficiency targets require a total operating cost saving of £67m*
 - lower than the September update due to Ofgem recognition of merger benefits
 - provides United Utilities Electricity with a £17m* 'singleton' benefit

* outturn prices

Turning to Electricity, we're allowed a real price increase of 8 per cent next year, followed by constant real prices thereafter.

This outcome means that, compared to Ofgem's initial proposals, United Utilities Electricity secured the largest revenue increase in the industry.

We're also tasked with delivering a capital investment programme of £640 million.

The vast majority of this expenditure is related to maintenance and load related growth on the network.

Our efficiency targets require us to deliver £67 million of operating cost savings over the period.

This target is lower than was assumed in the September update, as Ofgem recognised merger benefits in their final proposals.

We therefore gained a 'singleton' benefit, worth around £17 million.

Regulatory reviews

- The Board has considered Ofwat's and Ofgem's proposals carefully
 - particularly considering the group's operating efficiency challenges and its capital investment requirements
- Following movements from the regulator's draft proposals, which increased the group's revenues by around £345m*, **the Board has decided to accept both final determinations**
- The group has been set demanding cost savings targets over the 2005-10 period, **but has plans in place to meet these challenges**

* outturn prices

The Board has considered both sets of proposals carefully.

In particular it has focused on the group's operating efficiency challenges and its capital investment requirements.

Following movements from the draft proposals, which increased the group's revenues by nearly £350 million, the Board has decided to accept both final determinations.

Furthermore, although the group has been set demanding cost savings targets, I'm pleased to announce that we already have plans well in place to meet these challenges.

A consistent strategy

The group has pursued a consistent strategy...

- To improve the efficiency of our regulated businesses, enabling us to outperform regulatory targets and deliver additional returns
- To deliver growth in our support service businesses using our core skills of infrastructure management and business process outsourcing
 - without significant further investment or diversification risk

The successful execution of this strategy has supported our dividend policy over the last five years.

I'll now go on to talk about strategy and dividend policy.

Since Simon and I joined United Utilities, five years ago, the group has pursued a consistent strategy with two principal objectives, which are set out on this slide.

The Board views its dividend policy as being contingent on the successful execution of its strategy. This has supported our dividend policy over the last five years.

Dividend policy 2005-10

- Further to accepting the determinations, the Board has decided on dividend policy for the next regulatory review period, from 2005-10
- **Over the next five years the Board's target is to maintain dividends in real terms**
- This is contingent on the group continuing to successfully execute its strategy, which remains unchanged

Further to accepting the determinations, the Board has decided on its policy for the next regulatory review period.

Over the next five years, the Board's target is to maintain dividends in real terms.

Again, this target is dependent on the group continuing to successfully execute its strategy, which remains unchanged.

Dividend policy 2005-10

- Our dividend target assumes the group meets its regulated cost savings targets; and our non-regulated businesses continue to perform at least in line with current levels
- We expect that virtually all of the targeted dividend payout will be met from the allowed returns of our regulated businesses
 - after taking account of interest costs
 - 80% of which have now been fixed for the next five years
- Our aspirations are to identify further outperformance opportunities to increase dividend cover and grow non-regulated earnings to allow reinvestment within these activities

Our dividend target assumes that the group at least meets its regulated cost savings targets, and its non-regulated businesses continue to perform at least in line with current levels.

Provided that the group meets these targets, we expect that virtually all of the targeted dividend payout will be met from the allowed returns of our regulated businesses. That is after taking account of interest costs, around 80 per cent of which have now been fixed for the next five years.

Our aspirations are to identify outperformance opportunities to increase dividend cover, and grow non-regulated earnings, to allow further re-investment within these activities.

That's all I have to say for the time being. Now over to Charlie.



Charlie Cornish

Managing Director

United Utilities Service Delivery

Thanks John, good afternoon everybody.

Agenda

- **Meeting our operating efficiency challenges**
- **Our capital investment programmes**

I'll now go on to give you some more details about our regulatory contracts, starting with our operating efficiency challenges and then covering our capital investment programme.

Meeting our operating cost challenges

- Our regulators have set us a combined operating cost savings target of £214m* for the 2005-10 period
 - for United Utilities Water and United Utilities Electricity
- We have already put detailed plans into place to deliver around 75% of these savings
 - outline plans also in place to deliver the balance

* outturn prices

As John's just highlighted, our regulators have set us a combined operating cost savings target of £214 million in outturn prices over the next five years.

Having already put detailed plans in place to deliver around three-quarters of these savings, we're well on track to meeting this target.

Outline plans are also in place to deliver the balance.

Sources of operating efficiency savings

| | Water | Wastewater | Electricity |
|--|-------|------------|-------------|
| <ul style="list-style-type: none"> • Connect <ul style="list-style-type: none"> – new multi-utility work management system | ✓ | ✓ | ✓ |
| <ul style="list-style-type: none"> • Customer billing system <ul style="list-style-type: none"> – increasing efficiency and providing significant service improvements for our customers | ✓ | ✓ | |
| <ul style="list-style-type: none"> • Integrated Performance Management <ul style="list-style-type: none"> – improving the way we manage our assets | ✓ | ✓ | |
| <ul style="list-style-type: none"> • Management savings <ul style="list-style-type: none"> – United Utilities Service Delivery new business model | ✓ | ✓ | ✓ |
| <ul style="list-style-type: none"> • Procurement <ul style="list-style-type: none"> – renegotiating contracts with our suppliers | ✓ | ✓ | ✓ |
| <ul style="list-style-type: none"> • Accommodation and transport <ul style="list-style-type: none"> – further rationalising our property portfolio | ✓ | ✓ | ✓ |

This slide shows the principal sources of operating efficiency savings that will get us to our target.

As you may recall, John spoke about Connect, our new multi-utility work management system, at our interims last month.

He mentioned our new customer billing system then also.

I won't go into any further detail on these projects, except to say that both continue to progress well.

The other two main areas of savings relate to improving the way we manage our assets, and our new business model for United Utilities Service Delivery. I'll say a bit more about these initiatives in a minute.

We're also continuing to make efficiencies through the reletting of contracts with our suppliers, and further rationalisation of our property portfolio.

Sources of operating efficiency savings Integrated Performance Management

- IPM is about optimising the way we manage our water and wastewater treatment plants and networks
- We are making efficiencies through:
 - specific initiatives to 'fine-tune' the operation of our assets; and
 - the more general use of technology to reduce operating costs
- Examples include:
 - increasing the use of telemetry to remotely monitor the performance of our plants, rather than manually
 - optimising the frequency and dosage of chemicals used at water treatment works on a plant-by-plant basis
 - thickening sludge to reduce transportation and disposal costs

We have recently launched Integrated Performance Management, or IPM, which is about optimising the way we manage our water and wastewater treatment plants, and networks.

IPM is about making efficiencies through both specific initiatives to 'fine-tune' the operation of our assets, and the more general use of technology, such as automation, to reduce operating costs by demanning.

For example, one of the steps we're taking is to increase the use of telemetry to remotely monitor the performance of our plants. This is instead of manual inspections, which are more costly and time consuming.

More specifically, we're looking to make cost savings by 'fine-tuning' the frequency and dosage of chemicals used at our water treatment works, on a plant-by-plant basis.

On the wastewater side of the business, initiatives include looking at ways to thicken sludge in order to reduce transportation and disposal costs.

Sources of operating efficiency savings New business model

- United Utilities Service Delivery has been restructured into water, wastewater and electricity business streams, with support functions
- New role of Chief Operating Officer (COO's) introduced
 - one person is accountable for all aspects of strategy, planning, operations and customer service in each business stream
- We're envisaging up to 200 voluntary redundancies with further savings from a reduction in the use of agency, temporary and contractor staff
 - around 5% of our total workforce

As well as exploiting operational savings, we're also looking at ways to reduce management costs.

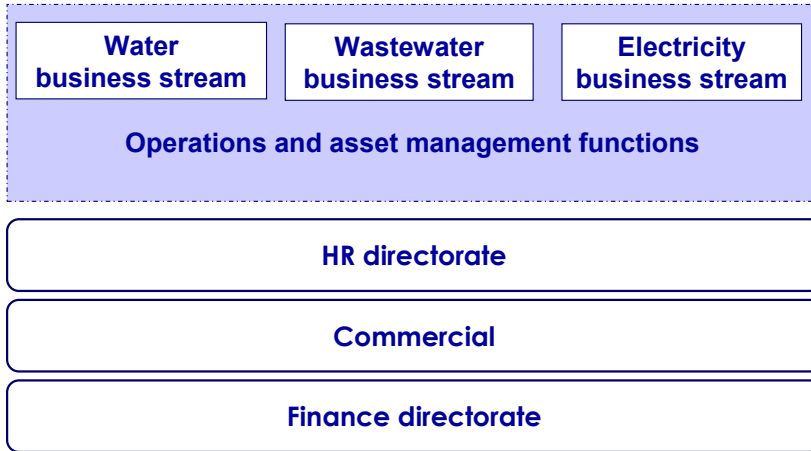
United Utilities Service Delivery is currently being restructured into water, wastewater and electricity business streams, along with support functions.

A new role of Chief Operating Officer has been introduced for each business stream. This means that there will be one person who is responsible for all aspects of strategy, planning and operations.

As well as providing us with a better business focus, this restructuring will save us money and improve customer service.

As a consequence of all our initiatives, we're envisaging up to 200 voluntary redundancies, or around 5 per cent of our total workforce, with further savings from a reduction in the use of agency, temporary and contractor staff.

Sources of operating efficiency savings New business model



Here you can see the Service Delivery's new structure.

Separating out each business stream will ensure that there is end to end accountability and balanced decision-making on operating and capital expenditure.

This structure retains the benefit of the multi-utility efficiencies we've gained in recent years through the continued sharing of support functions, and the pooling of property, depots and transport.

Agenda

- Meeting our operating efficiency challenges
- **Our capital investment programmes**

I'll now go on to talk about our capital investment programmes.

United Utilities Water Quality enhancement outputs

AMP4 (2005-10)

- Renovate 2,555 km of water distribution mains
- Improve facilities at 51 water treatment works
- Deal with 143 unsatisfactory intermittent discharges (UIDs)
- Improve facilities at 67 wastewater treatment works
 - including improvements at 30 sites to comply with the Freshwater Fish Directive

AMP3 (2000-05)

- Renovate 4,000 km of water distribution mains
- Improved facilities at 97 water treatment works
- Deal with up to 720 unsatisfactory intermittent discharges (UIDs)
- Improvement facilities at 155 wastewater treatment works

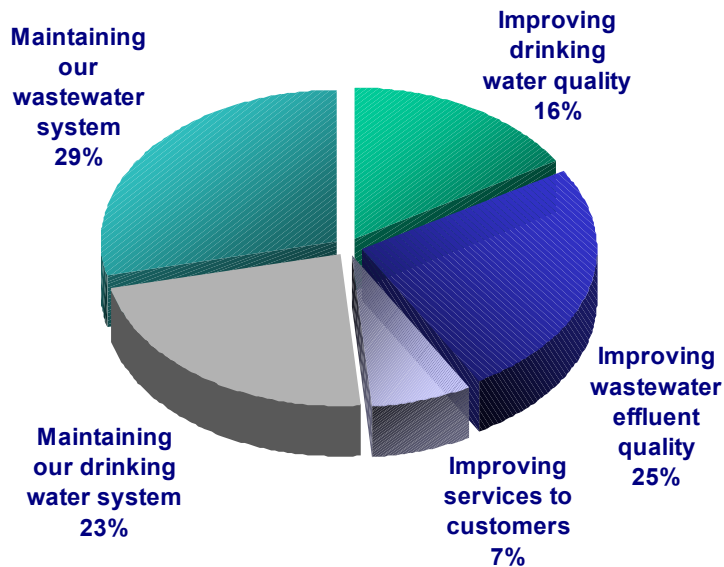
This slide shows the main capital outputs that United Utilities Water is required to deliver during AMP4, and a comparison with what we're doing in AMP3.

Looking to forward, over the next five years, we're renovating over 2,500 km of water mains, and upgrading treatment facilities at 51 works to improve drinking water quality in the North West.

On the wastewater side, we're dealing with over 143 unsatisfactory intermittent discharges, and improving facilities at 67 wastewater treatment works.

This is to improve the quality of our wastewater effluent, and is principally driven by the Urban Wastewater Treatment and Freshwater Fish Directives.

United Utilities Water £2.9 billion investment programme

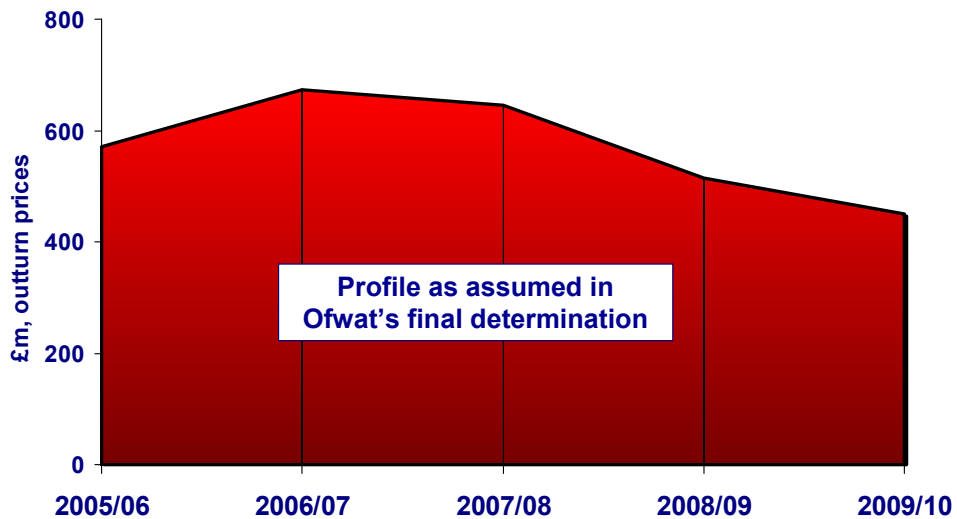


The split of our water investment programme, which totals £2.9 billion in outturn prices, is illustrated here using a pie chart. As you can see, just over half relates to maintaining our water and wastewater systems.

Around a sixth of our programme involves improving the quality of drinking water, and a quarter relates to wastewater effluent.

The rest, about 7 per cent, deals with improving services to customers, such as odour and foul flooding.

United Utilities Water Capital investment profile



This slide shows you the profile of our AMP4 capital investment programme as assumed in Ofwat's final determination.

Similarly to our price profile, capital investment is assumed to peak in the second year of the review period, at nearly £700 million.

However, for reasons that I'm about to explain, we wouldn't be surprised if this profile changed, particularly towards the end of the review period.

Additional capital investment during AMP4

- In its final determination Ofwat signaled that there may be further capital investment to come during AMP4
- Ofwat estimated that an extra £1.7 billion* could be needed to cover projects or new obligations that may be confirmed or placed on companies before 2010
- Some of this additional expenditure is likely to fall on United Utilities, increasing the size of our current programme
 - additional requirements will probably be dealt with through interim determinations during the next regulatory period
- Shipwreck clause reinserted into our licence from April 2005
 - caps our exposure to operational risk

* outturn prices

In setting price limits it was assumed that the industry invests around £17 billion over the next five years.

However, in its final determination, Ofwat has also signaled that there may be further investment to come during AMP4, in addition to the £17 billion.

Ofwat stated that an additional £1.7 billion could be needed to cover projects, or new obligations, that may be confirmed or placed on companies before 2010.

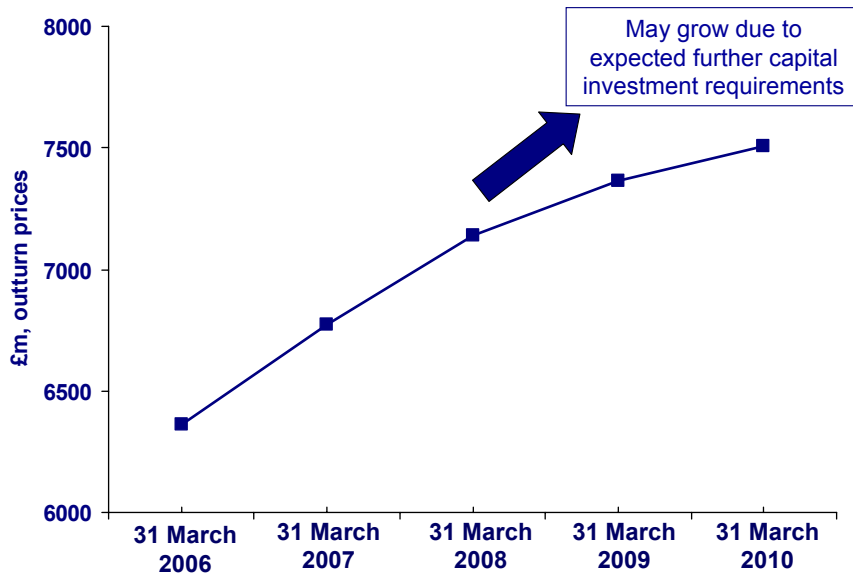
Some of this additional expenditure is likely to fall on United Utilities, increasing the size of our current programme.

Additional requirements will probably be dealt with through interim determinations during the next regulatory period.

It's also probably worth saying that Ofwat have undertaken to reinsert the substantial effect, or Shipwreck clause, into our licence from April next year.

This effectively caps to our exposure to operational risk.

United Utilities Water Regulatory asset value



Based on current assumptions this graph shows how our regulatory asset value, or RAV, will change over the next five years. However, as I've just mentioned, with further investment requirements likely to be placed upon us, we wouldn't be surprised to see our RAV grow further, particularly during the latter stages of the next review period.

United Utilities Electricity

- Ofgem's view of capex for 2005-10 was in line with United Utilities Electricity's estimates as put forward in our business plan
 - PB Power commented it was a 'well supported' forecast
- As a result, we benefited from Ofgem's sliding scale mechanism, which was introduced to reward 'reasonable forecasts'

* outturn prices

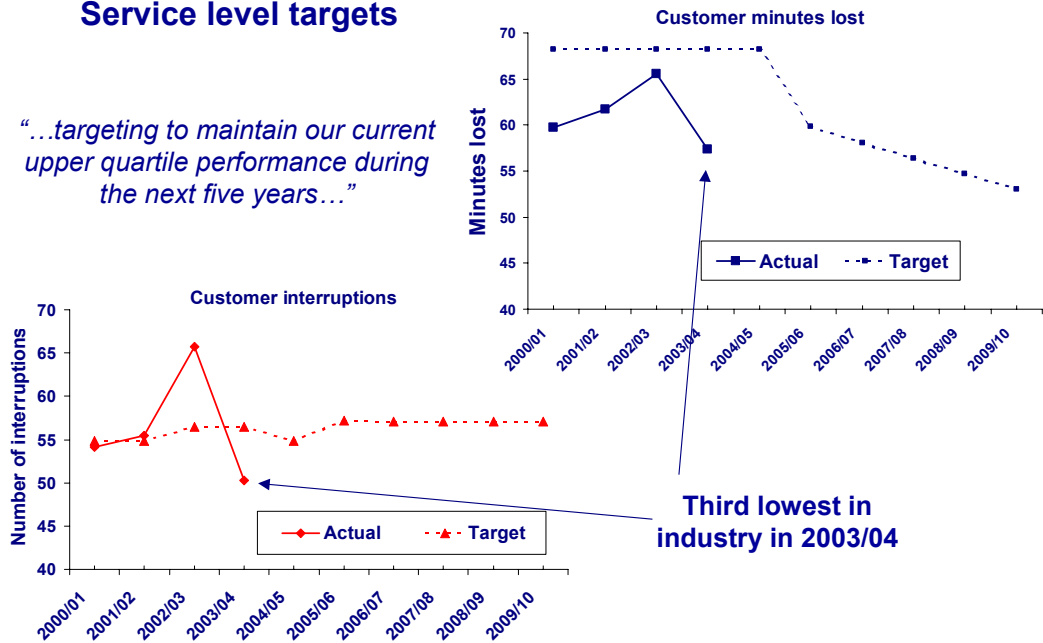
Turning to electricity, Ofgem's view of our capital investment requirements was broadly in line with our estimates, as put forward in our business plan.

In fact their consultants, PB Power, commented that it was a 'well supported forecast'.

As a result we benefited from Ofgem's sliding scale mechanism, which they introduced to reward 'reasonable forecasts'.

United Utilities Electricity Service level targets

"...targeting to maintain our current upper quartile performance during the next five years..."



United Utilities Electricity has made good progress improving network performance. We've reduced both the number, and duration, of customer interruptions to a position where they are the third lowest in the industry.

Based on our capital investment allowance, we're targeting to maintain our upper quartile network performance position during the next five years.

Investment strategy Partnering to improve performance

- We are currently in the process of selecting partners to help deliver our £3.5bn* investment programme
- Our approach to 2005-10 builds on our extensive experience of working with others
 - e.g. Scottish Water, Welsh Water, previous capital investment programmes in the North West
- We are better aligning incentives to ensure risks and rewards are more evenly shared between ourselves and our partners
- More integrated approach to our procurement strategy compared to 2000-05
 - water and electricity programmes will be managed as 'one'
 - enabling us to secure further multi-utility efficiencies

* outturn prices

With combined water and electricity capital investment programmes of at least £3.5 billion, who we choose to help deliver them is of crucial importance to us.

I'm pleased to say that the process for appointing partners is well underway.

Our approach to the next review period builds on the group's extensive experience of working with others, for example, through our Contract Solutions business with Scottish Water and Welsh Water.

Improvements we're making to the way we handle contractors include the better aligning of incentives between our partners and ourselves. This will ensure that risks and rewards are more evenly shared.

Compared to the current regulatory period, next time round we're also taking a more integrated approach to our procurement strategy.

We will manage the water and electricity programmes as one, enabling us to secure further multi-utility procurement and programme management efficiencies.

All of these initiatives will help us meet our capex efficiency targets.

That's all I have to say, so I'll now hand back to John.



John Roberts

Chief Executive

Thanks Charlie, I'll summarise then open the meeting up to questions.

Summary

- After considering Ofwat's and Ofgem's proposals carefully the Board has decided to accept both final determinations
- The group has been set demanding operating efficiency targets over the 2005-10 period, which require us to make cumulative cost savings of £214m*
- We have already put detailed plans in place to deliver around 75% of these savings, and are well on the way to securing the balance

* outturn prices

After considering our regulators' proposals carefully, the Board has decided to accept both final determinations.

The group has been set demanding operating efficiency targets, which require us make cumulative cost savings of £214m over the 2005-10 period.

However, we've already put detailed plans in place to deliver around three-quarters of these savings, and are well on the way to securing the balance.

Summary

- Further to accepting the determinations, we are targeting to maintain dividends in real terms during the next regulatory period
 - this is contingent on the group continuing to successfully execute its strategy, which remains unchanged
- We expect that virtually all of the targeted dividend payout will be met from the allowed returns of the regulated businesses, after taking account of interest costs
 - in addition current run rate from non-regulated earnings builds dividend cover
- Our aspiration is to identify further outperformance opportunities to increase dividend cover and grow non-regulated earnings to allow reinvestment within these activities
 - current non-regulated order book stands at £7 billion

Further to accepting the determinations, we're targeting to maintain dividends in real terms during the next regulatory period.

This is contingent on the group continuing to successfully execute its strategy, which we are confident of delivering and remains unchanged.

We expect that virtually all of the targeted dividend payout will be met from the allowed returns of the regulated businesses, after taking account of interest costs.

In addition, the current run rate from our non-regulated earnings builds dividend cover.

In summary, our aspirations are to identify further outperformance opportunities in the regulated businesses to increase dividend cover, and to grow non-regulated our businesses to allow reinvestment within these activities.

Can I remind you that they currently have an order book of around £7 billion.

That concludes the presentation, thank you for listening.

Over to you for questions, then drinks will be served.