United Utilities Group PLC
24 September 2008
Frankfurt credit investor update

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2. Business update
3. Capital structure and dividend policy
4. Setting prices for 2010-2015 current review
5. Financing
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   - Monopoly assets owned
   - Regulation
   - MAR – Market to asset ratio
   - Index linked trade

Credit ratings – stable

United Utilities Water PLC	A3 / A-
United Utilities PLC	Baa1 / BBB+

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2. Business update

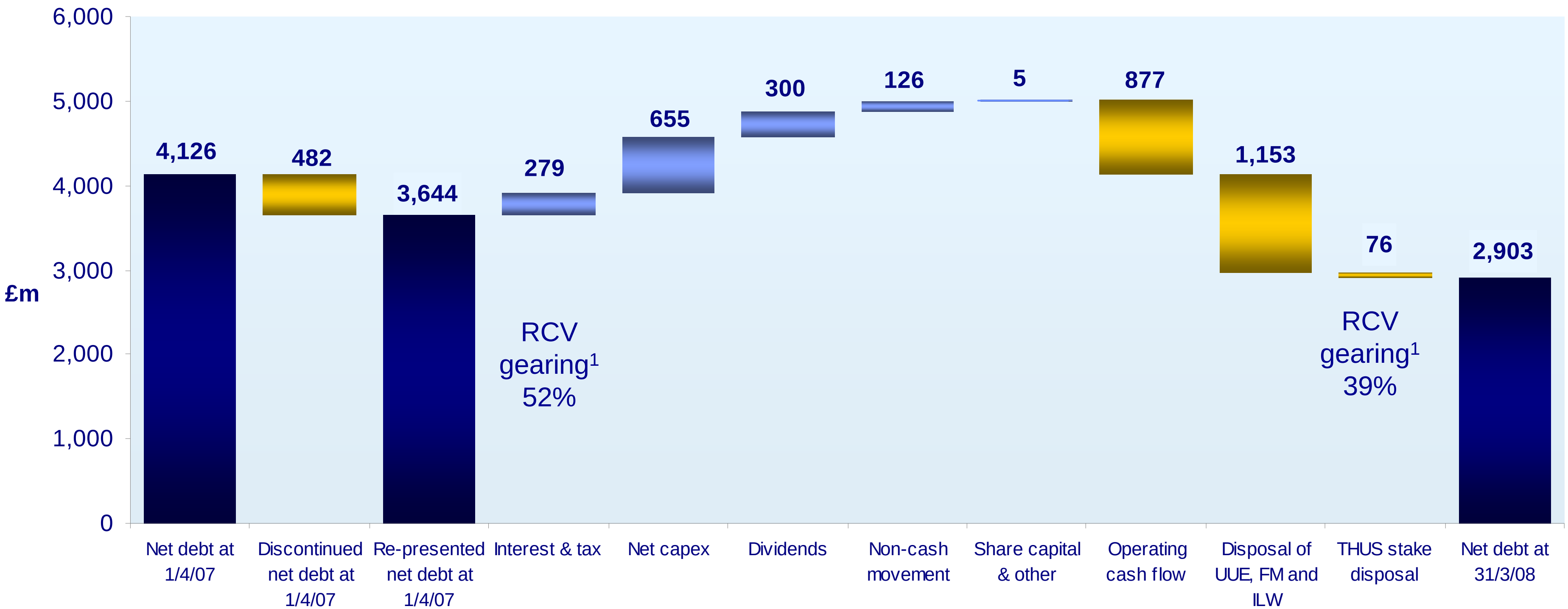
Overview

- Strong financial performance in 2007/08
- UUE sale completed at substantial premium to regulatory asset value
  - portfolio now focused on core skills
  - proposed £1.5bn return to shareholders complete
- Capital programme on track
- Operational performance improvements: outperformed tougher leakage target
- Contract extensions with Southern Water and British Gas Trading
- Robust liquidity position further enhanced: pre-funded to 2010

Key areas of focus

- Operational performance
- Delivery of 2005-10 regulatory contract
- PR09: price review for next period 2010-15
- Growth in the non-regulated business

Movement in net debt



- £1.1bn cash proceeds from sale of UUE: short-term reduction in net debt
- Expecting RCV gearing[1] level towards upper end of Ofwat's assumptions (55% to 65% for 2005-10 period) by 2010

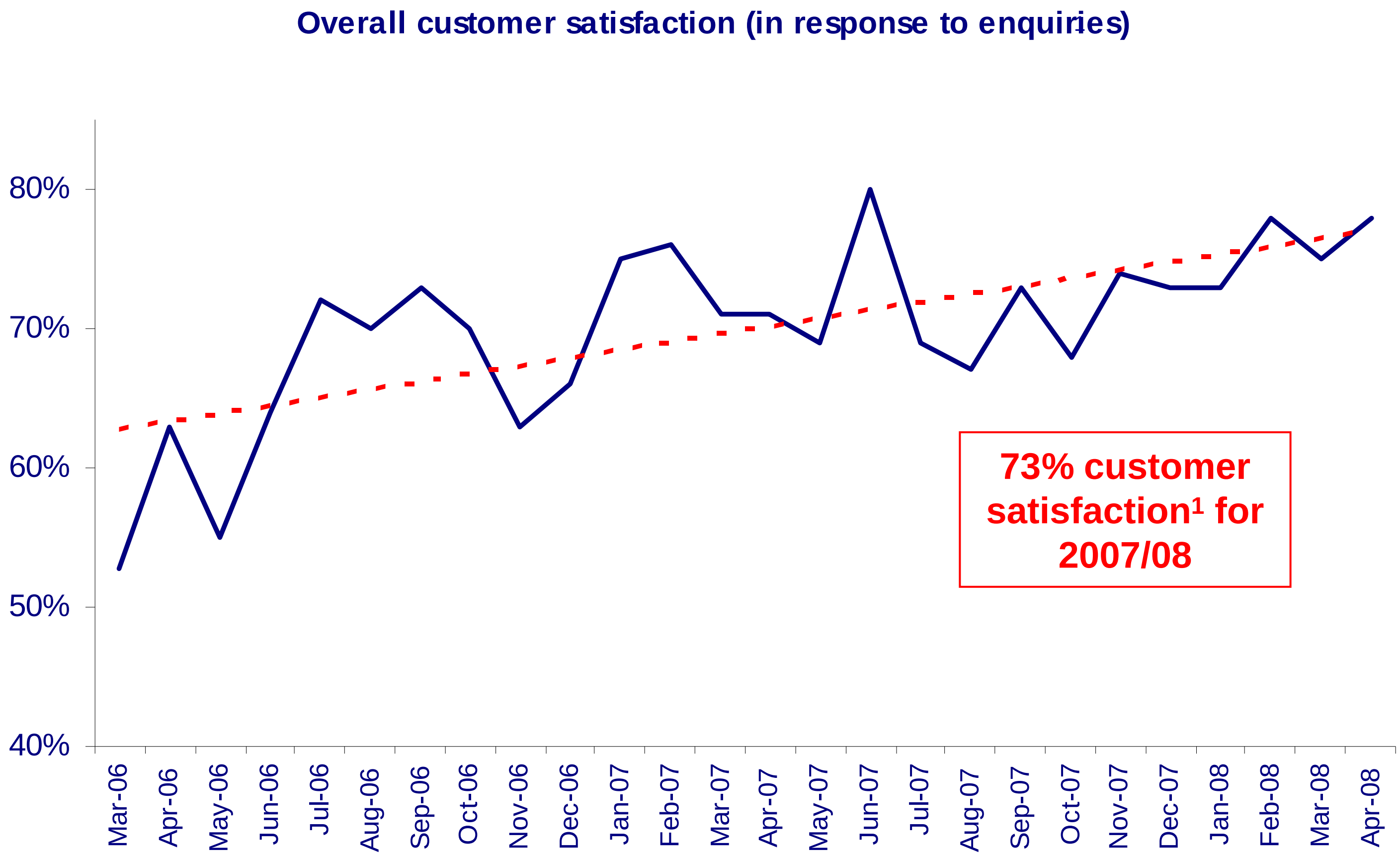
[1] group net debt less net debt associated with UUE / water regulatory capital value in outturn prices

Key operational and service measures
Improved and sustained performance

	Start point	Current	Target
Relative efficiency	Below average	**Narrowed operating efficiency gap to most efficient water companies[1]** over last two years from 16% to 12% for water and from 27% to 18% for wastewater. 2006/07 opex position of band B for water and band C for wastewater as assessed by Ofwat	Upper quartile in the medium term
Security of water supply	Had not met economic level of leakage rolling target since 2002	**Outperformed[2] tougher leakage target set by Ofwat in 2007/08. Second consecutive year of meeting leakage target.** No water restrictions during the year	Meet or outperform rolling leakage targets and avoid the need for water restrictions
Pollution	In 2005/06: 2 water & 21 wastewater incidents[3]	One[2] water and eight[2] wastewater category 1&2 incidents in 2007 – **again outperformed medium term target of a 50% reduction**	Reduce incidents by around 50% in the medium term
Sewer flooding	641 properties on flooding register in 2005/06[4]	**Further progress achieved in 2007/08 with an estimated 434 properties on the register[2], representing a 32% reduction since 2005/06** On track to meet medium term target	Reduce number by around 50% in the medium term
Overall customer satisfaction (in response to enquiries)	<50%	**73% – significant improvement over last two years**, but more to do	85% in the medium term Aspiration of 100%

[1] based on UU internal modelling estimates [2] subject to regulatory audit; [3] refers to Category 1 & 2 incidents as defined by the Environment Agency; [4] refers to properties at risk of experiencing at least one sewer flooding incident in 10 years

Customer satisfaction
Improving performance



- Strong focus on first time resolution of customer enquiries

[1] based on an independent monthly survey of 700 customers that contacted UU and made an enquiry

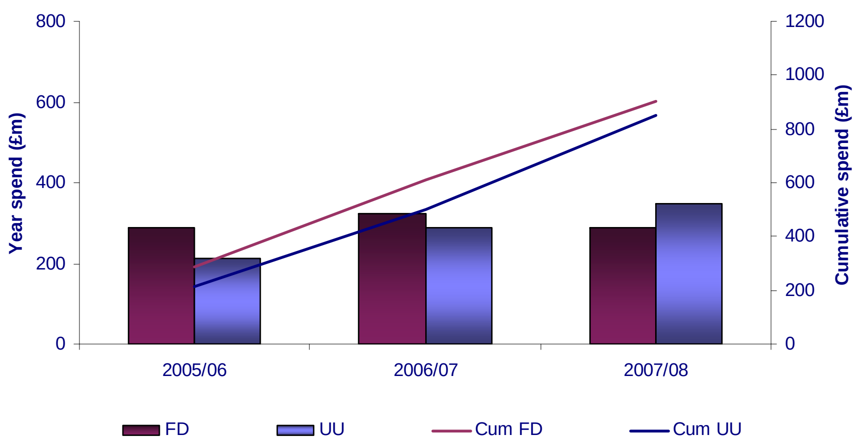
Business improvement initiatives
On track to meet regulatory efficiency targets

- **Integrated performance management** - improving treatment works' efficiency
- **Asset improvement** - cost savings from increasing pump efficiency
- **Combined heat & power** - sustainable strategy with cost benefits
- **Workforce management** – more efficient customer operations
- **Supply chain management**[1] - procurement economies of centralisation
- **Customer service transformation** - to deliver further benefits
- Increasing cost pressures in areas such as property rates, power & bad debts

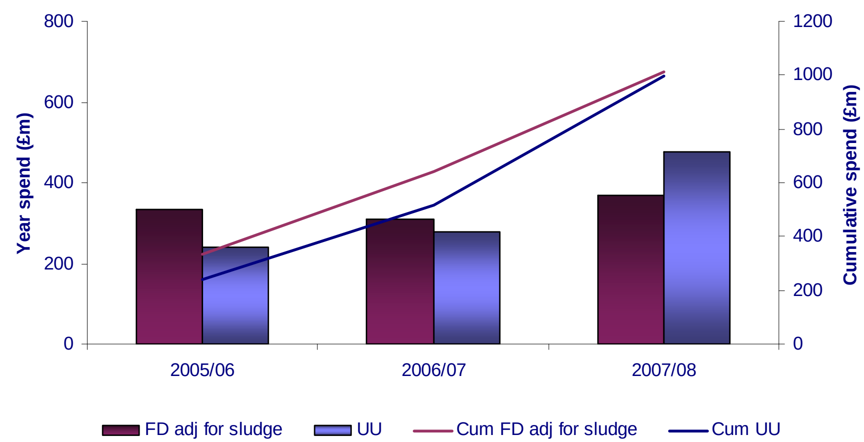
[1] will contribute to both the company's capital and operating efficiency targets

Regulatory capital expenditure
Spend and outputs broadly in line

Water



Wastewater



- Investment re-profiled for revised sewage sludge programme
- Outputs broadly in line with regulators' expectations

Unsatisfactory Intermittent Discharges (UIDs)
Potential for further investment

- 3,000 intermittent discharges in the region - c.10% are unsatisfactory[1]
- Funding submission (Change Protocol) made to Ofwat
- Further submissions being considered following appeals
- Funding requirement estimated at approximately £700m
- Statutory obligations to deliver environmental benefits
- Large proportion of these projects likely to roll into 2010-15 period

[1] An Unsatisfactory Intermittent Discharge is an overflow on the sewer network that requires to be improved so as to meet environmental standards for the water body into which it discharges or which it affects

Climate change and sustainability
Driver of future capital investment and growth

- Mitigation - good progress on carbon action plan
- Adaptation to climate change essential
  - strong influence on investment in the water sector in future
  - longer term investment planning
  - combat flooding to protect assets, water supplies and properties
  - counter increasing water supply volatility
  - importance recognised by Ofwat and HM Treasury

"…we would expect significant levels of capex to continue beyond 2010, driving further growth in our regulatory capital value…"

Non-regulated activities
Successful contract renewals

- In addition to first time inclusion of electricity outsourcing contract:

Southern Water

- Currently managing part of 2005-10 regulatory capital investment programme
  - worth £700m to 4D consortium in which UU has a 40% share
- Contract extension secured for 2010-15 period
  - builds on strong performance

British Gas Trading[1]

- Secured 18-month extension to metering contract
- Adds a further £45m to order book
- Added benefit of higher meter rental income

"…these contract renewals consolidate our position as the leading utility infrastructure outsourcing company in the UK…"

[1] a division of Centrica plc

Summary and outlook

Operational performance

- Efficiency initiatives delivering benefits
- Outperformed leakage target
- Focus on customer satisfaction

2005-10 regulatory contract

- Ofwat agreement on new sewage sludge strategy
- Spend and outputs broadly in line
- On track to meet efficiency targets

2009 water price review

- Significant investment required to improve services and adapt to climate change, driving growth
- We welcome Ofwat's position on climate change

Non-regulated growth

- Southern Water and British Gas contract extensions consolidate position as UK market leader
- Asset-light strategy based on core skills in selected markets

3. Capital structure and dividend policy

Capital structure and dividend policy

- Capital structure and target credit rating now mirrors regulatory assumptions
  - target A3 gives more efficient capital structure

- Returned £450m or 51 pence per share

- In light of revised composition and earnings profile of the group
  - rebased dividend per share for 2008/09 forecast to be 32.67 pence
  - real dividend growth target of RPI+2% per annum thereafter

Return components
Total return to shareholders

	£m
Net equity proceeds from sale of UUE	1,050
Additional return of value	450
Total return to shareholders	**1,500**

Return to shareholders by way of redeemable B share scheme

New A3 targeted capital structure…

- £1.5bn capital return accompanied by a
  - 23% reduction in the number of shares; and a
  - 30% reduction in dividend per share
- Material improvement to the group’s retained cashflow
  - Dividend payments reduced by approx 50%
  - Improvement in retained cashflow by more than £200m annually
- Medium term credit profile improved significantly
  - Benefiting from the improvement in retained cashflow; which
  - Leads to a modest de-leveraging impact; and
  - Results in greater financial flexibility to absorb potential adverse shocks in the future
- Enhanced by Board commitment to a A3 credit rating target for UUW
- Share price increased on announcement

“…a sustainable capital structure for the future”

4. Setting price limits for 2005-2010 current review

Ofwat PR09 timetable

Phase 1 - Preparation

- October 2007 – Consultation on approach to the 2009 price review
- March 2008 - Publication of “Framework and approach” document

Phase 2 - Setting the Scene

- June 2008 – Companies submit June returns
- August 2008 - Companies submit draft business plans
- October /November 2008 - Feedback to companies on draft business plans
- December 2008 – Ofwat sets intial CIS baselines

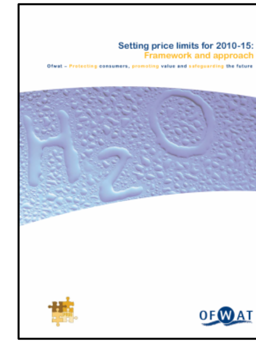
Current position

Phase 3 - Decisions and Determinations

- April 2009 – Companies submit and publish final business plans
- June 2009 – Annual returns
- July 2009 – Ofwat publishes draft determinations
- November 2009 – Final determinations

Phase 4 - Implementation

- January 2010 – Companies decide whether to accept price limits or to seek a referral to the Competition Commission
- April 2010 – New price limits take effect



2009 water price review
UU's preparations well advanced

- UU is well advanced in its preparations for the 2009 price review
  - draft business plan submitted August 2008

- We commend Ofwat for increased focus on climate change
- Cost of capital – important to consider short and long-term economic data
- Targeting an A3 credit rating for United Utilities Water PLC

The raising of debt finance is particularly important given the likely scale of investment that is still required in the water industry

UU Board targets A3

- *"We will be targeting an A3 credit rating for United Utilities Water PLC and believe that Ofwat should ensure that water companies can at least maintain this rating. I am sure that Ofwat will also consider recent developments in the credit markets."*
- *"… raising debt finance will remain vital in supporting the water industry's future investment requirements which will include addressing flooding risk and climate change. Maintaining a solid investment grade credit rating is therefore essential."*

Philip Green, CEO, Preliminary results announcement, 03 June 2008

UU believe it is important Ofwat ensures A3 is maintained and should consider recent events in the credit markets

“Setting price limits for 2010 – 2015: Framework & approach”

Published by Ofwat: March 2008

- “*…most of our methodology continues to rest on tried and tested experience from previous reviews…. We are sure that this methodology will enable each company to develop and deliver a strategy that offers fair reward to investors”.(p4)*

- *“One of our primary duties is to ensure that efficient companies can finance their functions…we continue to interpret this as having 2 strands. First a company that is efficiently financed and run can deliver its services to consumers earning a return on its capital base at least equal to the cost of capital. Second, a company’s revenues, profits & cashflows must allow it to raise finance on reasonable terms...The availability, cost and other conditions of financing are directly related to a company’s financial position and prospects. Such considerations are often referred to as ‘financeability’.” (p45)*

Ofwat reiterates it has a primary responsibility to ensure a company can finance its functions … in turn this means offering investors a fair return

“Setting price limits for 2010 – 2015: Framework & approach”

Published by Ofwat: March 2008

“It is important for consumers that investors and markets see water companies as good quality credits. We will continue to check cash flow indicators to make sure that an efficient company… can continue to finance its functions and retain stable credit quality. …we do not anticipate that the package of financial indicators will be significantly different to that considered at PR04.” (p52)

At PR04 Ofwat targeted financial indicators consistent with an A3 rating.

5. Financing

Robust liquidity position

- Pre-funded to 2010 in line with board approved policy
  - including the £1.5bn returned to shareholders
- Arranged or extended maturity date on £500m of facilities since 30 September 2007
- UU has long standing relationship with the European Investment Bank
  - £400m loan approved to support capital investment
- No need for UU to rush to market
  - always keen to issue opportunistically if market conditions are right

Long-term, index-linked debt

- Since September 2005, UUW has issued £1,195m of long-term, index-linked debt
  - maturities ranging from 30 to 50 years; and
  - real interest rates ranging from 1.3% to 2.0%
  - Average debt maturity of circa 36 years

- The group has also drawndown around £200m, from a ten-year loan facility provided by the European Investment Bank, in the form of index-linked debt

- This form of debt provides a good match for the group's regulated assets and revenue profile, as both are linked to RPI

- In total, the group's index-linked debt now amounts to £1,445m with an average real cost of debt of around 1.8% - less than the risk free rate (1)

- Credit crunch has all but closed the index-linked debt market

(1) The Competition Commission assumed a risk free rate of 2.5% for airport landing charges - March 2008

Long-term, index-linked debt
Financing outperformance

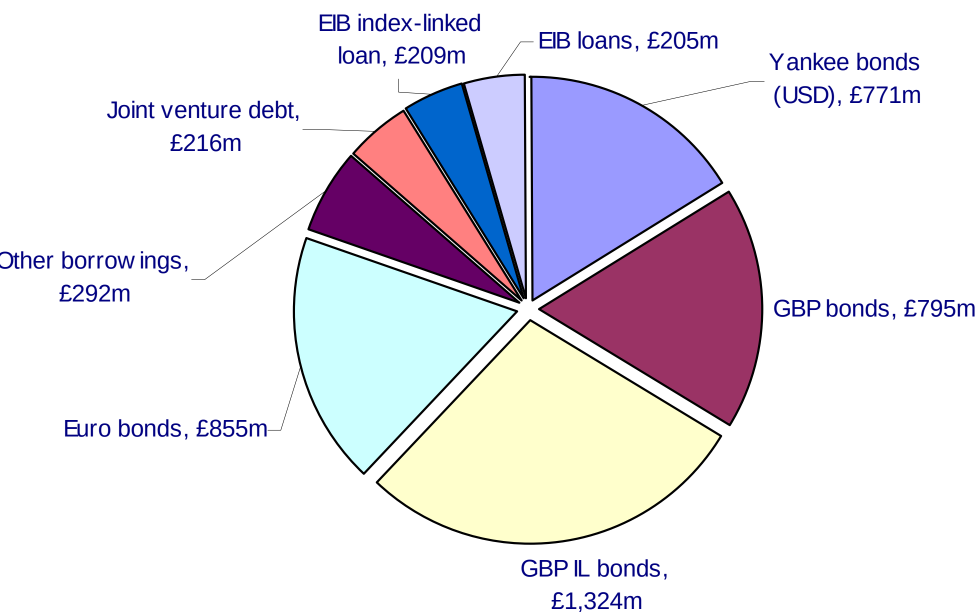
- In addition to providing a good match for our regulated assets and revenue profile, the relatively low cost of this funding has secured substantial additional value
  - represents outperformance of the regulatory allowance for the cost of debt of approximately **£140m** in the current five-year period
  - locks in an attractive position for decades
- Around 21% of UUW's regulated asset value is now supported by index-linked debt, which we believe compares favourably to the rest of the water industry

…the index linked debt provides £140m of regulatory outperformance in the current regulatory period alone!

Financing & liquidity as at 31 March 2008

Continuing operations

Gross debt = £4,667.3m



Headroom/prefunding = £2,494.4m

	£m
Cash and short-term deposits[3]	1,810.5
Medium-term committed bank facilities[2]	1,549.6
Short-term debt	(105.3)
Term debt maturing within one year[3]	(760.4)
Total headroom / prefunding	**2,494.4**

Liquidity

The group enhanced its liquidity further by arranging or extending the maturity date of £500m of committed medium-term bank credit facilities since 30 September 2007

The above figures do not include the £400m EIB loan recently approved

Debt structure under new parent co - no change

United Utilities PLC
BBB+ stable; Baa1 stable

Yankees:
- $500m in 08's
- $250m in 18's
- $350m in 19's
- **$400m in 28's***

Euro MTN:
- USD10m in 08's
- USD10m in 09's
- EUR 10m in 08's
- GBP 6.5m in 13's

United Utilities Water PLC
A3 stable; A- Stable
Ring-fenced and regulated by Ofwat

Euro MTNs:
- €600m in 09's
- £150m in 10's
- £150m in 18's
- €500m in 20's
- £300m in 27's
- £50m in 32's
- £200m in 35's
- £100m in 35's
- £35m in 37's
- £100m in 40's
- £50m in 41's
- £100m in 42's
- £50m in 43's
- £50m in 46's
- £50m in 49's
- £510m in 56's
- £150m in 57's

Other term debt & smaller issues:
- £581.6m

United Utilities Group PLC

United Utilities PLC
BBB+ stable; Baa1 stable

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- £100m in 35's
- £35m in 37's
- £100m in 40's
- £50m in 41's
- £100m in 42's
- £50m in 43's
- £50m in 46's
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- £581.6m

6. Appendices

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Monopoly assets owned

Monopoly assets owned

Wastewater

- **40,323**km of sewers
- **1,749** pumping stations
- **3,087** combined sewer overflows
- **584** waste water treatment works
- **36** sludge treatment facilities

Water

- **40,080**km of distribution main
- **862**km of treated water large diameter trunk mains
- **192** impounding reservoirs
- **1,183**km of aqueducts
- **108** water treatment works
- **455** service reservoirs
- **633** pumping reservoirs

Assets owned - not a concession
Current replacement value £60bn

Earth circumference: 40,000 km

Regulation

Regulatory capital value (RCV)*

Market capitalisation
(shortly after flotation)

+

Net investment

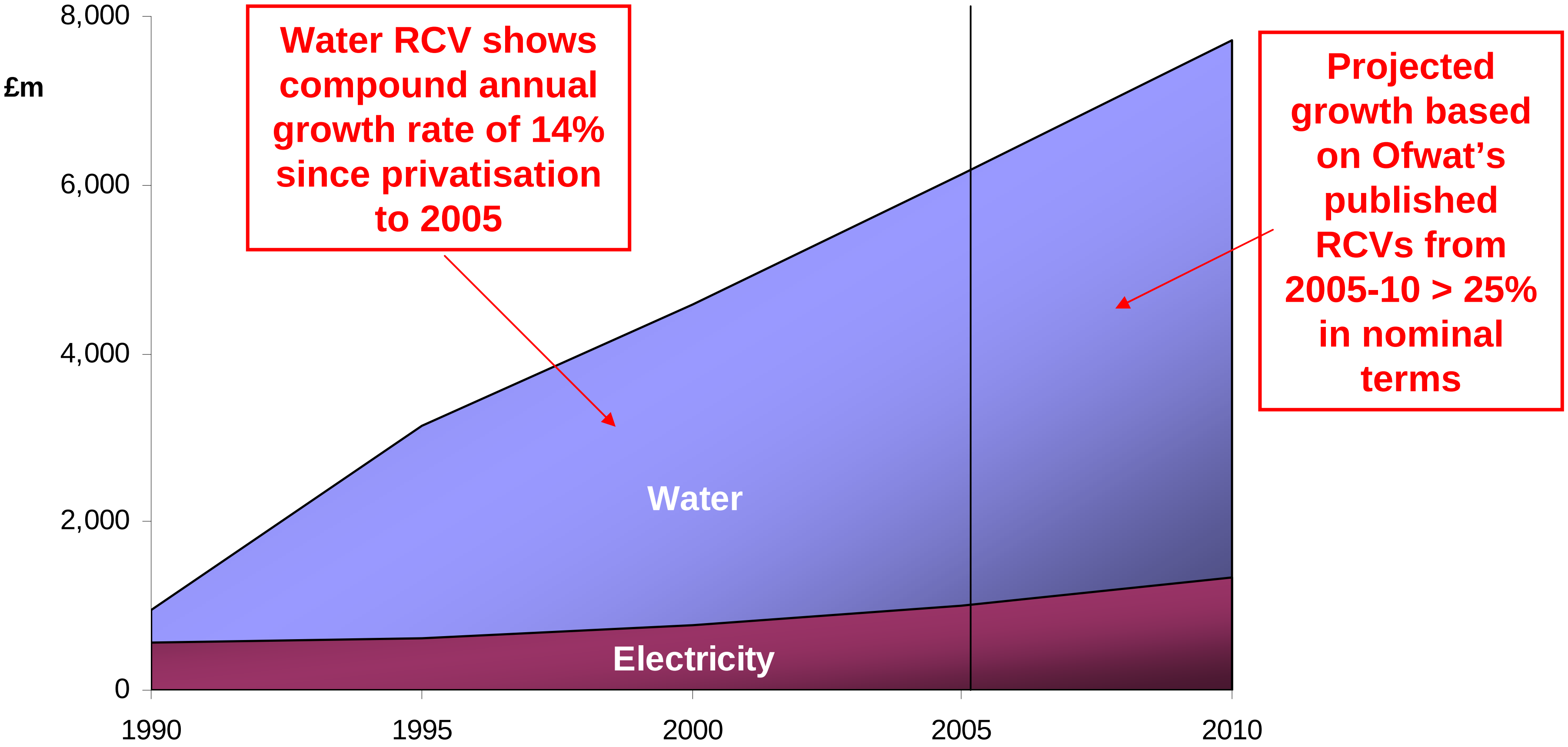
=

Regulatory capital value (RCV)

Adjustments
Inflation & Deflation- natural hedge for index linked debt
Depreciation

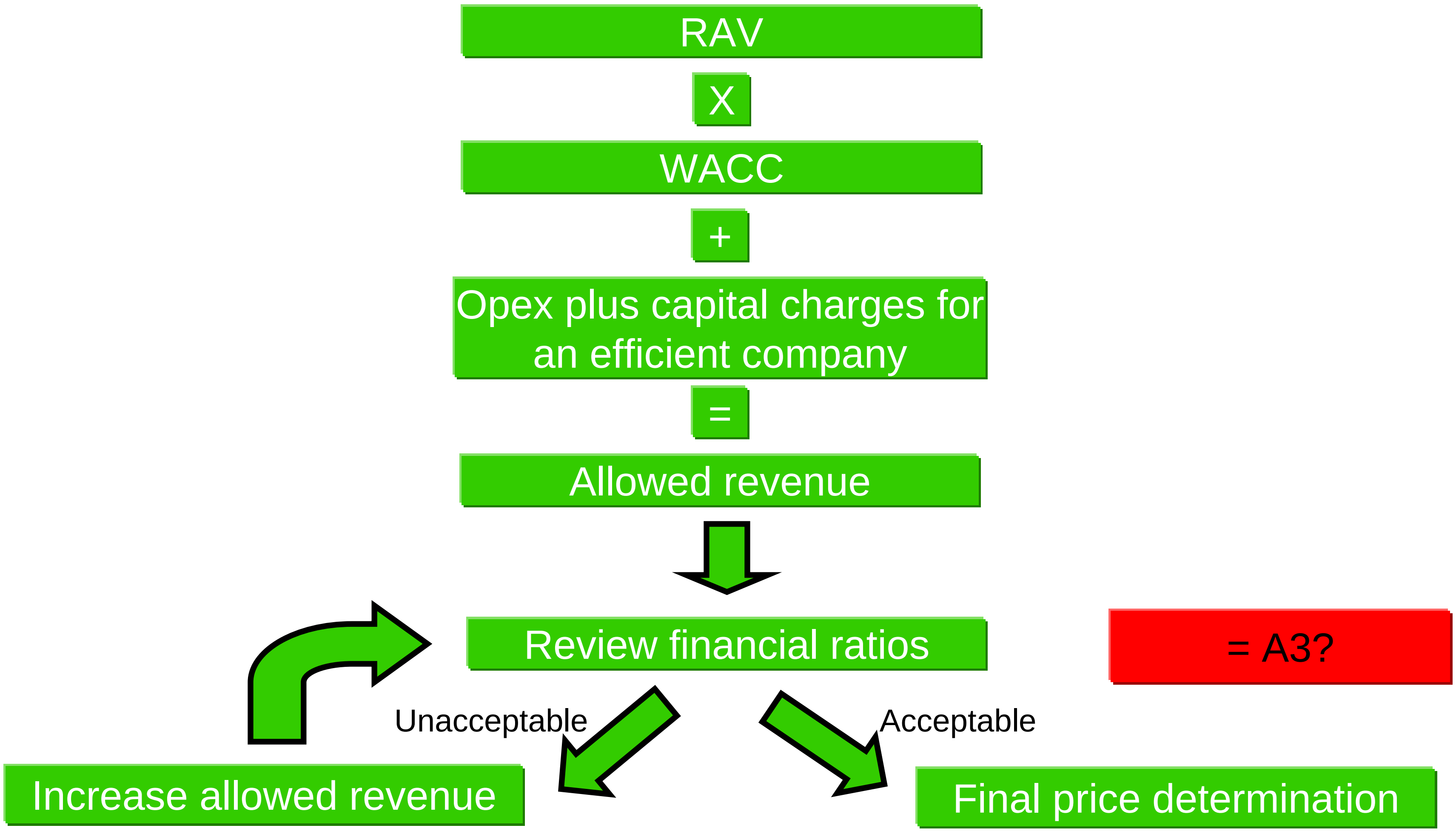
*RCV sometimes also known as regulatory asset value (RAV) and regulatory asset base (RAB)

Growth in regulatory capital value (RCV)



No plans to sell water and wastewater assets which provide significant growth in the regulated income stream

Price setting methodology



Ofwat cost of capital 2005-10

Debt	Equity
Real pre tax 4.3 %	Real post tax 7.7 %

WACC

Real vanilla 5.8%

Real post tax 5.1%

+ financeability

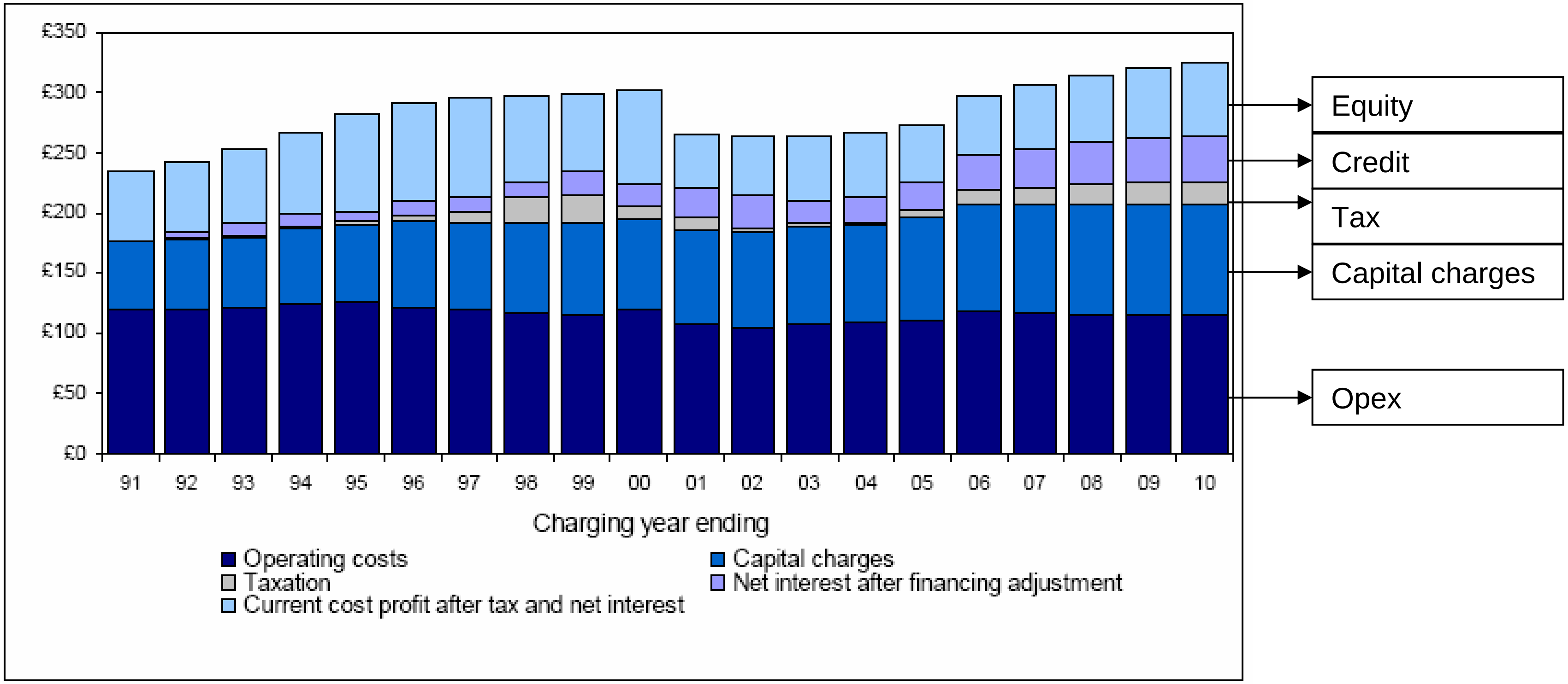
Water regulatory review 2005 - 2010

Ofwat price caps: Retail price inflation +

Year to 31 March	2006	2007	2008	2009	2010
k factor	5.0%	6.4%	4.4%	3.5%	3.0%

- Cumulative opex savings of £147m over five years
- Capital investment programme of £2.9bn over five years

Components of the average household bill 1991-2010 (2007-08 prices)



Source: Ofwat's "Framework and approach" document published March 2008

Operating expenditure reduced as a proportion of the total – fairly flat operating costs despite running more infrastructure

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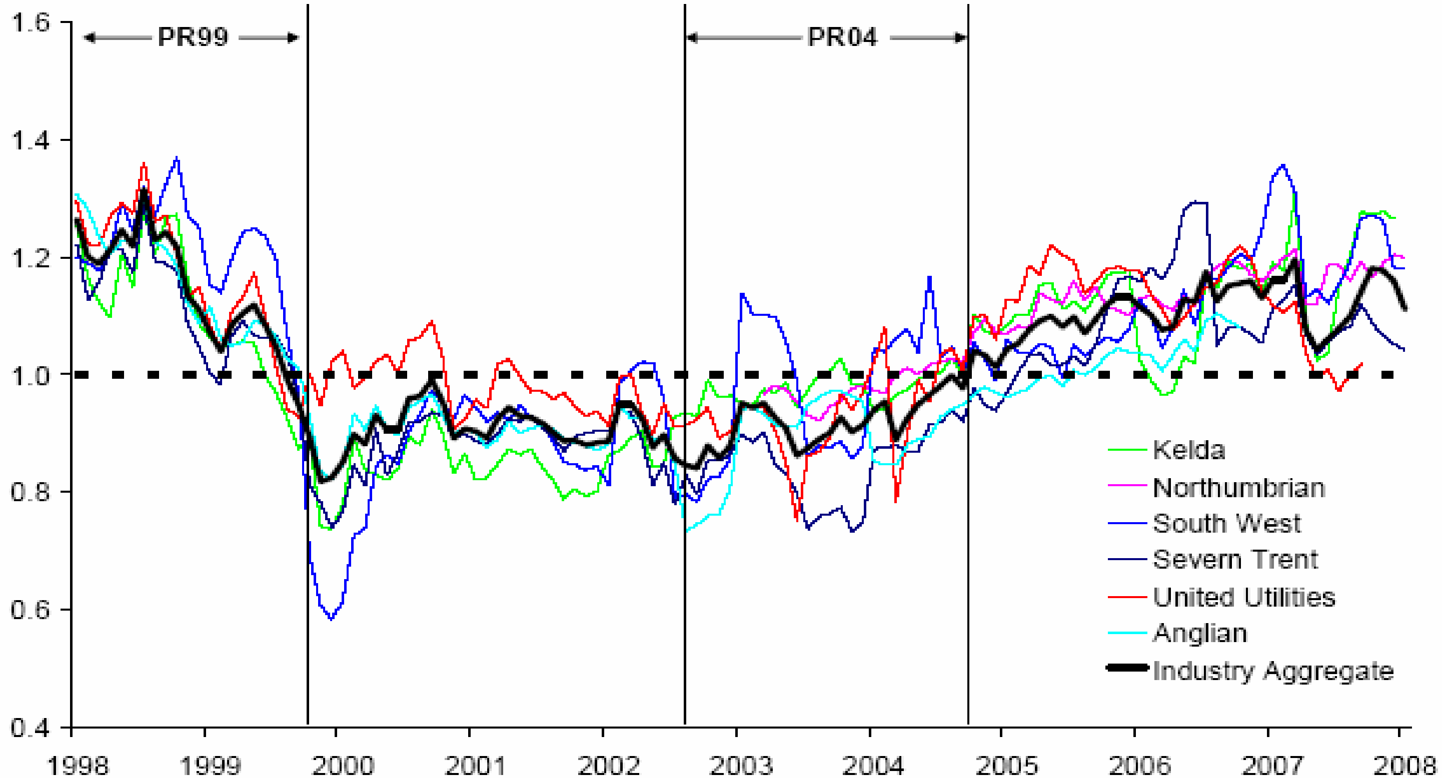
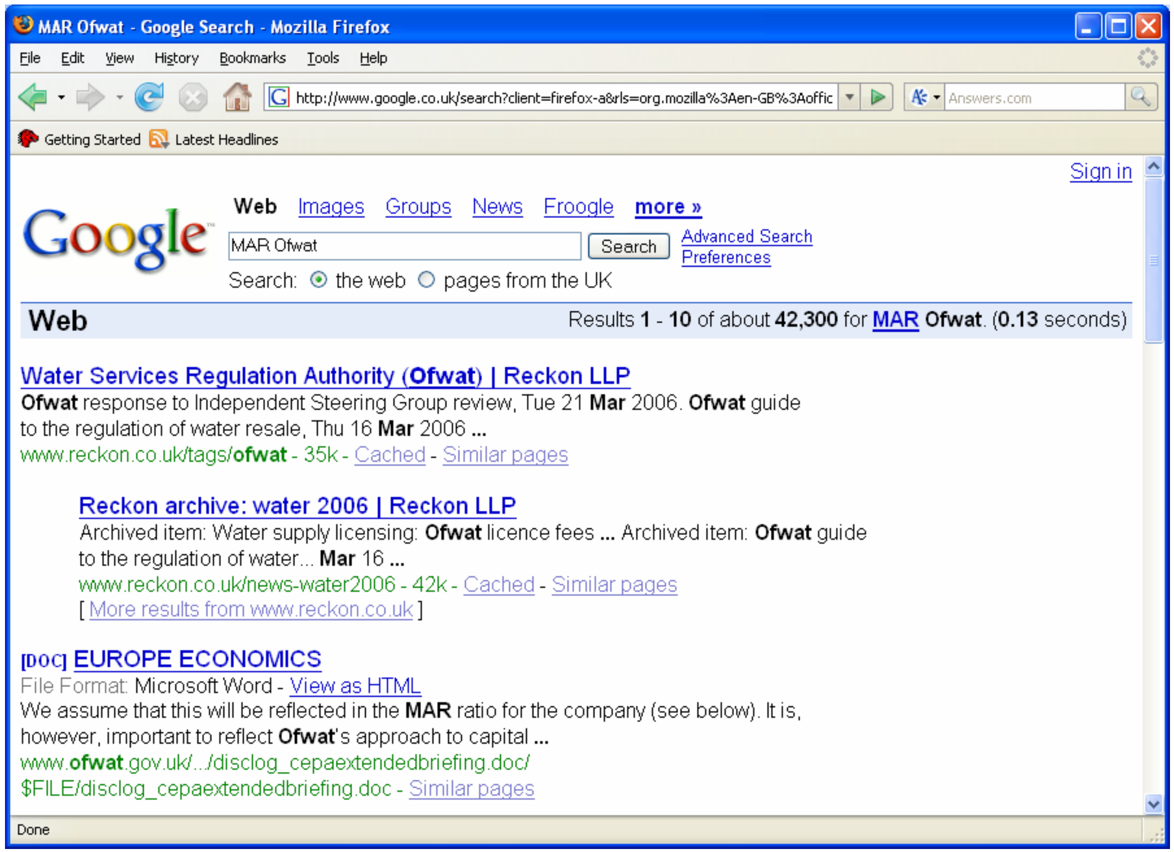
MAR - Market to asset ratio

Market to Asset Ratios for Listed UK WaSCs



Source: NERA analysis of Bloomberg data and analyst reports. Aggregate MAR constructed by summing RCV, Enterprise Value and non-regulated businesses across companies. Price review periods are between the release of the final 'Setting price limits' document and the publication of the Final Determination.

MAR on Google



MAR definition

CEPA – Cambridge Economic Policy Associates

$$MAR = \frac{MarketCap + NetDebt - NonUKregulatedAssets}{RCV +/- NPVofCapitalEfficiency}$$

Leverage effect on risk (obvious!)

130% of RAV & 90% leverage

MAR = 1.3

Debt:	90
Equity:	40
Total EV:	130

Revert to par and same leverage

MAR = 1

Debt:	90
Equity:	10
Total EV:	100

In this scenario: equity loses 75% of its capital

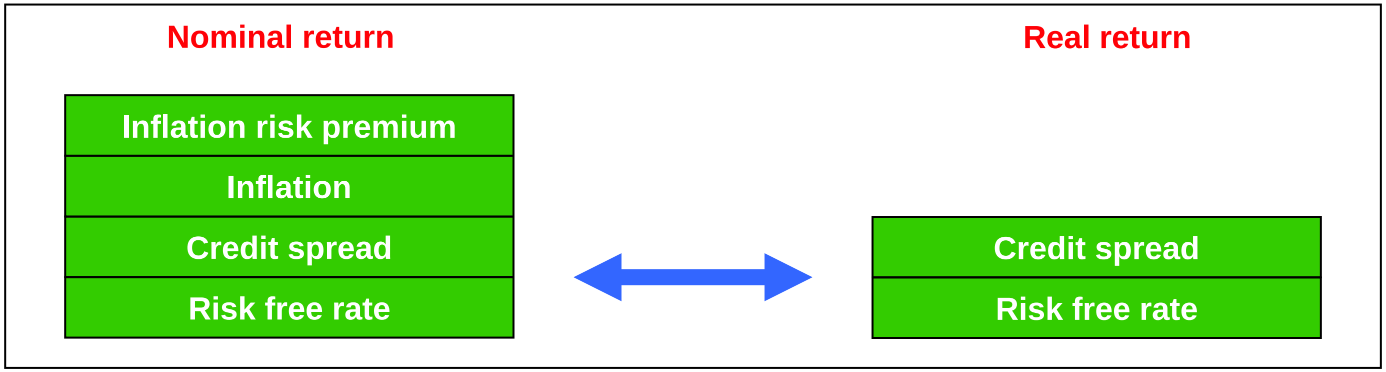
Leverage amplifies equally the effect of both value creation and value destruction

Inflation & financeability

- RAV indexed to UK inflation (RPI)
- Like fine art
  - Asset growth
  - But … no immediate cashflow

Financeability solution: more *equity* or IL

- Financeability is due to the mismatch between real and nominal returns



- The regulatory model
  - Allows a ***real return*** on the regulatory asset base to be paid through revenues
- Actual returns to investors comprise
  - Equity dividend -- represents a ***real return*** to equity
  - Interest -- represents a ***nominal return*** to debt (in the absence of IL debt)
- Mismatch can be mitigated by assuming either
  - A greater ***equity*** component; and/or
  - An increased proportion of long dated ***IL debt*** (technically perpetual IL debt)

How do we retain equity in the sector?

Professor Colin Mayer, Saïd Business School, University of Oxford 2003 Beesley lecture on regulation:

“… rising levels of leverage increase the risk of firms sweating assets, minimizing investment and leaving future generations of owners and customers to clean up the mess**”**

“Debt gives shareholders a put option to exit – to put the firm in the hands of the creditors and receiver … **”**

“Railtrack is a salutary reminder of the costs of an industry failure that will in all probability be with us for years to come.**”**

“… if the regulator wishes to encourage more companies to retain or implement equity structures then an element of conditionality could be introduced into price determinations, i.e. *higher rates of return could be offered to low than highly leveraged firms*.**”**

Index linked trade

Structured linker trade