

Southern Water Services Limited

PR24 Business Plan Update

September 2024



Presenting Today



Stuart Ledger
Chief Financial Officer

- Appointed CFO in January 2023
- Held a number of senior finance positions including CEO and CFO at Affinity Water and 9 years at Thames Water as the CFO of the Retail Business and as Group Financial Controller

James Gillard
Group Treasurer

- Joined SWS in May 2023
- Treasurer at Land Securities for ~10 years



Pooja Shah
Senior Vice President

- Been at MAM and associated companies since June 2018
- A Board Observer at Southern Water since July 2023

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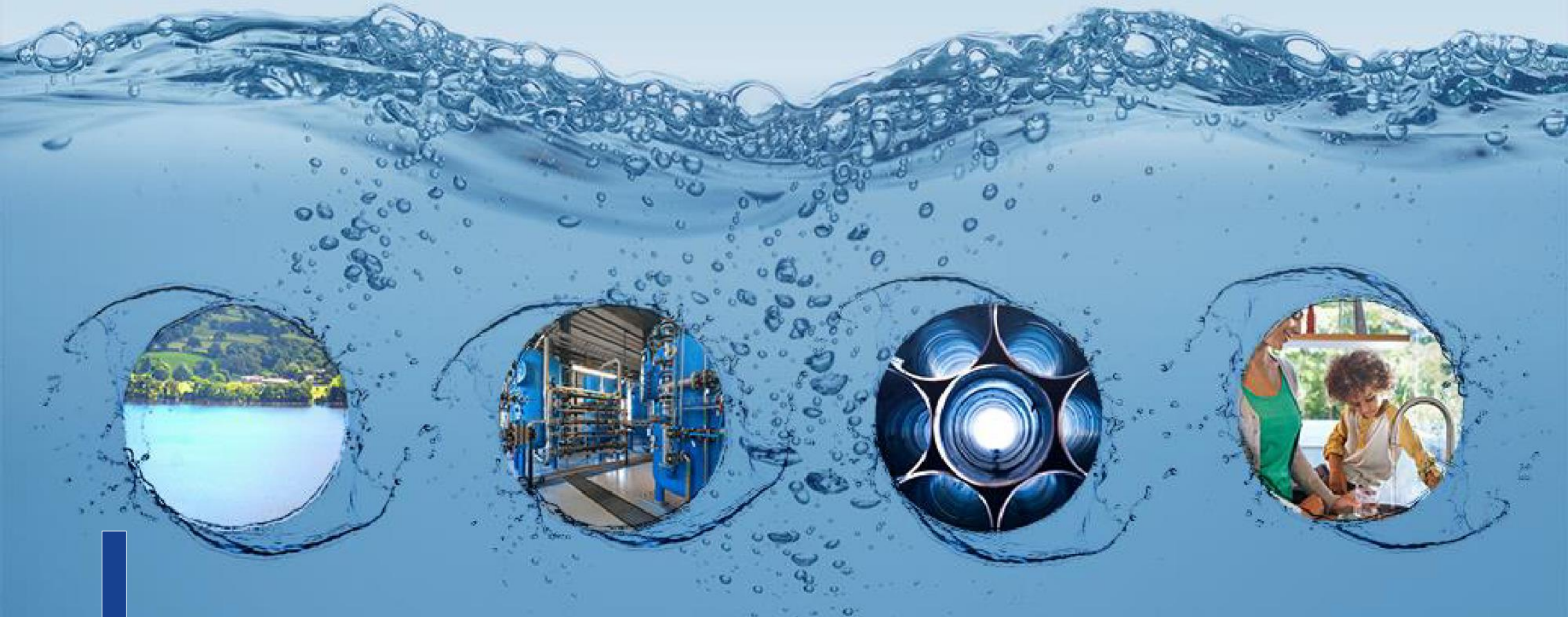
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Introduction



from
**Southern
Water** 

Introduction to Southern Water



£7.6bn

Regulatory Capital Value⁽¹⁾

570m

Litres of water supplied per day

£1.6bn

Equity investment (AMP7)

4.7m

Waste customers

40,058km

Sewer network

2.7m

Water customers

£290m

EBITDA⁽²⁾

13,973km

Water network

1,522m

Litres of wastewater received per day





2,600+

Employees

Notes: (1) Forecast for March 2025 post-midnight adjustment; (2) As at March 2024

Update on Turnaround Plan

Significant progress in the Turnaround Plan and on track for a step change in performance

		Start Year	Last Year	Target
		Year 1 20/21	Year 4 23/24	Year 5 24/25
	Water Quality score CRI	4.53	3.07	3.23
	FEO delivery	n/a	On track	On track
	Leakage MI/day (in-year)	93.8	107.5	104
	EPA Star Rating *	2*	2*	2/3*
	Pollutions (including serious pollutions)	402	234	224
	Serious Pollutions	4	13	0
	Treatment works compliance	97.1	99.4	>99.1
	C-MeX	16th	16th	16th
	CSS (C-MeX excluding reputation)	67.5	63.6	68.6
	Complaints	88,210	18,975	17,324
	Lost Time Incidents	0.44	0.18	0.20

Key Highlights:

Operational **performance is improving**, Turnaround Plan is working

Strong performance improvement in drinking **water quality compliance 6/17**

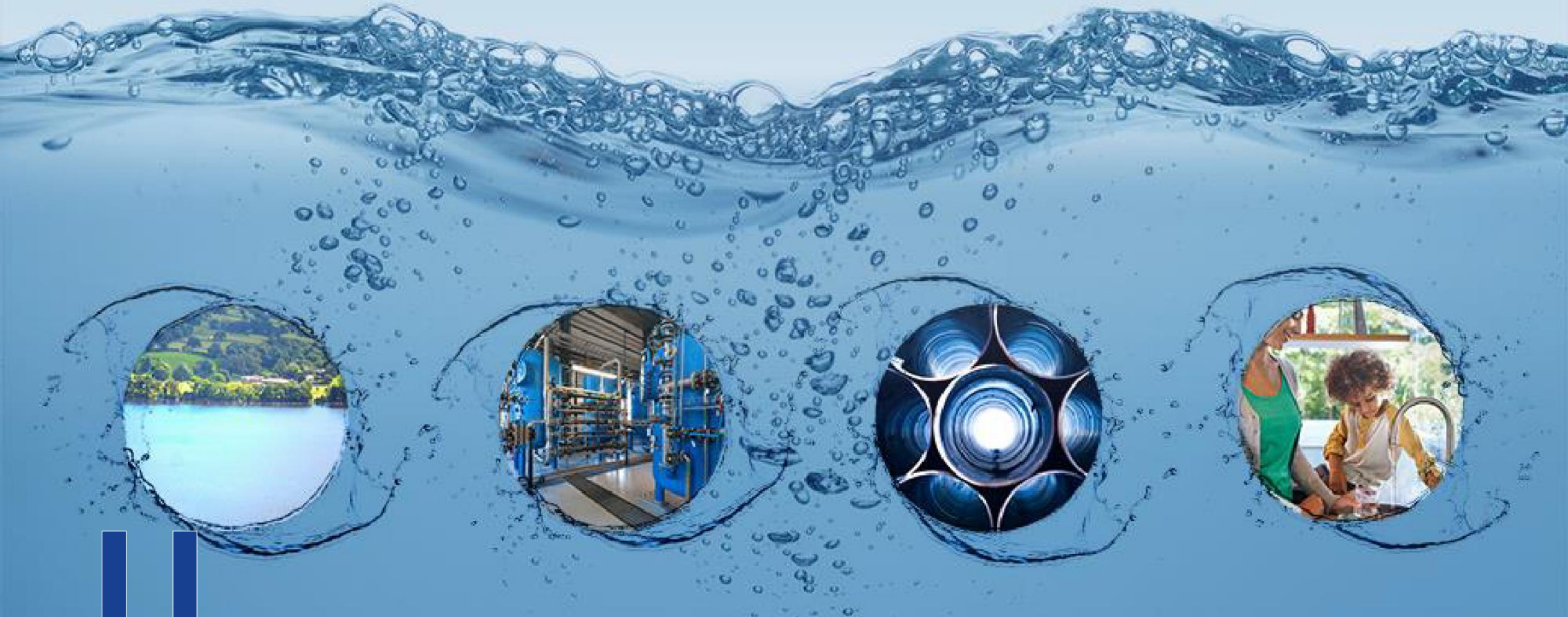
Pollution performance improved by 42% from 402 to 234

Customer complaints have reduced by 78% from 88,210 to 18,975

On track to **reduce lost time incidents ahead of target**

Targeting 3* calendar year 2026

Management changes to support turnaround and key capability shifts (e.g. control room, digitising sewer network, Clean Rivers & Seas), companywide engagement



PR24 Business Plan - Overview



£7.5bn

Gross Totex⁽¹⁾
(2022/23 prices)

53%

RCV growth⁽⁴⁾

£1bn

AMP8 spend on overflow
enhancements

BBB+

Target credit rating

70%

AMP8 gearing maximum target

£734

2030 average annual household
bill (2022/23 prices)

50%

Reduction in supply interruptions

21%

Reduction in storm overflow spills⁽³⁾

57%

Reduction in pollutions

35%

Reduction in leakage⁽²⁾



Notes: (1) Real as per the 'core plan'; (2) Convergence reporting method; (3) reduction in average spills per overflow – monitored spills; (4) Closing FY25 of c.£7.6bn and FY30 of c.£11.6bn on a nominal basis

Delivering for Stakeholders

Customers

- We recognise the challenges with the increase in bills proposed over the next 5 years. However, our approach to **managing affordability includes multiple incentives**
 - **45-90% discount** for those who are struggling to pay their bills
 - Further extend support by using any future penalties from underperformance into **customer affordability schemes**
- Our customers have told us that putting off investment to future generations is the wrong thing to do
- **35% reduction** in category 1-3 pollutions last year



Environment

- Plan to deliver the **largest and most complex programme** to protect the unique environment specific to the Southeast of England
 - **£1.1bn** spend on **storm overflows**
 - **£794m** to enhance **waste treatment**
 - **£743m** towards the **WRMP⁽¹⁾ Supply** ensuring efficient support of water and minimal wastage
- Through the WRMP, we include a performance commitment to **reduce leakages by 35.4%⁽²⁾** in 2029/30



Investors

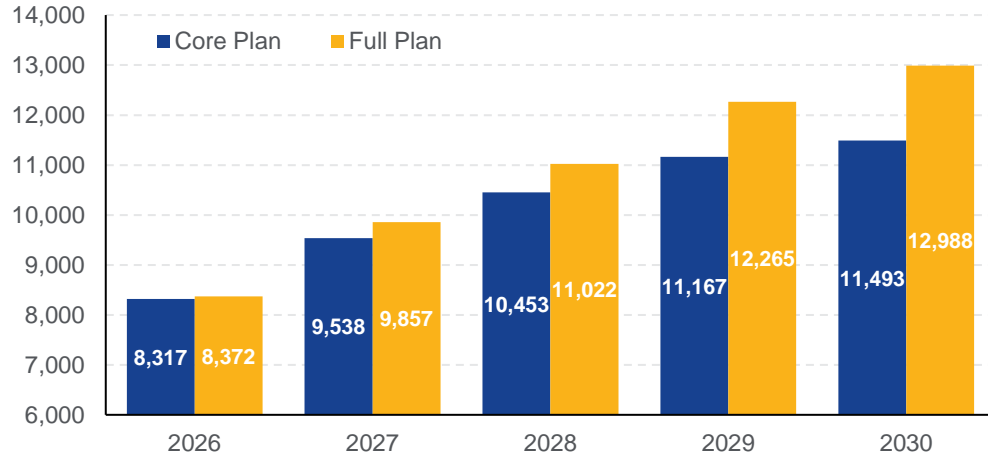
- **£4.0bn nominal RCV growth** based on proposed business plan resubmission⁽⁴⁾
- **Plans to raise £650m equity** in AMP8 to support the ambitious plan from funds managed by Macquarie Asset Management⁽³⁾
- **70% gearing threshold**, to enable SWS to reach target **BBB+ rating** and be able to pay distributions
- Allowing an **appropriate level of WACC and RCV recovery rates** to support increased investment



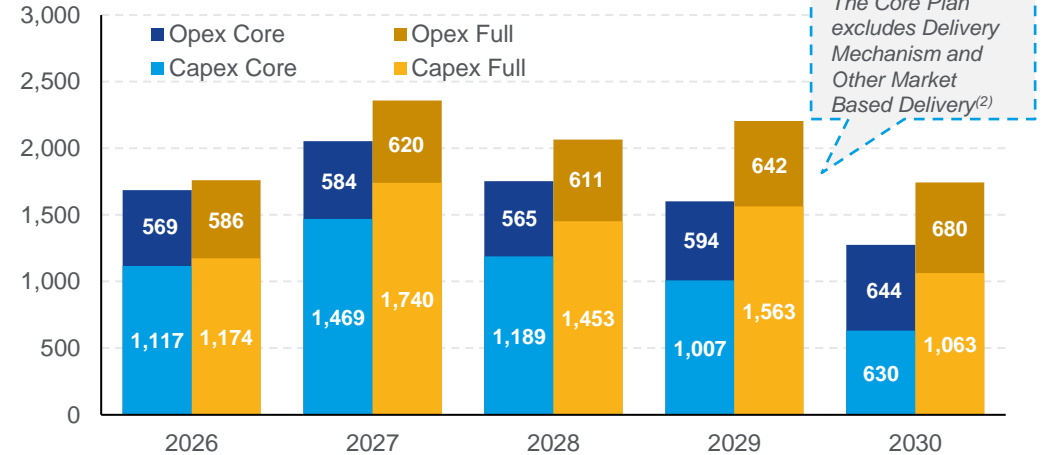
Notes: (1) Water Resource Management Plan; (2) Convergence reporting method from 2020/21 baseline; (3) controlling shareholder (with 87.51% shareholding); (4) Based on the core plan

Unprecedented Levels of Investment Driving RCV Growth

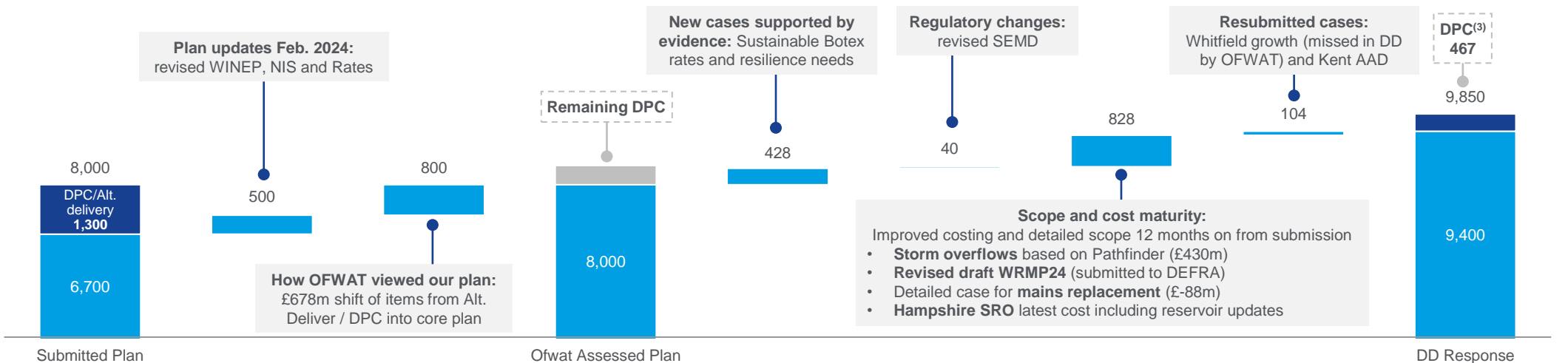
Record RCV Growth (nominal, £m)



Driven by higher Totex requirements (nominal, £m)⁽¹⁾



An extensive update in Totex in the full plan since the October 2023 submission to meet additional scope set out by OFWAT (real, £m)



Notes: (1) Net Totex excludes G&C; (2) Totex differences driven by (i) Delivery Mechanism (£1,167m) and; (ii) Other Market Based Delivery (£596m); (3) 22/23 Price Base, pre RPE's and frontier shift
Source: Company response to Ofwat's Draft Determination

PR24 Resubmission | Industry Comparison

	2029-30 Average Bills (real, £m)		AMP8 Allowed Net Totex (real, £m)		Assumed Equity (£m)
	Draft Determin- ation ⁽⁴⁾	PR24 BP Resub- mission	Draft Determin- ation ⁽²⁾	PR24 BP Resub- mission	PR24 BP Resub- mission
	557	614	8,206	9,773	170 ⁽⁶⁾
	496	546	10,236	12,223	- ⁽⁵⁾
	603	734	5,873	7,246 ⁽³⁾	650
	535	696 ⁽⁷⁾	14,548	22,672 ⁽⁷⁾	3,300
	536	584	9,253	12,668	1,079
	537	583	6,616	7,495	838 ⁽¹⁾

Key Issues Raised

- **Climate change** - reconsider £250m proposed enhancement projects
 - **WACC** - reflect diminished spread between costs of equity and debt in setting WACC
 - **Performance improvements** - recalibrate AMP8 performance commitments & incentives
 - **Infrastructure** – allow for more dynamic setting of cost allowances mid-AMP
 - **Risk and return** – correct proposed 70% gearing mechanism
- **ODIs** – cap ODI rates at 20% above initial range
 - **Financing** – allow a 4% dividend yield
 - **Cash flow** – allow annual true-ups to manage cash flow constraints
 - **Bioresources** – uncapped the modelled efficiency uplift to the benchmark
 - **Cost of debt** – add a “reverse halo” by adding 45bps to the iBoxx index
- **Risk and return** – recalibrate overall risk-return package incl. ODIs, RoRE and PCDs
 - **WACC** – increase allowed wholesale cost of equity by 105bps
 - **RCV recovery** – reset rates to those detailed in original submission (4.49%)
 - **Totex** – increase botex by 20% to £536m and enhancements by 60% to £1,971m
 - **Delivery mechanisms** – support the use of markets-based delivery of projects
- **Price control** – remove PCDs where statutory obligations exist
 - **ODIs** – reconsider £1.6bn penalty by consulting resubmitted data
 - **Risk and return** – increase wholesale WACC range to 4.01-4.69%
 - **Turnaround oversight regime** – aggregate cap and collar from 200bps to 100bps RoRE
- **Enhancement allowances** – reconsider £1.5bn site investment proposal
 - **Performance commitments** – decelerate reduction of internal flooding incidents
 - **Gated allowance operation** – add £186m of new WINEP requirements to “Large Scheme Gates Process”
 - **Aiming down** – re-evaluate several cost allowances and financial arrangements
- **Funding** – across storm overflows, new water treatment works and other, there is a £762m funding challenge
 - **ODIs** – reconsider the suggested £300m of penalties
 - **Risk and return** – set WACC between 4.15-4.85% and reconsider RCV run-off change

Notes: (1) Split into (i) Reduced dividend yield (£505m) and (ii) equity injections (£333m); (2) As per page 4 of the total expenditure allowances by Company; (3) net plan; (4) as per Ofwat Sector Summary; (5) £1bn of equity raised in 2023 which will be utilised across AMP8; (6) reduction from £613m as per DD due to higher allowed return; (7) Post delivery mechanism



Financing and Returns

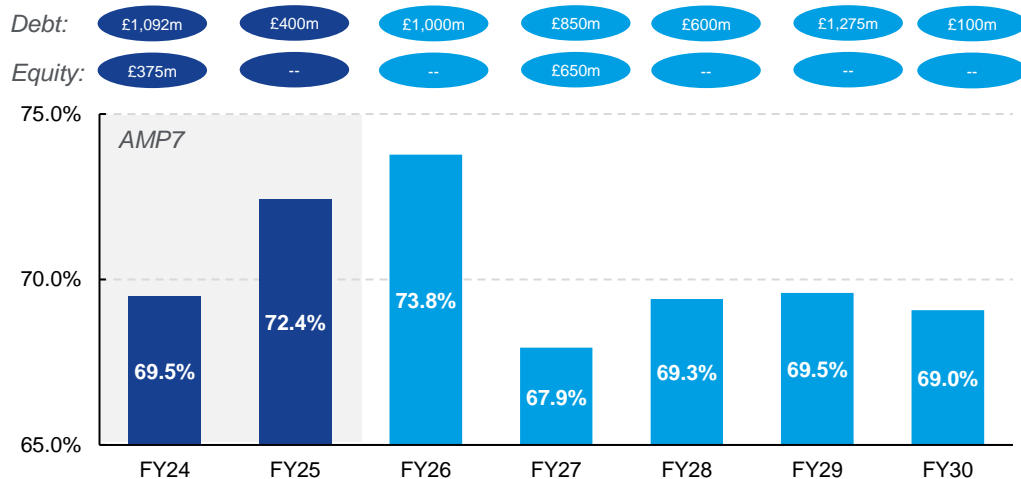
Proven Track Record of Capital Raising

- In FY24, we **successfully raised over £1.6bn of debt and equity** to support the Turnaround Plan, supported by funds managed by Macquarie Asset Management. This further supports the £1.1bn of equity raised in FY22



- The BP Resubmission requires equity of £650m and debt of £3,825m in AMP8
- Maintain gearing below 70% (post equity)
- Target credit rating of BBB+

Forecast Actual Company Gearing (%)



Notes: (1) £375m downstreamed to OpCo

Ensuring a Financeable and Investable Level of Return

- Midpoint WACC from the KPMG Club Project assumed (4.49%)
- Cost of Equity increase vs. the DD due to higher capex intensity and asset beta in addition to a higher aiming up adjustment
- Cost of Debt increase supported by a higher share of new debt, which is more expensive than embedded debt
 - Ofwat has indicated that at FD, it will set the CoD allowance to include 2024 APR data, supporting higher CoD given recent issuances

	Draft Determination	BP Resubmission
Cost of Equity	4.80%	5.76%
TMR	6.58%	6.84%
Equity Beta	0.60	0.69
Cost of Debt	2.84%	3.45%
Cost of New Debt	3.36%	3.96%
Cost of Embedded Debt	2.46%	2.88%
Share of New Debt	26%	26%
Appointee WACC	3.72%	4.49%
PAYG Rate (Weighted Average)	37.00%	35.19%
RCV Run-off Rate	4.18%	4.49%

Electricity Transmission Operators range (early view)
4.57 – 6.35%

Electricity Transmission Operators range (early view)
3.71 – 4.42%

Risk Framework

Enhancement Capex Framework

Standard		Delivery Mechanism	
Over/underspend trued-up at the end of AMP8 via midnight adjustment		If deliverability improves, companies can request access to funding on a yearly basis	
£1,840m Quantum	60 : 40 Sharing rate ⁽³⁾	£991m Quantum	N/A Sharing rate
Enhancement Engagement		Large Scheme Gated Process	
Lower sharing rates on over/under-spend and RCV true-up		Requires two formal gated submissions to develop more accurate cost estimations	
£1,202m Quantum	25 : 25 Sharing rate ⁽³⁾	£359m Quantum	0 : 0 (in dev.) 60 : 40 (once agreed) Sharing rate ⁽³⁾

Totex Over/Underspend Mechanism

Category	Over-spend/under-spend borne by company (OFWAT DD)	Over-spend/under-spend borne by company (SW proposal)	AMP8 DD allowed Totex (% of total)
Botex ⁽¹⁾	60% / 40%	50% / 50%	£2.6bn (26%)
Energy and wages unit prices: RPE true-up ⁽²⁾	0% / 0%	Accept DD	£0.4bn power £0.9bn wages (13%)
Business rates	10% / 10%	0% / 0%	£0.3bn (3%)

Aggregate Sharing Mechanism (ASM)

- New framework for AMP8, similar to OFGEM's RAMs framework
- For Totex over/underspend up to ± 2% of RoRE, Totex sharing rates apply
- Above ± 2% of RoRE, companies bear ½ of the Totex sharing rates

Performance and Incentives/Penalties (ODIs)

1% of RoRE = -£ 40m

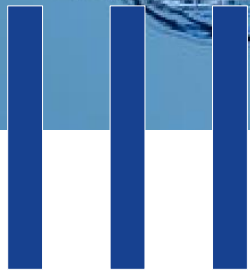
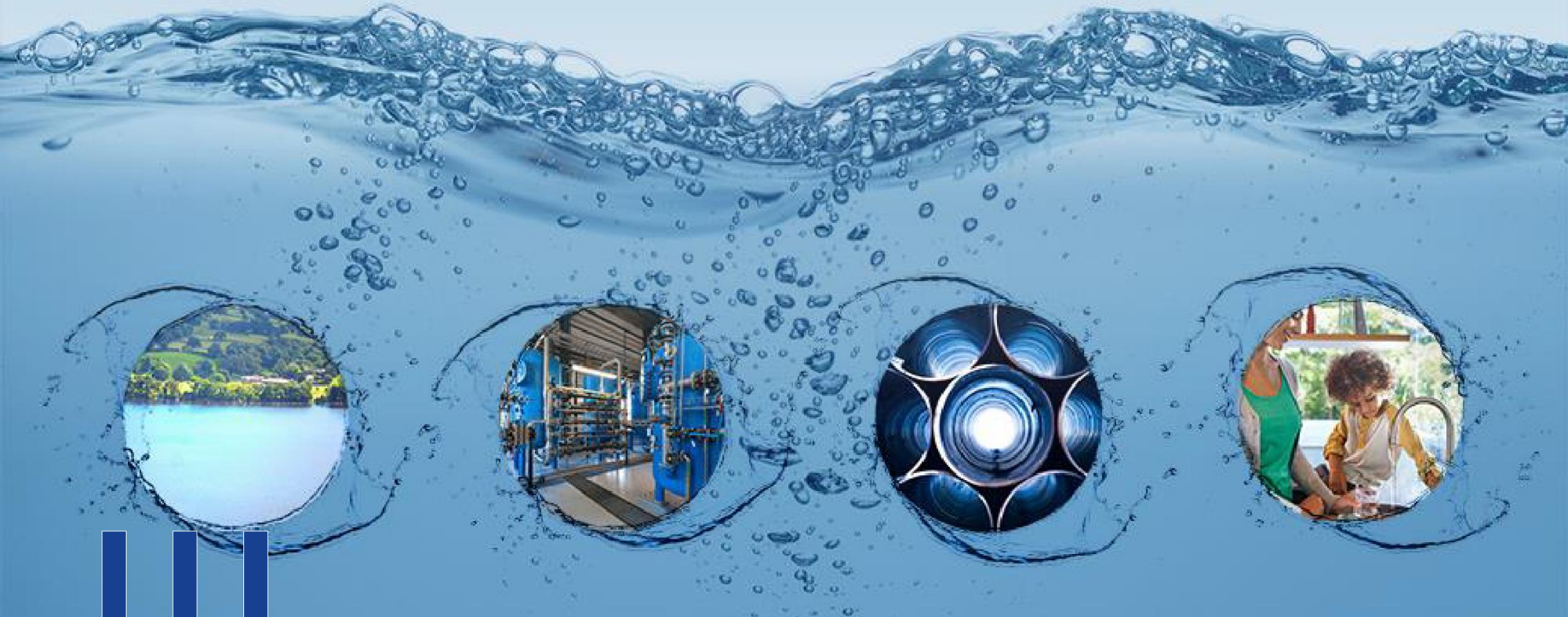
Key performance commitments	Units	Draft Determination			Southern Water performance / ambition		Annual caps / collars (% of RoRE)	
		Yr 1 of AMP8	Yr 5 of AMP8	Number of companies achieving this today	CY24/FY25	CY29/FY30	OFWAT DD	Response
Wastewater	Internal sewer flooding	ft / 10k connections	1.3	1.2	2	1.6	1.3	± 0.25%
	External sewer flooding	ft / 10k connections	17.1	14.0	4	15.5	14.0	± 0.25%
	Total pollution incidents	ft / 10k length	18.3	13.7	0	56.4	24.0	± 0.25%
	Sewer collapses	ft / 10k length	5.9	5.7	3	5.8	5.7	± 0.25%
	Treatment Works Compliance	%	100.0%	100.0%	0	99.1%	100.0%	± 0.25%
	Storm Overflows	Spills / overflows	17.6	13.3	0	18.0	14.3	± 0.25%
Water	Bathing water quality	% sites 'Good/Excellent'	89.1%	90.7%	2	74.1%	85.6%	± 0.25%
	Leakage	MI/d 3-year average	79.1	68.4	8	109.6	66.3	± 0.25%
	Unplanned Outage	% peak	3.2	2.1	16	3.1	2.1	± 0.25%
	Compliance Risk Index	score	1.8	1.0	9	3.2	0.0	± 0.25%
	Water Supply Interruptions	hh:mm:ss / property	00:05:00	00:05:00	4	1:14:34	00:04:30	± 1.0%
	Mains Repairs	# / 1k length	115.6	107.3	8	150.0	152.9	± 0.25%
Other							± 0.25%	
Total							See below	See below

- Accept OFWAT DD target
- Minor tweaks to OFWAT target
- Challenge OFWAT DD target

OFWAT proposed aggregate caps / collars: Up to ± 3% of RoRE, there is no sharing ie companies bear full downside/upside. Between 3-5% RoRE, the ODI impact is halved. Beyond ± 5% RoRE, companies only bear 10% of this

We have proposed to tighten these ranges: Up to ± 1.5% of RoRE, there is no sharing ie companies bear full downside/upside. Between 1.5-3% RoRE, the ODI impact is halved. Beyond ± 3% RoRE, companies only bear 10% of this. And that anything up to 1% of RoRE is adjusted from revenues (but targeted at vulnerable customers) and >1% RoRE is adjusted via end of AMP adjustment to RCV

Notes: (1) excl. RPEs for energy, wages and business rates; (2) (energy RPE was not included in AMP7); (3) company bear 60% of o/s and keeps 40% of u/s



PR24 Business Plan – Outputs



OpCo Cash Flow | Latest BP Resubmission¹

Injection of £650m of equity brings gearing to below 70% for the remainder of the plan

YE 31 March, £m	Covenant level				AMP8				
	PFI	Trigger	Default	Guidance	2026	2027	2028	2029	2030
RCV					8,393	9,621	10,542	11,265	11,592
Gross Debt					6,362	6,953	7,703	8,058	8,288
Closing Cash					170	417	385	217	281
Net Debt					6,192	6,536	7,317	7,841	8,007
Equity Injection					-	650	-	-	-
SWS metrics									
Class A Debt / RCV	75.0%	75.0%	95.0%		73.8%	67.9%	69.4%	69.6%	69.1%
Cash Headroom to PFI (£m)					103	679	590	608	688
Cash Headroom to Default (£m)					1,781	2,603	2,698	2,861	3,006
Class A Adjusted ICR (x)		1.30x			2.37x	2.04x	1.86x	1.72x	1.51x
Cash Headroom (£m)					186	161	141	127	76
Class A ICR (x)			1.60x		4.45	3.96x	3.72x	3.36x	2.96x
Cash Headroom (£m)					498	510	530	537	493
Class A PMICR (x)			1.00x		2.80x	2.50x	2.41x	2.27x	2.06x
Cash Headroom (£m)					314	325	352	387	385
Class A average adjusted ICR (x)		1.40x			2.09x	1.87x	1.70x	1.61x	1.51x
Moody's - Adjusted gearing				75.0%	74.3%	68.2%	69.4%	69.6%	69.1%
S&P - OpCo FFO / Debt				6.0%	10.3%	8.2%	8.0%	7.7%	7.6%
Fitch - Adjusted Gearing				77.0%	76.3%	69.9%	71.0%	71.1%	70.5%

Notes: (1) Source: Company response to Ofwat's Draft Determination, updated for subsequent financing timing assumptions

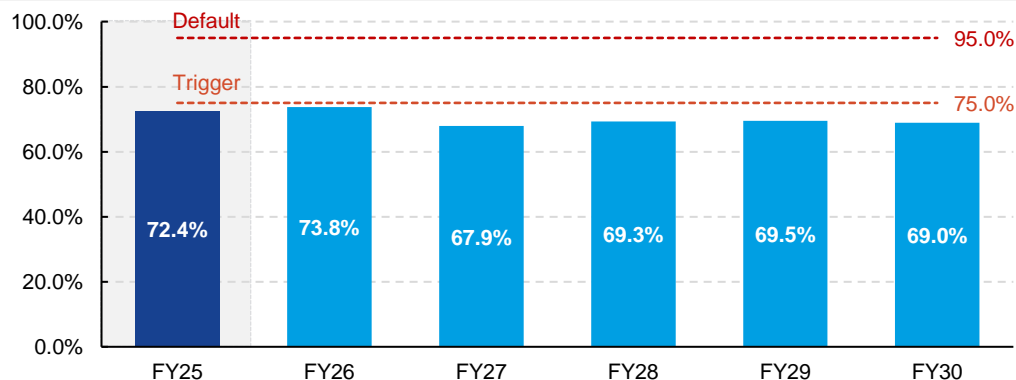
OpCo | Covenants and Trigger Event Outputs

Under the latest Business Plan, forecast gearing reduces to below the 70% threshold. There is sufficient headroom under ICR metrics across AMP8 for both Default and Trigger Ratios

OpCo Gearing (%)

AMP8 Avg: 69.9%

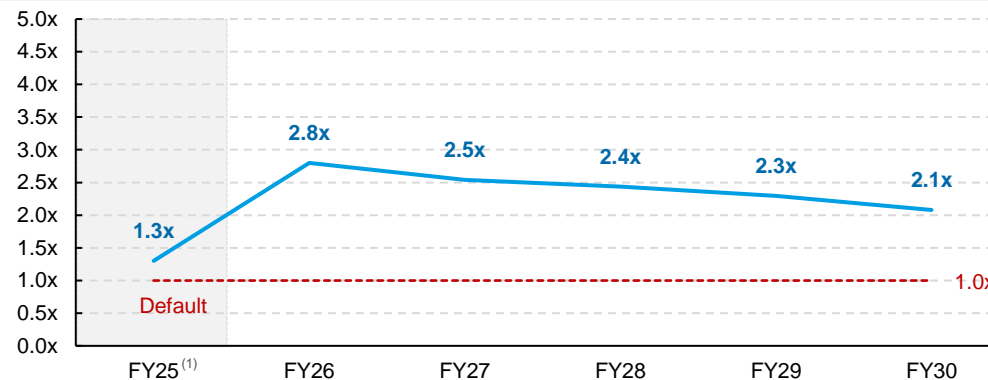
Equity had been sized to sustain gearing below 70% net debt/RCV. FY25 gearing is shown post the midnight adjustment



OpCo Post Maintenance ICR (x)

AMP8 Avg: 2.4x

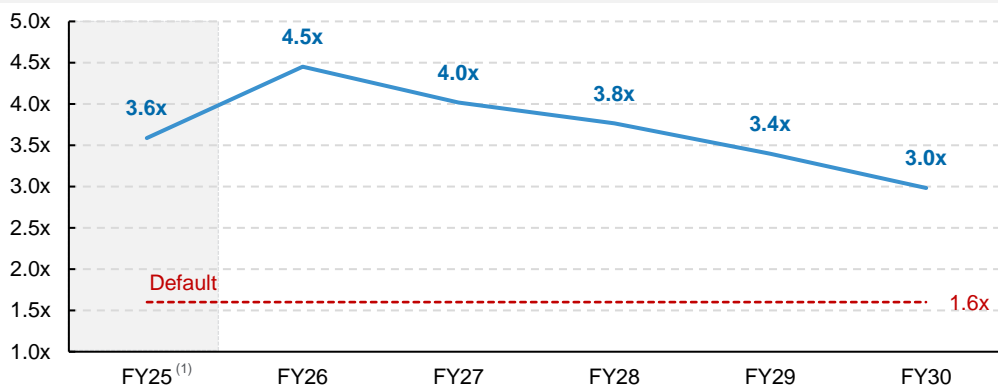
There is sufficient headroom over the financial ratios that relate to Event of Default covenants



OpCo Net Cash Flow ICR (x)

AMP8 Avg: 3.7x

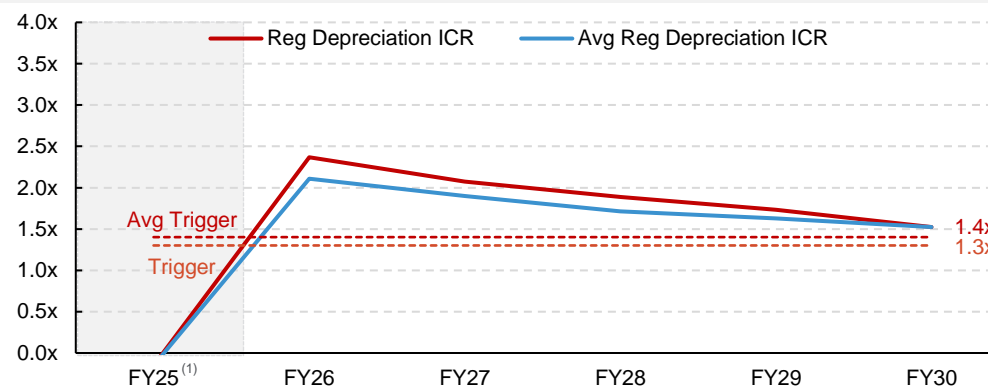
Headroom is maintained to the default level across AMP8



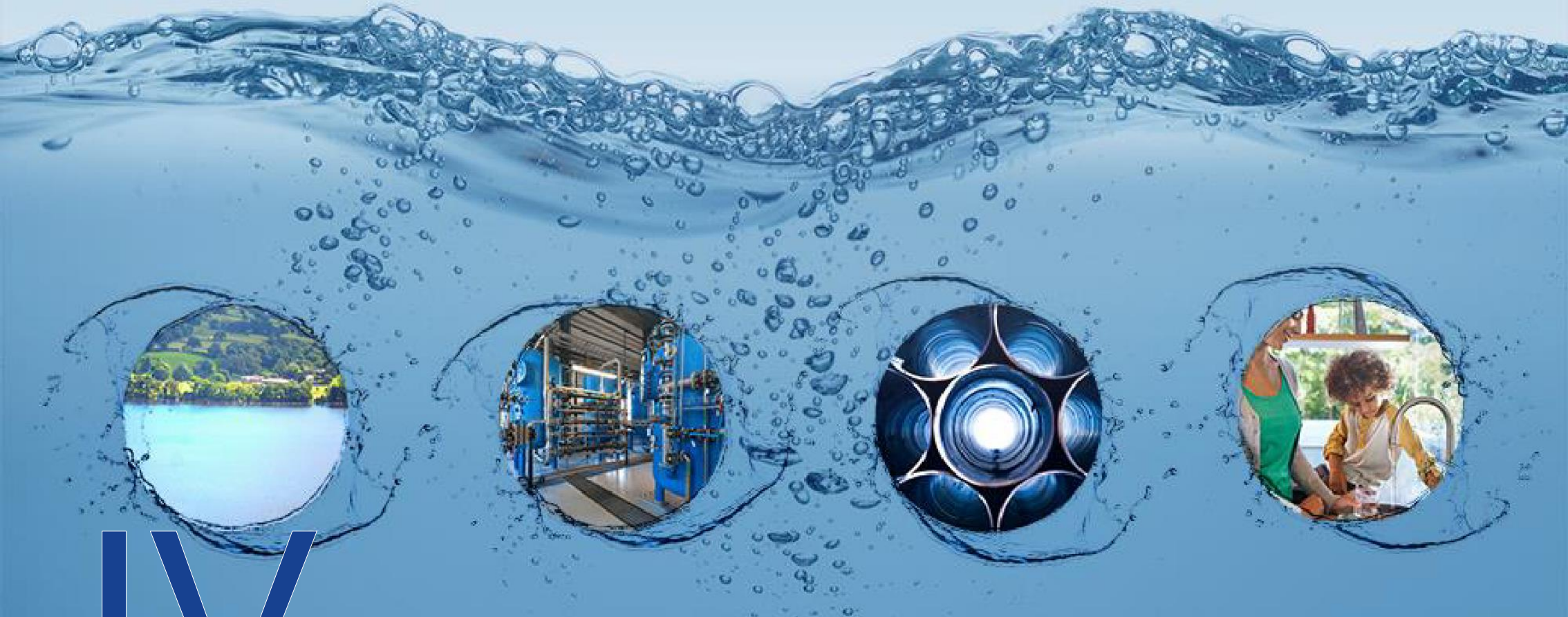
OpCo Reg Depreciation ICR (x)

AMP8 Avg: 1.9x

SWS is currently breaching the Trigger Event threshold related to the Regulatory Depreciation ICR ratio driven by higher opex, depreciation (due to higher RCV) and higher interest costs vs. allowed revenues which have been depressed by ODI penalties. This is forecast to improve from 2026 onwards



Note: (1) FY25 ICR ratios assume £29.3m of exceptionals consisting of (i) £16.7m related to exceptional weather and 'Clean River and Seas' projects, and (ii) £12.6m attributed to in-year costs for excessive groundwater



IV

Appendix



Our Investment Programme | Supporting Long-term Priorities

Trends



Growing population



Changing shape of communities



Evolving customer expectations



Increasing use of technology



Rising concerns over environment



Climate emergency

Challenges



Water scarcity



Increased flooding



Meeting customer expectations



Affordability



Decarbonisation



Reputation



Scope of ambition

Priorities



Ensuring a reliable supply of high-quality water for the future



Protecting and improving the environment



Understanding and supporting our customers and communities



Enabling and empowering our people



Renewable power generator

Enablers



Collaboration



Technology and innovation



Resilience

Strategic delivery themes

Water

Provide extra water supply

Make our supplies more resilient to severe drought

Reduce leakage

Lower water use in homes and businesses

Improve water quality

Wastewater

Network flow management to reduce flooding and spills

Recycling wastewater and nutrient removal

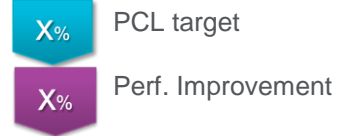
Asset health and resilience

Bio-soil disposal

Performance commitments

How the Plan Delivers For Customers

The Plan will meet our regulatory and statutory obligations and deliver customer priorities



Supply Resilience

62%

- Significantly increase the resilience to 62% of our customers – five sites
- Once-in-a-generation investment in site and drought resilience
- Reduce drought risk by 2034 on Test and Itchen – +90Mld
- New sustainable sources of water with a reservoir and 5 water recycling plants

Leakage

35%

- WRMP24 & AMP8 investment plans include full smart metering roll out
- Replace 300km of mains
- Enhanced leakage improvement
- Trajectory to reach UQ from FY27

PCC

7%

- Our PCC among the lowest since 2019/20
- Our targets for AMP8 keep us above UQ in l/p/d

Supply Interruptions

50%

- Improve underlying performance by 50%
- Go from 01:14:34 in 2024/25 to UQ 00:04:30 in 2029/30⁽¹⁾ (actual reduction of 94%)
- Biggest improvement in the industry
- Propose enhanced GSS throughout AMP8
- Residual risk of incidents in AMP8 while delivering major investment programme

Sewer Flooding

15%

- Fourth biggest improvement from 2024/25
- Close to UQ rate of reduction
- Activities in our plan support this level of stretch

Nutrients

73%

- WINEP addresses new targets for river water quality
- 1000km of rivers improved
- Removing nutrients, like phosphorus (73% removal) and nitrogen, across 143 works

Pollution

57%

- Targets result in biggest improvement from 2024/25
- Forecast reduction greater than industry UQ rate
- Activities in our plan support this level of stretch but will not meet the Ofwat target
- Funding for enhancement power and infiltration resilience investment is critical to achieving target.

Storm Overflows

21%

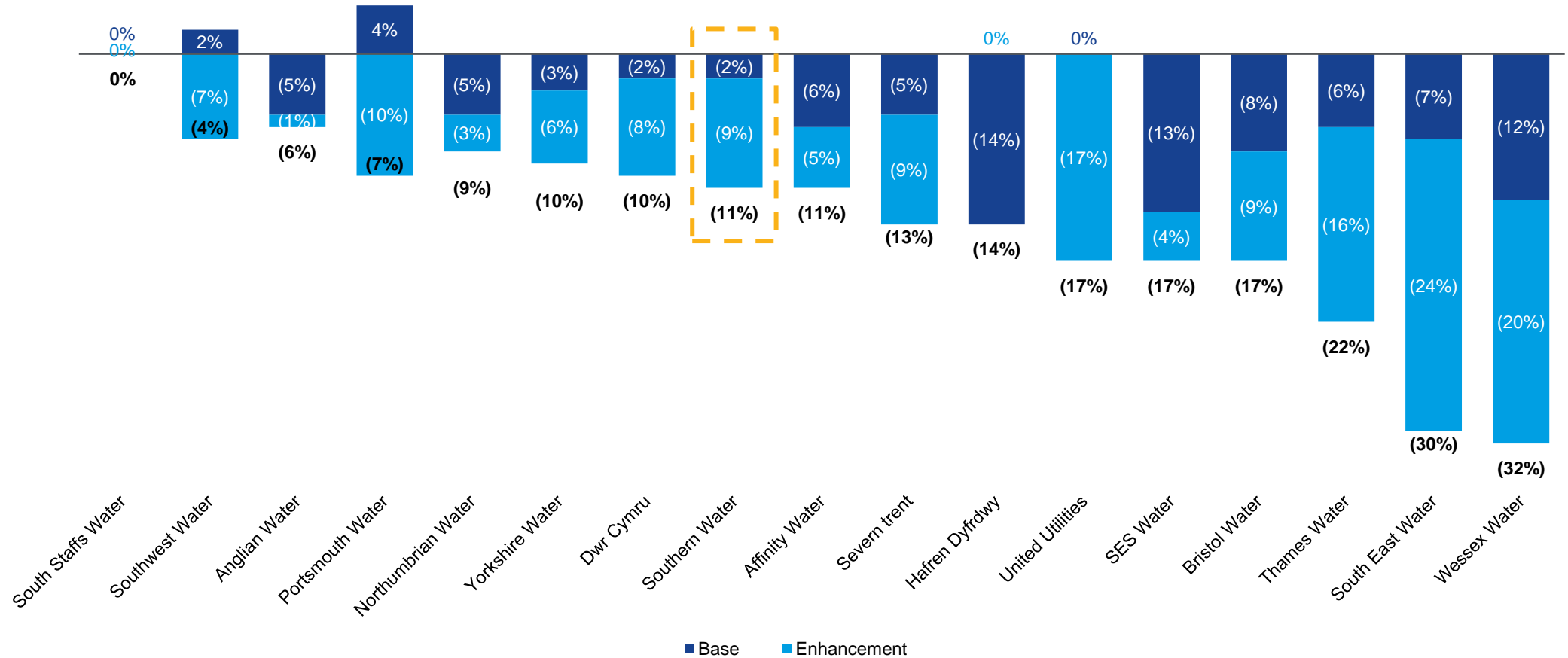
- Updated WINEP to meet EA's changes
- 70% sustainable solutions embedded
- Target for monitored spills remains top 2 in the industry
- Reduce avg. number of monitored spills per overflow from 18 in 2024/25 down to 14.3
- Industry UQ 16.5 monitored spills in 2029/30
- Stretching but realistic uptime remains at 97%
- Backed by learning from AMP7 Pathfinders

Notes: (1) Excludes exceptional events; (2) PCL = Performance Commitment Level

Recap of DD Outcome | AMP8 Allowed Totex vs October BP Submissions

SWS' 11% reduction was lower than industry average of 16%. Most companies have submitted a higher Totex than original BP given increases in scope and unit costs

Ofwat DD cuts vs. Company BP Submissions (%)



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