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Annual Investors’ Update

11th July 2018

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Croeso

Welcome

Chris Jones, Chief Executive

Introduction

Chris Jones, Chief Executive

Financial results and financing update

Peter Bridgewater, Finance Director

Roger Morgan, Treasurer

Operating performance

Peter Bridgewater, Finance Director

Storm Emma & PR19 preparations

Chris Jones, Chief Executive

Q&A

Film


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Financial results and financing update
Peter Bridgewater, Finance Director
Roger Morgan, Treasurer

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Preliminary Results - 2018

Best credit ratings in the utility sector

£415m
capital investment

2017: £325m

£319m
operating costs

2017: £313m

£12m
accounting loss

2017: £70m loss

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Totex - extract from the Annual Performance Report

	2017/18 Totex			AMP6 Totex		
	Wholesale	Retail	Total	Wholesale	Retail	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Allowed totex at outturn prices	575	63	638	1,699	179	1,878
Actual totex at outturn prices	646	65	711	1,688	197	1,885
Difference	**(71)**	**(2)**	**(73)**	**11**	**(18)**	**(7)**

- Wholesale:
  - the Totex overspend for Wholesale during 2017/18 reflects the catch-up on capital spend versus its original profiling for the AMP6 period plus additional discretionary capital spend.
  - meeting our Wholesale "Opex determination"
- Retail: we have made a conscious decision to spend more than our Final Determination (FD) on Retail in order to continue to improve our customer service
- Overall: meeting FD

Meeting our AMP6 Totex determination

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Cashflow and net debt

Year ended 31 March (£m)	2018	2017
Revenue: RPI(2.2%) + K(-0.2%) + WRFIM*(-1%) = 1%	757	744
Operational expenditure	(319)	(313)
EBITDA (before IRE)	438	431
Net interest payable (inc. indexation)	(172)	(143)
Capital expenditure (net of grants & contributions)	(415)	(325)
Net working capital movements	(52)	(34)
Decrease/(Increase) in net debt	(201)	(71)

Increasing capex delivery/spend driving higher net debt

**Wholesale Revenue Forecasting Incentive Mechanism, the means by which an over- or under-recovery of a prior year's revenue cap is adjusted for in current year bills. In this case the adjustment relates to an over-recovery of some £6m in 2015/16*

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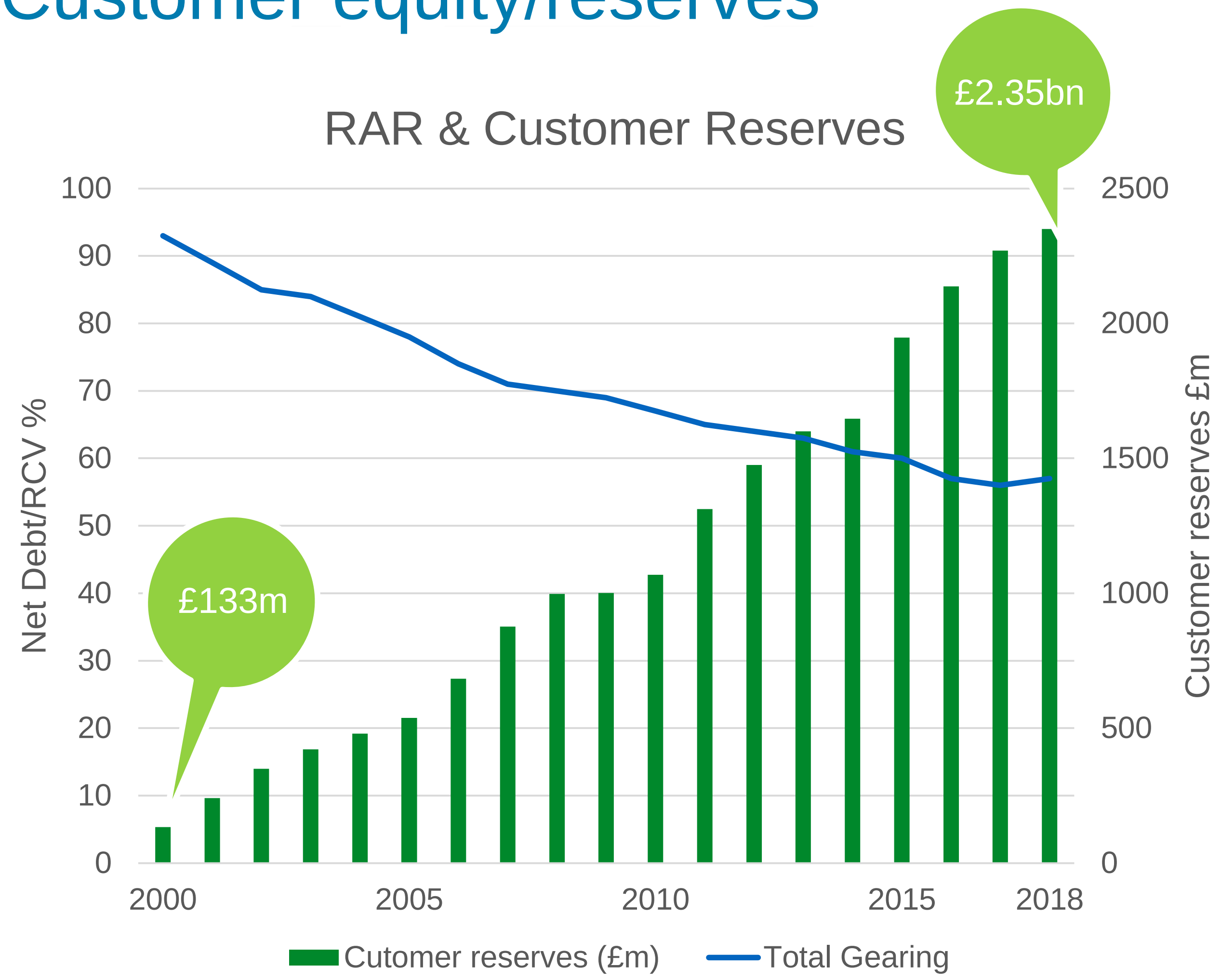
Customer equity/reserves



As at 31 March (£m)	2018	2017
Regulatory Capital Value (RCV)	5,468	5,217
Net debt	(3,118)	(2,947)
Financial reserves	2,350	2,270
Gearing	57%	56%

Significant customer equity/reserves (£2.35bn as at 31st March 2018)

Continuing prudent financial management

Financing activity

2017/18

May 2017	Drawdown of £60m KFW loan facility (10 year floating, amortising after 5 years)
Nov 2017	Barclays £40m RCF to replace JP Morgan taking total to £170m (all undrawn)
Jan 2018	£300m bond issue at 2.5% fixed until 2036

- **AMP6 funding needs met**

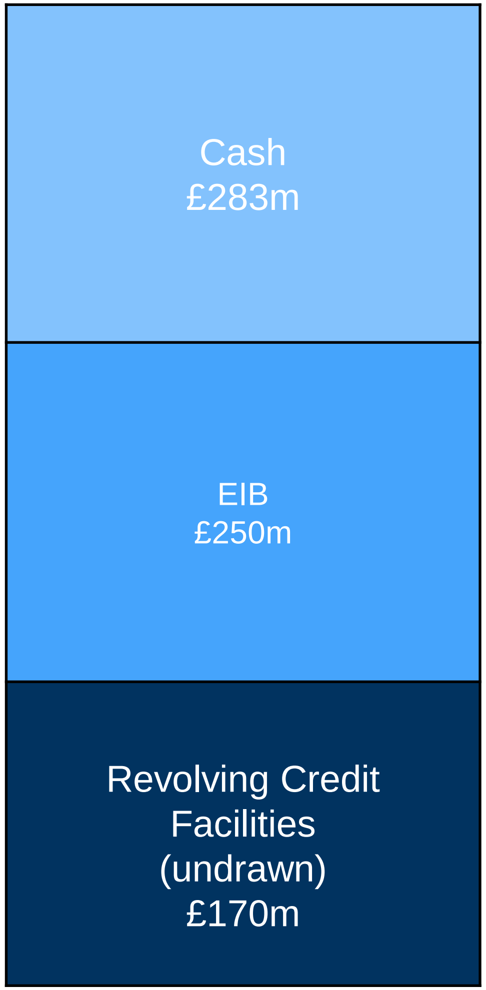
Forward planning

Sep 2018	STID proposal for CayCo unwind
Nov 2018	CayCo unwind
Dec 2018	Drawdown of £250m EIB loan (15 year floating amortising after 10 years)
Post CayCo	Considering a deferred issuance to part refinance 2021 bond maturity @ 6.9% coupon

Excellent ongoing capital markets access

Liquidity – as at 31 March 2018

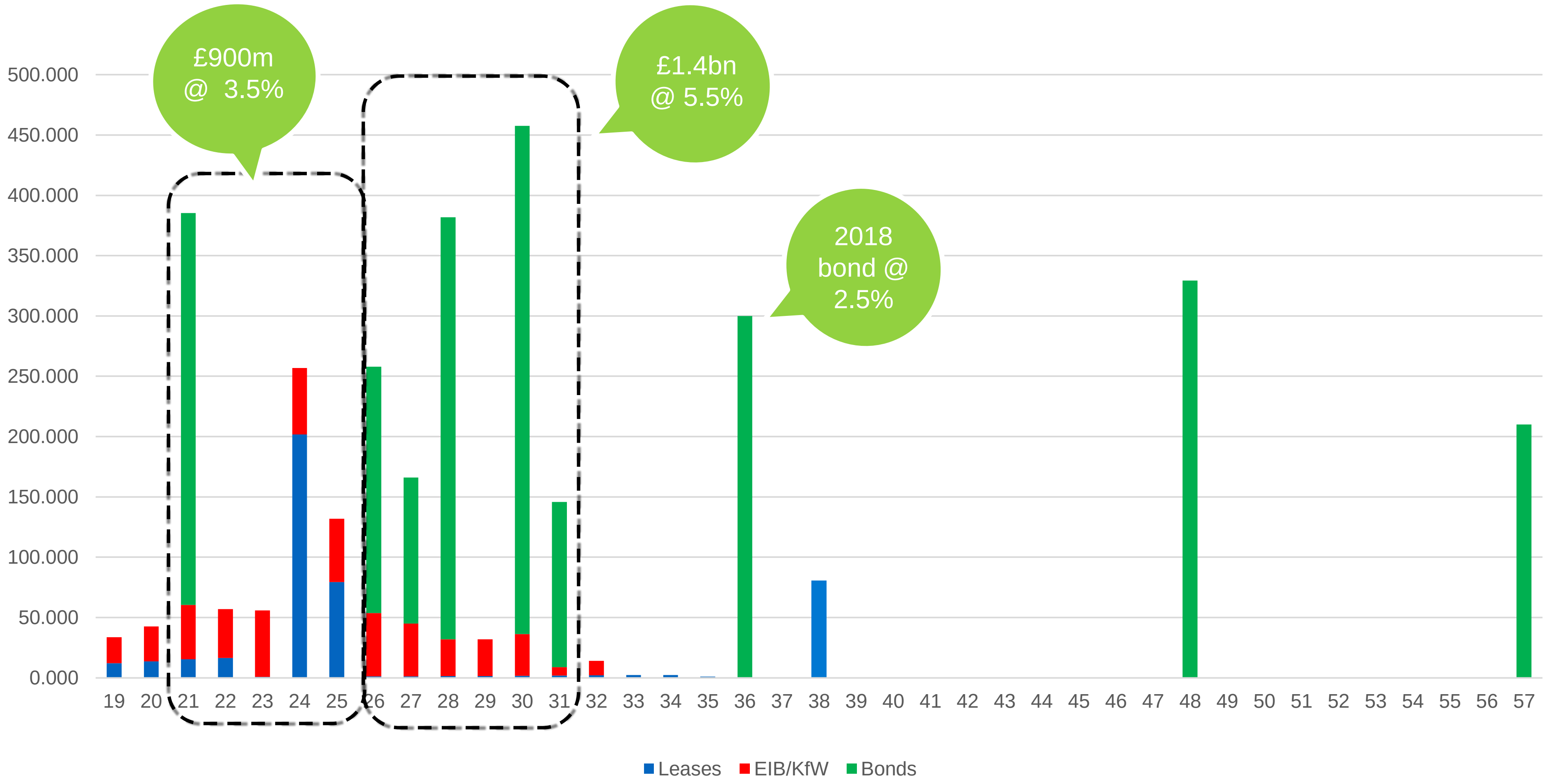
Liquidity as at 31 March 2018
£703m



- Revolving credit facilities available until 2020
- £250m AMP6 loan funding agreed with EIB and available until January 2019
- Prudent investment policy for surplus cash continues with deposit maturities limited to maximum of one month, with counterparties rated minimum A-

Strong liquidity position of £703m at 31 March 2018 – at least 3 years' financing needs

Maturity profile of debt



Reducing our cost of debt significantly over the next 2 AMPs

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Summary

- Robust 2018 financial performance in line with business targets
- Overall expenditure is on track to deliver AMP6 allowed Totex
- Capital programme continued to accelerate with capex outturn of £415m and expected to be on track for the remainder of the AMP
- AMP6 funding requirements met following the raising of £300m at 2.5% through the debt capital markets in 2018
- Regulatory gearing 57% - consistently maintained below 60% gearing policy. Slight YOY increase (2016:56%) in line with the Group's increased capital spend
- Strong liquidity in place, continue to focus on additional longer-term funding options to address funding requirements for AMP7

Operational performance

Peter Bridgewater, Finance Director

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CCWater - Water Matters: Draft July 2018

95%
colour & appearance

8.15/10
trust
Welsh Water

85%
tackling sewer flooding

93%
taste & smell

98%
reliability

89%
pressure

Strong customer support

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Operational performance

Water Supply	Performance
• Continued improvement in water use leakage targets (175.4 Ml/d to 172.8 Ml/d) • 99.9% compliance with drinking water standards • Weather related water supply interruptions increased to 43.3 mins (2017:12.15 mins)	• ODI rewards earned of £2.4m • Ranked fifth in Ofwat's SIM table of customer satisfaction • 41% reduction in written complaints from 6,582 to 3,862
Environmental	**Customer Support**
• Marginal reduction in pollution and sewer flooding incidents to 333 (2017:353) - still below FD targets to 2020 • 47 'Blue Flags' for Welsh bathing waters	• Broken through 100k target of social tariffs to help disadvantaged customers

Achieving strong operational performance

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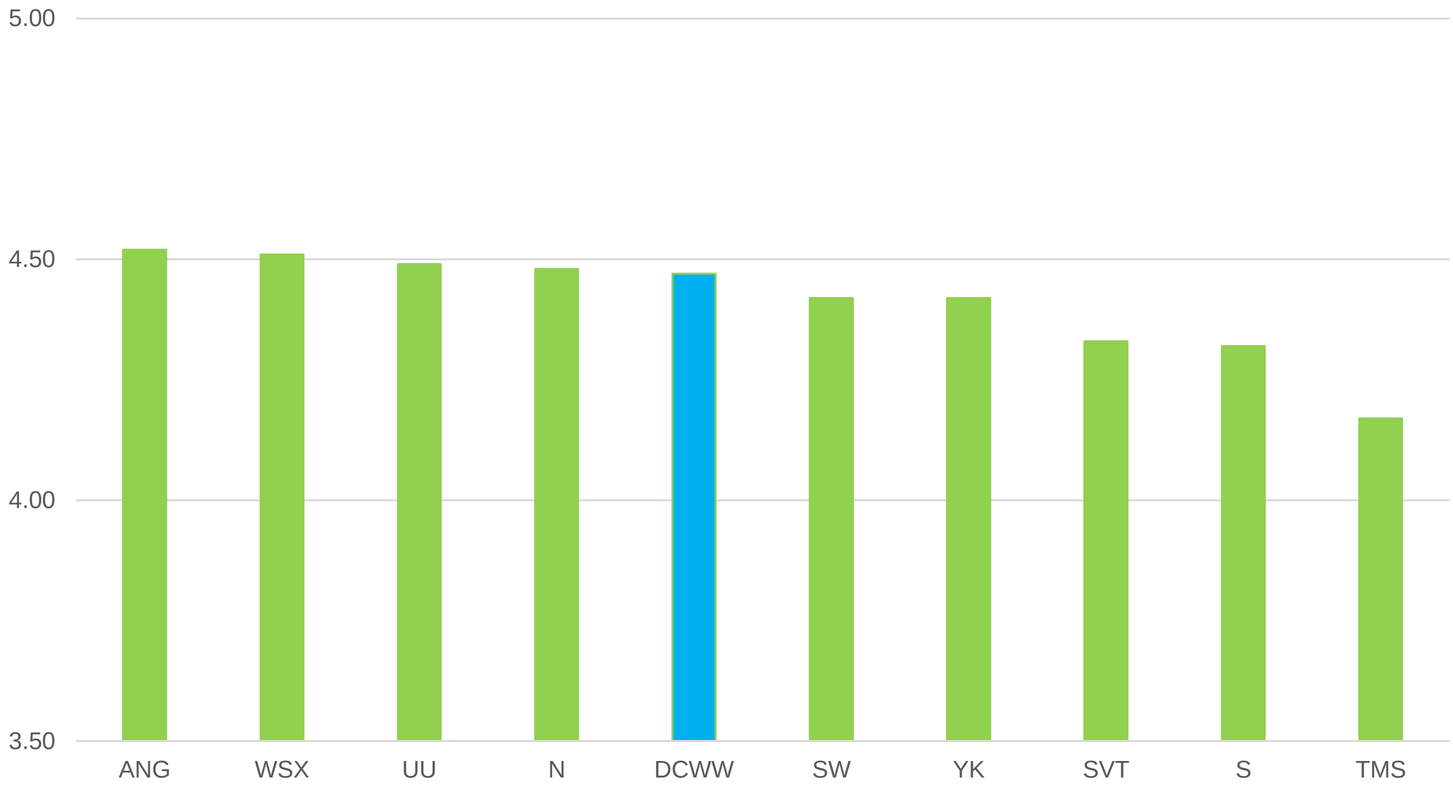
Operational performance – Customer satisfaction 2017/18

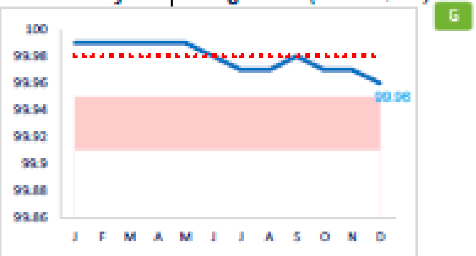


Q1 scores for 2018/19 show that we have moved to 2nd place compared to other water and sewerage companies

Ofwat ODIs (Outcome Delivery Incentives)

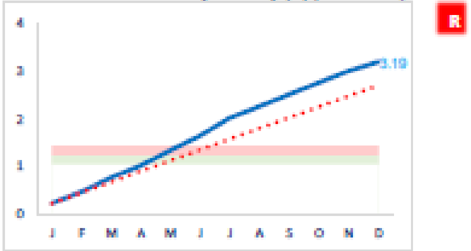
Charts for the year

A1b - Safety of Drinking Water *(Actual MZC)*



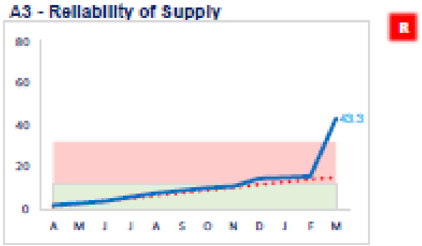
Penalty: £2.5m per 0.01% per year within the penalty zone
Maximum £10m pa "in year" penalty. c
2017 year end – ODI Penalty deadband

A2 - Customer Acceptability (appearance, taste & odour)



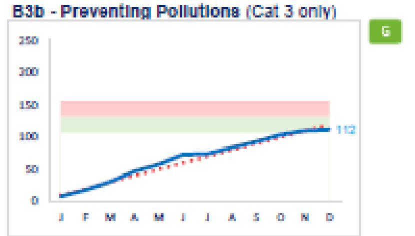
Penalty/Reward: £930k per 0.1 contacts per 1,000 population.
A Maximum of £1.86m pa "in year" penalty or reward. c
2017 year end – ODI Penalty of £1.86million

A3 - Reliability of Supply



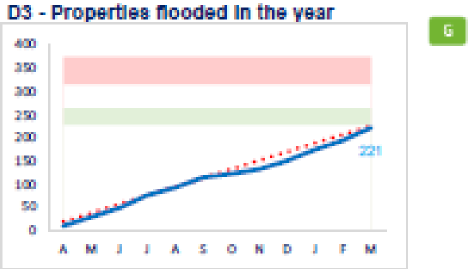
Penalty/Reward: £0.195m per minute.
Reward Max £2.34m pa "in the year"
Penalty Max £3.9m pa "in the year".
2017 year end – ODI maximum Penalty of £3.9million

B3b - Preventing Pollutions (Cat 3 only)



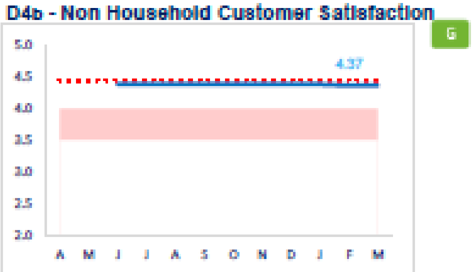
Penalty: £0.400m per incident (Max of £10m pa)
Reward: £0.047m per incident (Max of £1.175m pa). c
2017 year end - ODI Reward payment of £0.893million

D3 - Properties flooded in the year



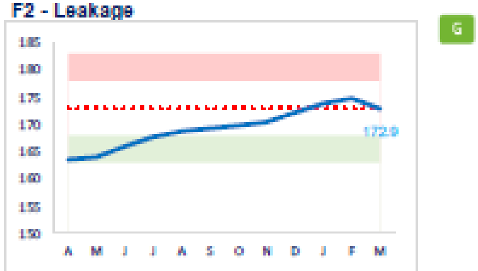
Penalty: £0.161m per property
Reward: £0.062m per property.
2017 year end – ODI Reward £1.488million

D4b - Non Household Customer Satisfaction



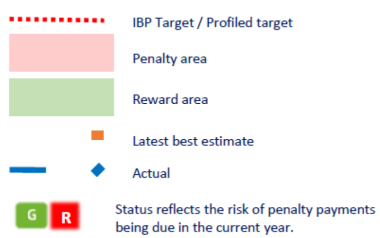
Penalty: £1m per 0.1 points scored (Max £5m pa).
[Opinion Research Services commissioned to carry our survey]

F2 - Leakage



Penalty: £1.84m per Ml/d (Max £9.2m penalty pa)
Reward: £0.92m per Ml/d (Max £4.6m reward pa).

Key



Net ODIs broadly neutral (net penalties of £0.1m) had it not been for the severe weather in March 2018 disrupting supply (£3.3m)

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Return of Value - 2018

£40m
(2017:£33m)

- **£7 million** to help reduce the risk of flooding in Cardiff West & Bay
- **£5 million** towards improving the reliability of our water network in areas such as Rhondda Fach and Anglesey
- **£9 million** to adapt our dams to meet challenges of climate change
- **£6 million** to improve our business systems
- **£7 million** to help fund support for our lowest-earning customers to help pay their water bills
- **£6 million** to reduce the risk of a major water supply loss in Hereford

Focus on discretionary spend to further improve service to customers

Non-regulated activities

- Acquisition of energy from food waste plant in December 2017

- Considering investment in other minor activities to utilise existing resources (no further material funding expected)

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Operational performance - summing up

- ODI rewards of £2.4m
- Underlying ODI penalties of £2.5m
- Severe weather penalties £3.3m

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Storm Emma & PR19 preparations

Chris Jones, Chief Executive

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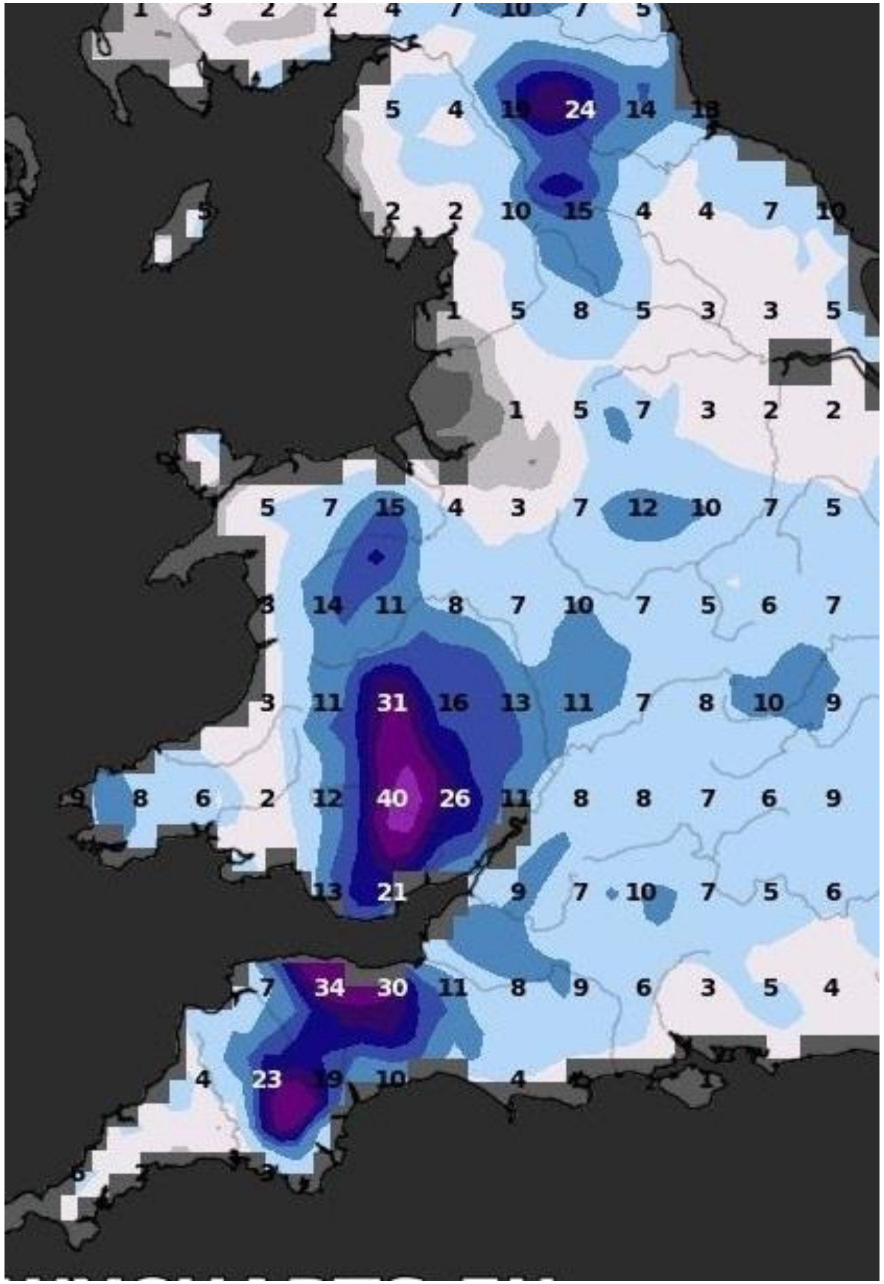
Storm Emma

- Four days of sub-zero temperatures followed by red warning
- -12°c recorded in Wales
- Wales bore the brunt of the Met Office 'Red Warning' for snow and high winds
- Deep and drifting snow
- Further snowfall and poor conditions a week later



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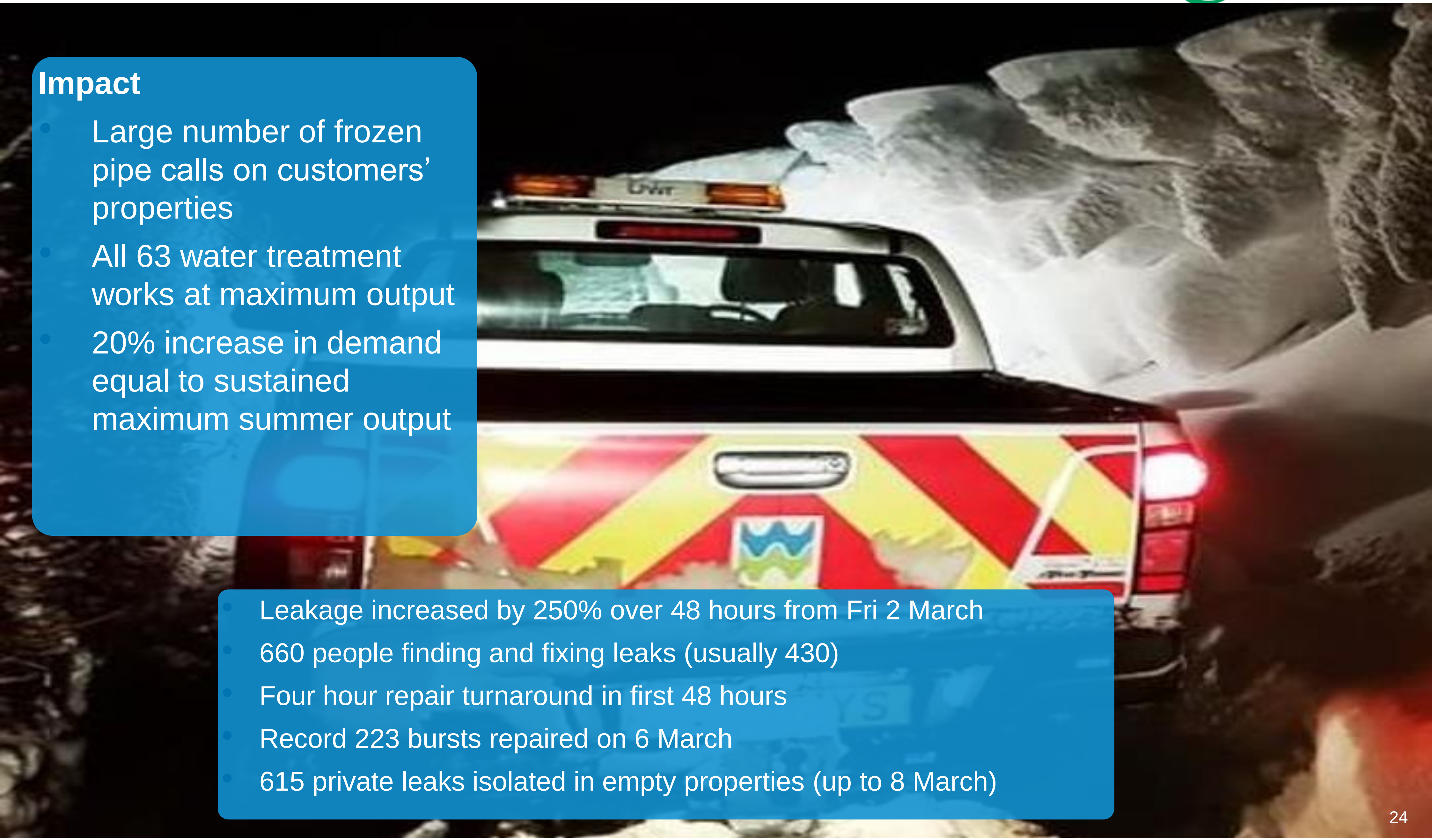

Impact

- Large number of frozen pipe calls on customers' properties
- All 63 water treatment works at maximum output
- 20% increase in demand equal to sustained maximum summer output

- Leakage increased by 250% over 48 hours from Fri 2 March
- 660 people finding and fixing leaks (usually 430)
- Four hour repair turnaround in first 48 hours
- Record 223 bursts repaired on 6 March
- 615 private leaks isolated in empty properties (up to 8 March)

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28 Sept Report to Ofwat

Lessons Learned

- Localised customer communication
- Increased remote network monitoring in the affected rural areas (4k already in place across Wales)
- Increase our own 'snow clearing' capability – to reduce reliance on 'stretched' local authorities
- Faster bottled water deployment
- Reviewing 2020-25 investment plans in light of recent events

Challenging times for the water sector

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Backdrop to PR19

PR19

THE INDEPENDENT

Water watchdog Ofwat growls at industry… but will it bite?

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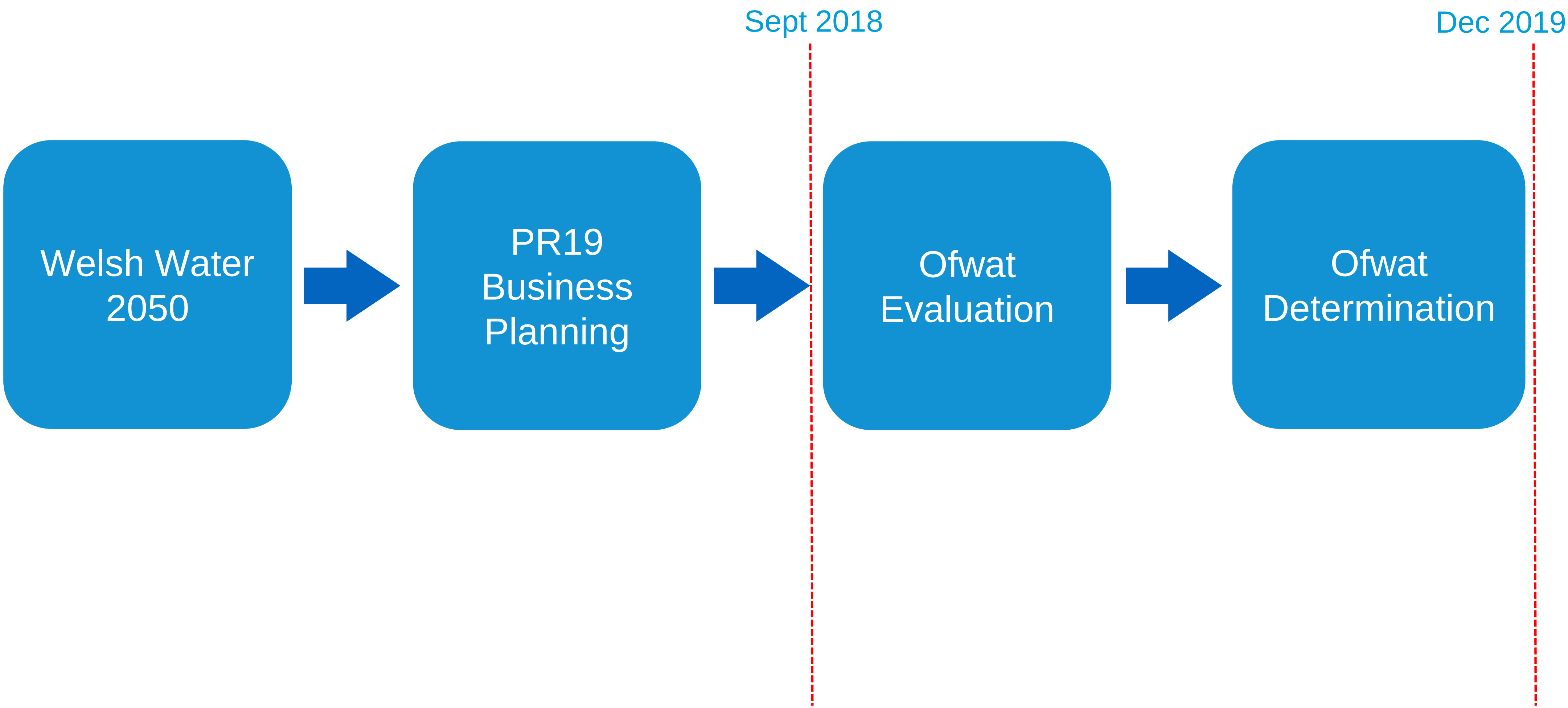
Where are we now?



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PR19 preparations

Highlights

- Ofwat indicates a tough affordability challenge with bill reductions
- Cost of new debt will be adjusted to actual interest rates
- Overall cost of capital expected to be lower than PR14: AMP7 WACC (real to RPI) expected to be 2.4% (per Ofwat 13 December 2017)
- Ofwat are targeting a maximum of 70% gearing
- Botex (opex plus base maintenance) allowance based on econometric modelling
- Ofwat will model Totex where possible (based on CMA case example)
- Greater revenue at risk via outcome delivery incentives, range 1% to 3% of RORE, (for rewards and penalties assuming a neutral plan)

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PR19 preparations continued…

Upstream reforms

- Bio resources sludge assets (RCV £205m) and water resources assets (RCV £182m) have been revalued and submitted to Ofwat
- Significant investment in sludge assets planned for AMP6 (£142m). The Group is well-placed to take advantage of opportunities in sludge markets

Small impact on the business

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Research and engagement in numbers

Around 30,000 customers engaged in past 12 months

2,600 1-2-1 interviews with customers

64 focus groups with household customers

1,200 interviews with non-household customers

10 focus groups with non-household customers

20,000 customers respond to Have your Say

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Overall messages for Business Plan

Customer priorities	Welsh Water response
Affordability is key priority, but no overriding desire to reduce bills	Average household bill to fall (Ofwat expect £15 - £25 reduction)
No reduction in service is acceptable even if bill falls	Maintain or improve service levels
Safe, clean drinking water a given	Core priority
Support for vulnerable customers and those struggling to pay	Social Tariffs & Vulnerable Customer Strategy
Support for investing in long term	- New "Resilience" MOSs and commitment to report on WW2050 - Maintain low gearing
Company needs to be efficient and innovative	- Major efficiency drive - Our cost of debt is falling
Expectation company educates customers and is more visible in communities and "good citizen"	New MOS & Strategic Responses in WW2050


Thank you

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Appendices

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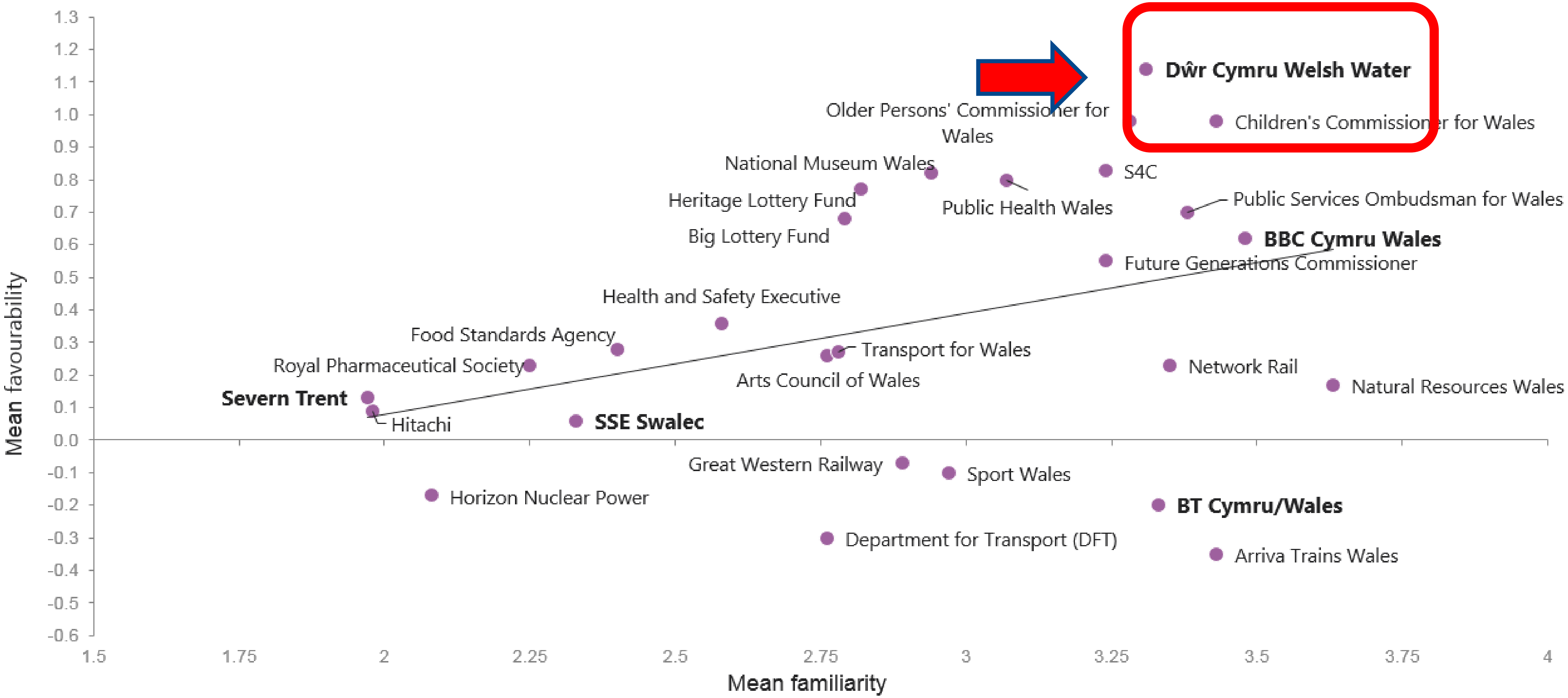
Welsh Assembly members hold the business in high esteem



Base: All AMs asked (familiarity, 26), All AMs who have heard of organisation (favourability), Winter 2017

Ipsos MORI Survey of Welsh Assembly Members, Winter 2017

Ipsos MORI
Reputation Centre

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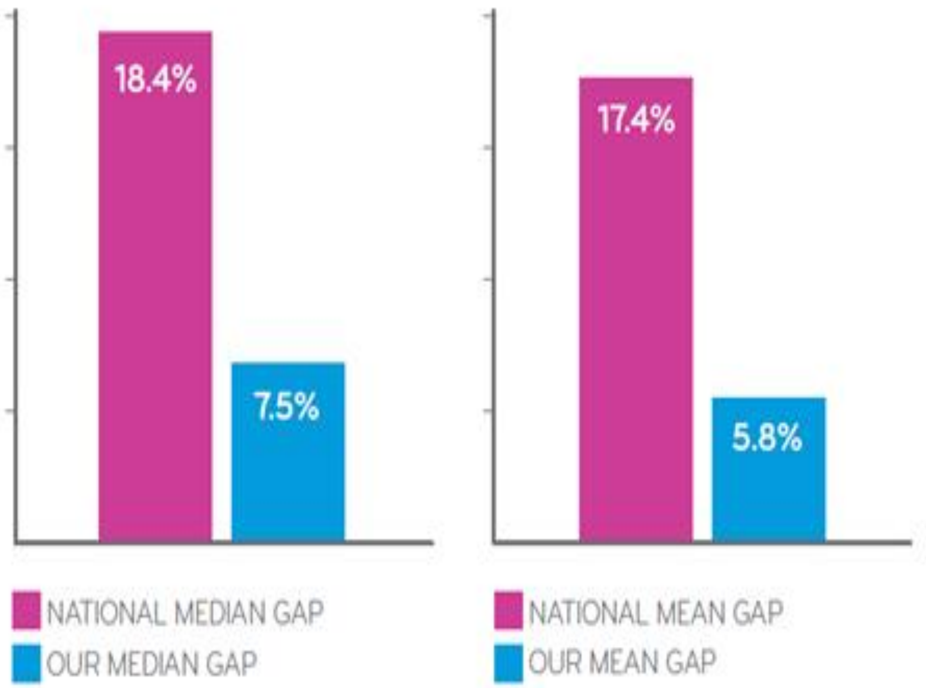
Gender pay gap - Welsh Water



MEDIAN The difference between the midpoints in the ranges of male and female pay

MEAN The difference between the average of male and female pay

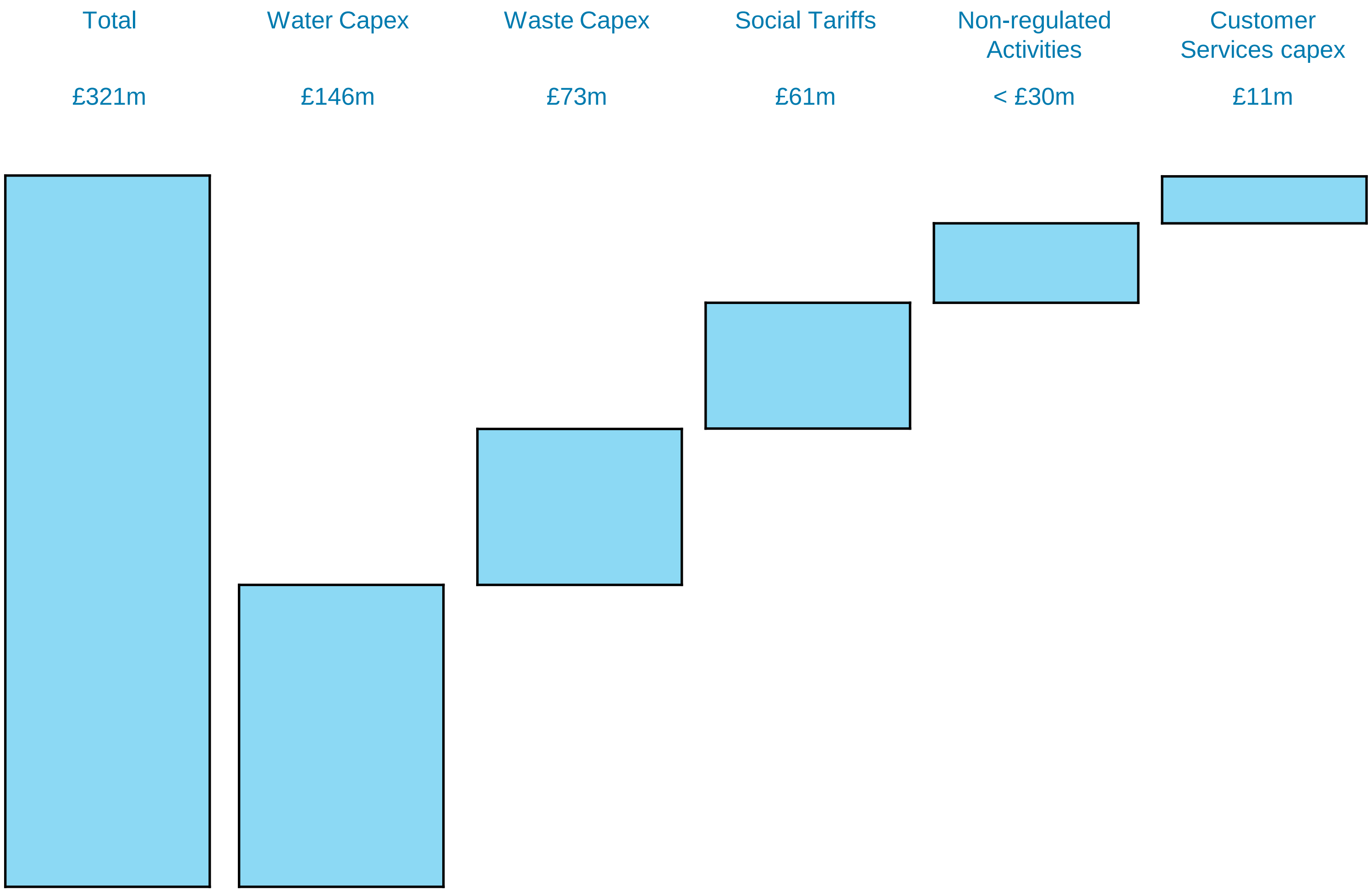
Next Steps

We have set out a specific action plan over the next 12 months to become a more inclusive workplace by:

- Providing training
- Promoting diversity
- Working in partnership
- Engaging young people

AMP6 indicative distribution policy

Customer distributions: High-level AMP6 allocation



Operational expenditure

Year ended 31 March	2018 £m	2017 £m
Employee costs	97	86
Power	43	41
Chemicals, materials and equipment	15	15
Water and sewerage contractors	19	19
Severe weather costs	3	-
Other outsourced costs	38	39
Bad debts	22	23
Laboratories and analytical services	1	1
Vehicles and plant	9	8
Office and property costs	12	10
Insurance	4	6
Collection commissions	4	4
IT contracts	11	16
Research and development credit	(1)	-
Rates	27	30
Regulators' charges	15	15
Total operational expenditure	**319**	**313**

- Increased employee costs have resulted from increased operational demand and additional roles in the wholesale and retail divisions. The increase is already being addressed as part of the AMP7 change programme
- Power cost increases of £2.3m due to higher prices have been offset by lower carbon reduction charge of £0.4m
- Severe weather costs as a result of storm Emma comprises £1.7m customer compensation payments and £1m additional costs paid to water and sewerage contractors
- Other outsourced costs include £4.5m agency staff costs
- Lower bad debt provision continues to reflect the company focus on improved collection performance
- Insurance costs reduced: lower premiums/claims £1.1m and credit of £0.5m for cryptosporidium claims from 2005
- £5m YOY reduction in IT costs: 2017 was a transition year with two contracts running in parallel (resulting in one-off additional costs of £2m). During 2018 the new contract resulted in savings of £3m
- **Wholesale opex on track to deliver AMP6 allowed Totex. Overall operational costs have increased by 1.9% (including RPI)**

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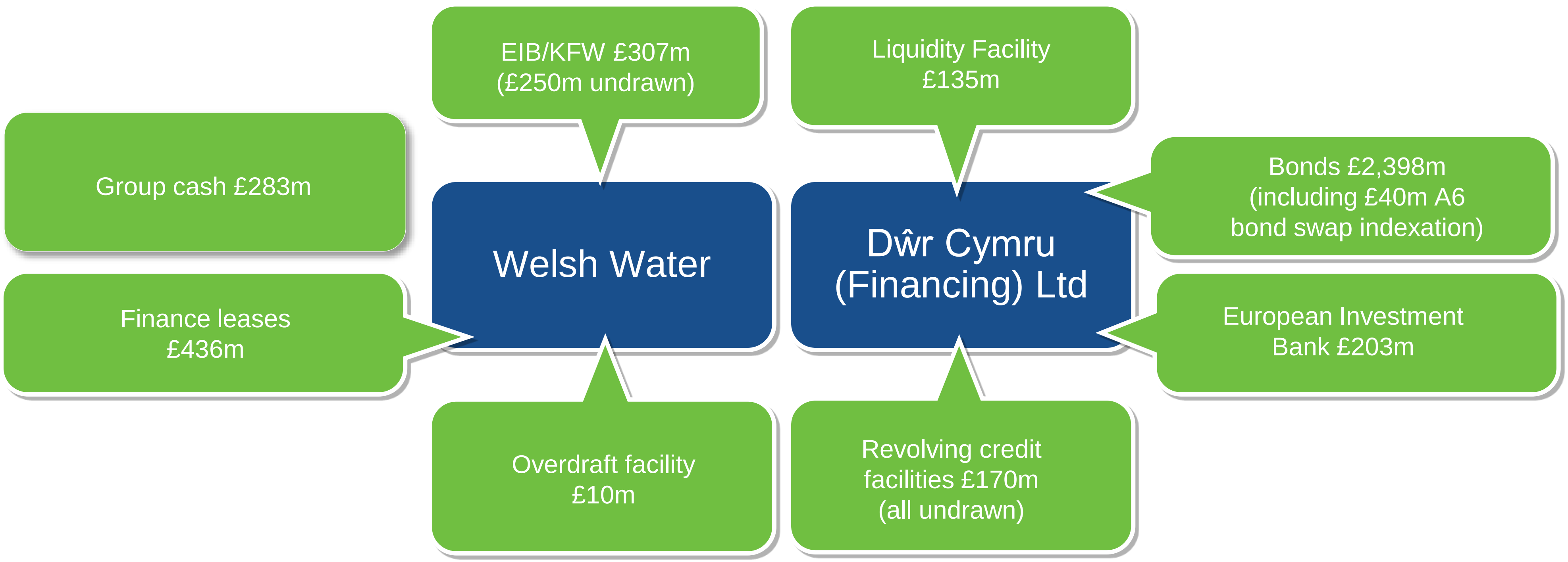
Net interest payable

12 months to 31 March (£m)	2018	2017
Fixed rate bonds	45	44
Index-linked bonds	42	41
EIB and KfW loans	3	3
Finance leases	3	3
RPI PAYG inflation swaps	24	14
Fixed interest swap	10	10
Financial guarantee fees	4	4
Other interest costs	4	2
RPI indexation of bonds & EIB loans	54	31
Interest receivable	(4)	(4)
Net interest payable	185	148
Pension scheme interest charge	3	2
Interest capitalised (IAS 23)	(16)	(10)
Total per IFRS accounts	172	140

- Indexation charge based on higher RPI of 3.6% (2017: 1.9%)
- Average nominal interest cost of 6.2% (2017: 5.1%)
- Indexation of £54m for bonds/EIB loans is split: Bonds £44m and EIB £10m

Glas Cymru - financing structure 31 March 2018



*£30m held at Glas Cymru Holdings Cyfyngedig level.

Financing: capital structure as at 31 March 2018

Rating	Class	Type	Interest rate %	Expected maturity	(£m)
A/A2/A (Assured Guaranty wrap)	A1	Fixed	6.015	2028	350
	A4	RPI	3.514	2030	421
	A5	LPI	3.512	2031	137
	A6	Fixed (RPI swap)	(1.35%)	2057	140
A/A2/A	B1	Fixed	6.907	2021	325
	B3	RPI	4.377	2026	205
	B4	LPI	4.375	2027	121
	B5	RPI	1.375	2057	70
	B6	RPI	1.859	2048	329
	B7	Fixed	2.500	2036	300
Bonds					2,398
Finance leases					436
European Investment Bank and KfW					510
Other debt					1
Gross debt					3,345
Accrued interest					57
Cash					(283)
Net debt					3,119

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Debt characteristics

Gross debt at 31 March 2018 (£m)	Fixed	Index-linked	Floating	Total	
Finance leases	-	382	55	436	13%
Bonds	975	1,423	-	2,398	72%
EIB/KfW	-	247	263	510	15%
Local authority debt	-	-	1	1	-
	975	2,050	319	3,345	100%
Swaps - floating to fixed/index linked	192	132	(324)	-	
Gross debt	1,167	2,182	(5)	3,345	
Percentage	34.9%	65.2%	0%	100%	

Reconciliation to Investor Report:	
Gross debt as above	3,345
Accrued interest	57
Cash	(283)
Net debt as at 31 March 2018	3,119

Fair market value movements on swaps

Derivatives as at (£m)	31/3/2018	31/3/2017	Movement
Floating to fixed rate interest rate swaps	(90)	(94)	4
Index-linked swaps	(312)	(382)	70
Energy Swaps	5	(1)	6
Total MTM	**(397)**	**(477)**	**80**

Notes:

1. Swap contracts are with Royal Bank of Scotland, HSBC and Lloyds
2. None of the swap contracts have break clauses or accretion paydowns
3. In addition to the MTM values above, there is an additional liability for cumulative indexation of £40m (2017:£35m) relating to the A6 bond swap

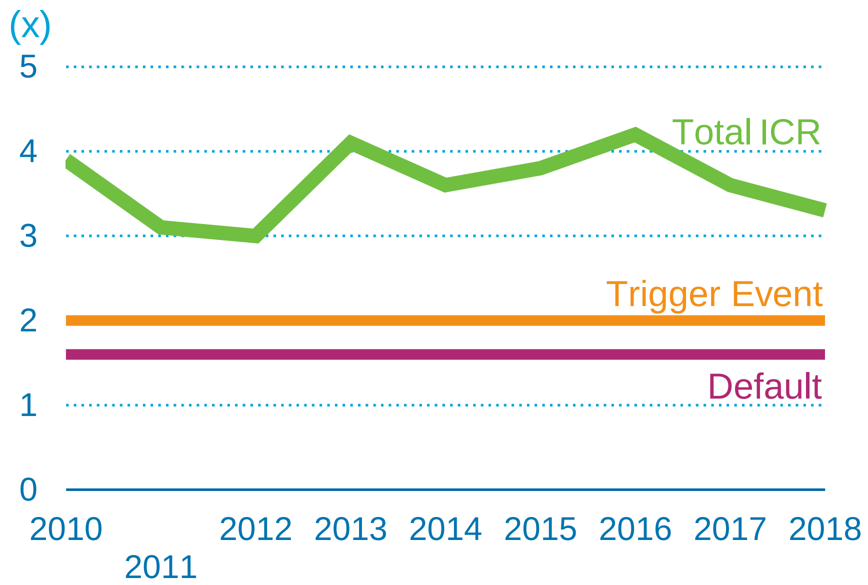
Stringent Investor Protections – Covenant package

Normal business Operating within covenant package	**Trigger event step-in period** One or more financial or operational 'trigger' covenants breached	**Default standstill period** One or more events of default occur and continue	**Special administration**
No creditor involvement	No customer dividends	Majority of secured claims frozen	Regulator applies to court to appoint a Special Administrative Receiver (SAR) to run business
	Option to commission independent review	18 month opportunity to remedy situation or find a buyer for Welsh Water	SAR acts in interest of creditors and customers
		Liquidity facilities keep senior debt whole	
		Security over shares of Welsh Water and holding Group can be enforced	
Financial covenants:			
	• Senior ICR: <2.0 • Senior PMIC: <1.0 • Gearing Ratio: >85%	• Senior ICR: <1.6 • Senior PMIC: N/A • Gearing Ratio: >95%	

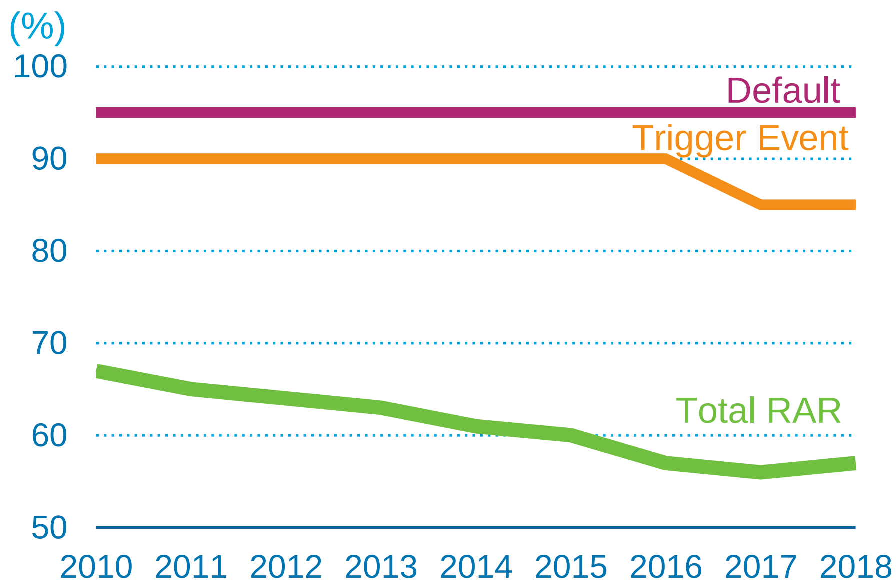
Financial covenants - interest cover and gearing

- ICR of 3.6 and Gearing of 57% as at 31st March 2018
- Trigger event threshold lowered to 85% (from 90%) during 2017

Interest cover ratios (ICR)



Gearing (RAR)



Significant headroom over trigger event default levels