



## Half Year Report 2009/10

19 November 2009

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# Pennon Group Plc (“Pennon Group”)

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## Pennon Group Plc

### *Another Strong Half Year Performance*

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- Underlying profit before tax up 10.7% to £97.3m
  - South West Water up 10.6% to £71.8m
  - Viridor up 14.0% to £22.8m
- Underlying earnings per share up 11.6% to 21.1p
- Interim dividend per share up 3.0% to 6.95p
- Strong liquidity position
  - cash balances of £428m at 30 September 2009
  - £125m convertible bond issued in August
- Group businesses well positioned in the current economic slowdown

# Pennon Group Plc

## *H1 2009/10 Operational and Business Highlights*

### **South West Water:**

- On target to deliver 2005 – 2010 Regulatory Contract
- Regulatory Capital Value expected to reach £2.5bn by end of K4
- Thirteenth consecutive summer without hosepipe bans and drought orders
- Operating efficiency target exceeded
- Energy saving target achieved
- Capital investment of £70.8m

# Pennon Group Plc

## *H1 2009/10 Operational and Business Highlights*

### **Viridor:**

- Continued strong growth in PBT
- Greater Manchester 25 year PFI contract operating successfully
  - planning permissions achieved for all required 23 sites / 36 facilities and construction programme under way
- Lakeside EfW currently under final commissioning
- Preferred bidder for Oxfordshire PPP
- London Recycling and Intercontinental Recycling acquired during the period



# **Pennon Group Plc**

# Pennon Group Plc

## Summary Financial Results<sup>(1)</sup>

For the half year ended  
30 September

	2009	2008	Change	Full Year 2008/09
	£m	£m		£m
<b>Group revenue</b>	535.5	505.1	6.0%	958.2
<b>Group operating profit</b> <sup>(2)</sup>	135.1	136.8	(1.2)%	257.0
- SWW	101.9	101.8	0.1%	191.6
- Viridor	32.6	33.1	(1.5)%	63.5
<b>Group profit before tax</b> <sup>(2)</sup>	97.3	87.9	10.7%	165.6
- SWW	71.8	64.9	10.6%	121.9
- Viridor	22.8	20.0	14.0%	41.1
<b>Earnings per share</b> <sup>(3)</sup>	21.1p	18.9p	11.6%	38.0p
<b>Dividend per share</b>	6.95p	6.75p	3.0%	21.0p

<sup>(1)</sup> Including IFRIC 12 'Service concession arrangements'

<sup>(2)</sup> Underlying - before restructuring costs and intangibles amortisation

<sup>(3)</sup> 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
	2009 £m	2008 £m	2008/09 £m
Cash inflow from operations	157.7	171.9	339.3
Net interest paid	(23.6)	(32.5)	(80.1)
Dividends and tax paid	(36.7)	(33.5)	(99.9)
Capital expenditure	(101.3)	(116.6)	(235.3)
Acquisitions (net of disposals)	(8.4)	(3.4)	(3.4)
Pension prepayment	-	(11.4)	(38.7)
Net cash outflow	(12.3)	(25.5)	(118.1)
Shares issued	1.6	1.3	1.6
Equity component of convertible bond	10.0	-	-
Debt acquired with acquisitions	(5.4)	-	-
Non-cash movements	0.2	(22.1)	(12.4)
Increase in net borrowings	(5.9)	(46.3)	(128.9)



## Pennon Group Plc

### Net Borrowings

	As at 30 September		As at
	2009	2008	31 March
	£m	£m	2009
			£m
Loans and finance leases			
- over one year	2,009	2,065	1,982
- under one year	317	50	263
	<u>2,326</u>	<u>2,115</u>	<u>2,245</u>
Less: cash and cash equivalents	(428)	(306)	(353)
Net borrowings	<u>1,898</u>	<u>1,809</u>	<u>1,892</u>
Net gearing <sup>(1)</sup>	77%	76%	76%
SWW debt/RCV	62%	58%	64%

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

<sup>(1)</sup> Net debt / (equity + net debt)

## Pennon Group Plc

### Net Debt Analysis as at 30 September 2009

	£m
Finance leasing	1,225
Bank bilaterals - RCFs/term loans	270
EIB	290
Index linked bond 2057	218
Private placements	199
Convertible bond	112 <sup>(1)</sup>
Other	12
Total gross debt	2,326
Less: Cash/liquid investments	(428)
Total net debt	1,898

- **Key role of finance leasing**
- **Diversified funding sources**

<sup>(1)</sup> Net of equity component (£125m gross)

## Pennon Group Plc

### Net Interest Payable<sup>(1)</sup>

	For the half year ended 30 September		Full Year
	2009	2008	2008/09
	£m	£m	£m
Interest payable	(40.1)	(60.2)	(109.5)
Interest receivable	4.6	12.4	21.1
Net interest payable	<u>(35.5)</u>	<u>(46.7)</u>	<u>(88.4)</u>
Average rate of interest	3.7%	5.2%	4.8%
Net interest cover <sup>(2)</sup>	3.8x	2.9x	2.9x

- **Effective management of interest rates**

- **Group 3.7%**
- **SWW 3.7%**

<sup>(1)</sup> Excludes pensions net interest, discount unwind on provisions and IFRIC 12 interest receivable

<sup>(2)</sup> From underlying profit

## Pennon Group Plc

### *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 2004 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 and secured margins
- New financing initiatives in 2009/10:
  - £125m convertible bond
  - £25m RCF renewed and increased to £35m
  - £25m 5-10 year finance lease facility for Viridor
- New provider for £35m Environment Agency bonds sourced
- **Average debt maturity 22 years**
- **Index-linked debt: average real rate 1.66%**

## Pennon Group Plc

### *Liquidity*

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- Cash balances of £428m at 30 September 2009 (includes c£70m deposits with L/C providers and lessors)
- Committed undrawn facilities of £224m at 30 September 2009
- Committed funding in place for South West Water to at least 2011
- Refinancing of existing facilities being progressed

## Pennon Group Plc

### Taxation

	For the half year ended 30 September		Full Year
	2009 £m	2008 £m	2008/09 £m
UK corporation tax	23.1	21.2	31.3 <sup>(1)</sup>
Deferred tax	3.0	0.1 <sup>(2)</sup>	11.7 <sup>(1)(2)</sup>
Deferred tax arising on abolition of industrial buildings allowances	-	29.2	24.9
	26.1	50.5	67.9

- **Mainstream tax charge 24% (H1 2008/09 - 25%)**

<sup>(1)</sup> Includes tax relief on pension contributions of £39m. Further contribution of £11m expected in H2 2009/10

<sup>(2)</sup> Deferred tax restated for IFRIC 12

## Pennon Group Plc

### *Pensions as at 30 September 2009*

- Gross pension deficit of £129m (March 2009 - £66m)
  - £93m net of tax (March 2009 - £48m)
- Pension fund assets £384m  
Pension fund liabilities £513m  
£129m = £93m net of tax
- Deficit increased from March 2009 due to impact of reduction in the interest rate used to discount fund liabilities
- Fund assets increased from £276m to £384m reflecting
  - increases in asset values
  - inclusion of share of Greater Manchester pension funds

## Pennon Group Plc

### *Dividends*

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- Interim dividend increased by 3.0% to 6.95p per share
- Progressive dividend policy: 3% real to end of this financial year
- SCRIP dividend alternative





**SOUTH WEST WATER**

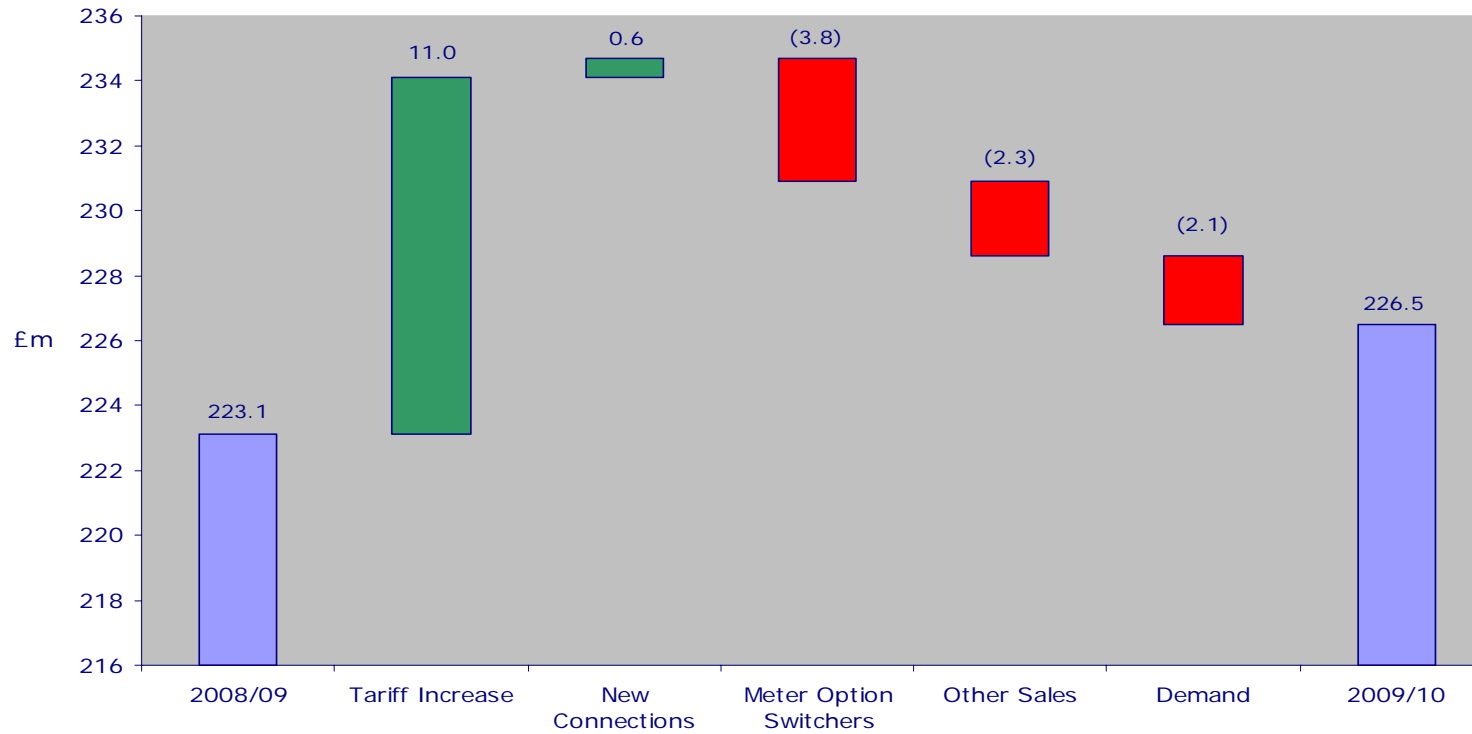
## South West Water

### Financial Performance Summary

	For the half year ended 30 September		Full Year
	2009 £m	2008 £m	2008/09 £m
Revenue	226.5	223.1	431.7
Operating profit <sup>(1)</sup>	101.9	101.8	191.6

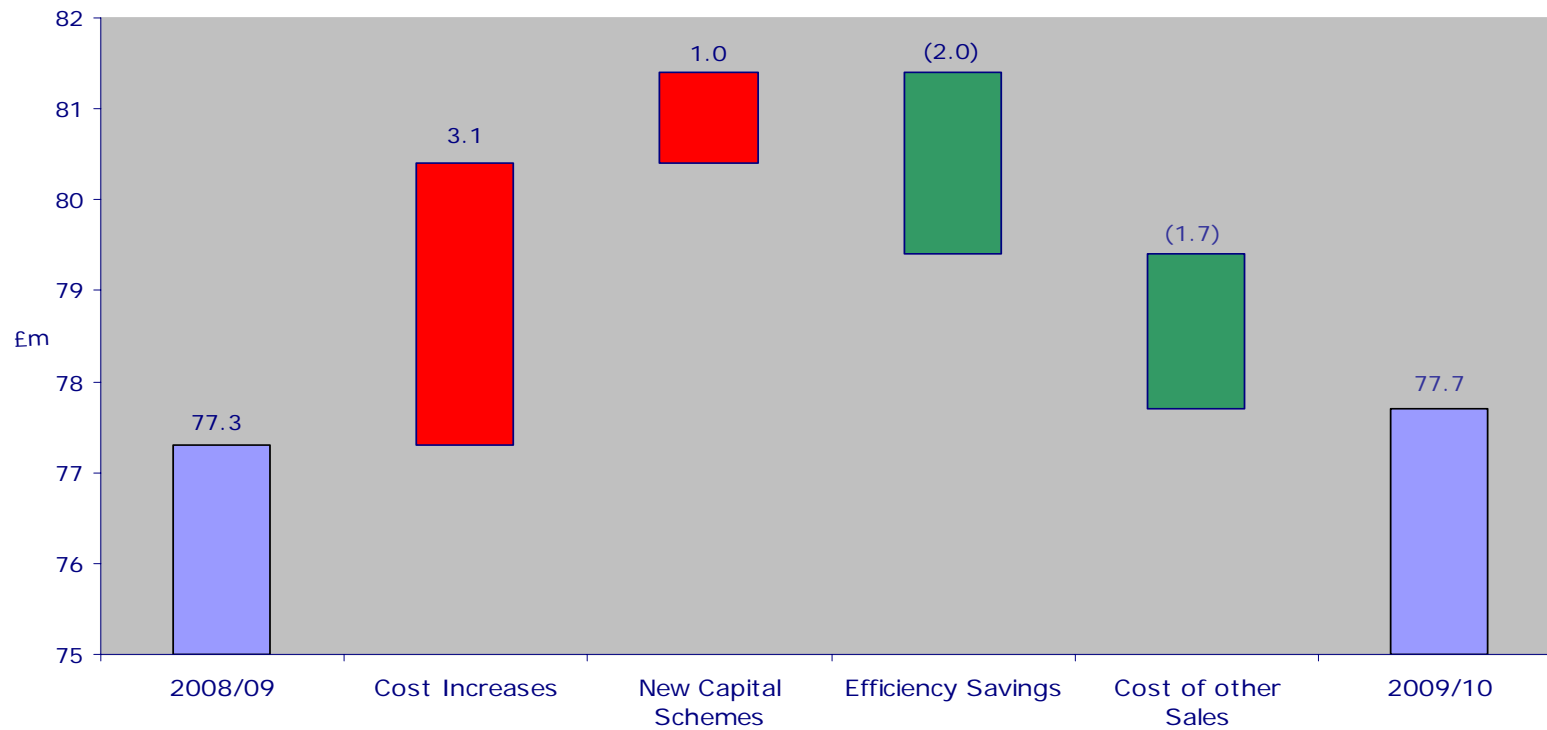
<sup>(1)</sup> Underlying – before restructuring costs

# South West Water Revenue



	H1 2009/10	H1 2008/09
• Number of meter switchers	9,300	14,500
• Number of new customers	2,600	4,200
• Domestic customers now metered	67%	64%
• Existing metered customers' volume usage	(1.8)%	(4.3)%

## South West Water Operating Costs

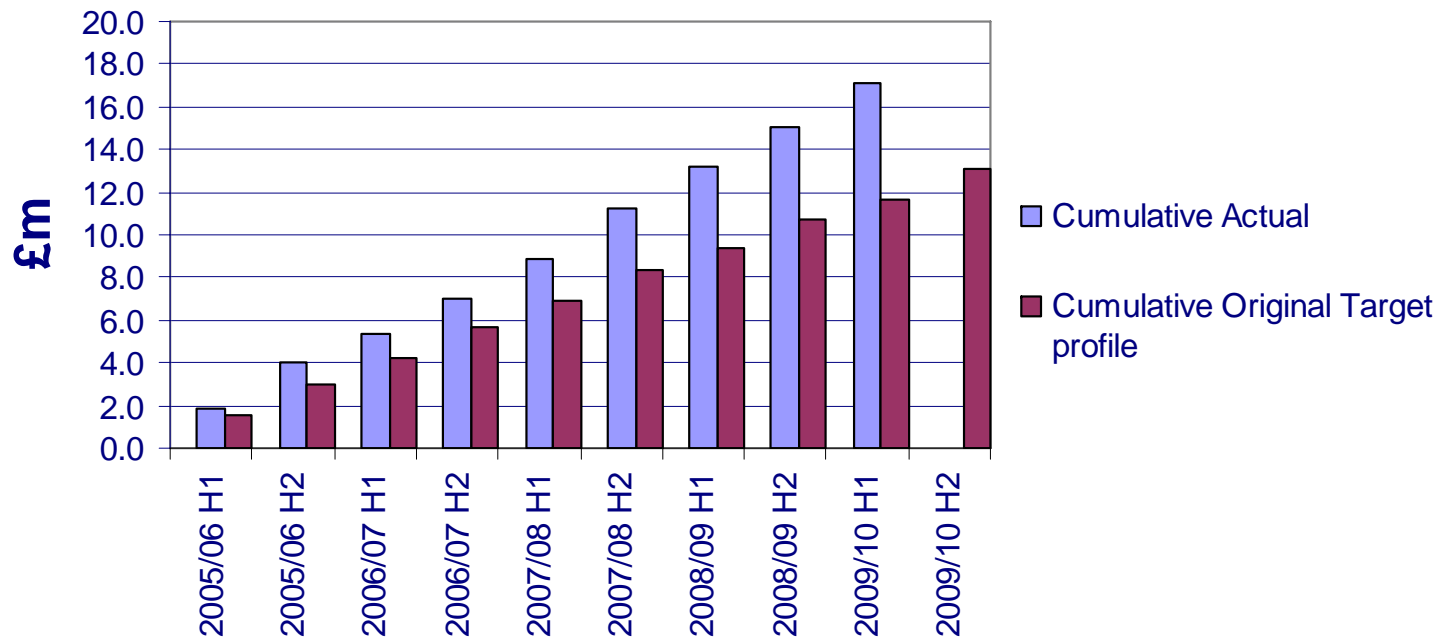


- Minimal increase in overall costs
- Debt collections stable
- Efficiency in energy usage delivered

# South West Water

## K4 Opex Efficiency Achievement versus Target

### Efficiency Achievement



- Further delivery of K4 cost efficiency
- Continuing outperformance

## South West Water Capital Programme

- Capital expenditure half year to 30 September 2009 – £70.8m (H1 2008/09 - £67.4m)
  - 89km water mains replaced/refurbished
  - programme on track to finish December 2009 - ahead of schedule
  - one of the last major deliverables of the “Clean Sweep” programme now under way
- Higher depreciation charges of £46.9m (H1 2008/09 - £44.0m) reflect the increased asset base
- K4 capital programme on track
  - all major projects delivered in line with OFWAT/DWI/EA expectations
  - total K4 spend to date £804m<sup>(1)</sup> (outturn prices)
  - **5% outperformance targeted**

<sup>(1)</sup> UK GAAP

## South West Water Regulatory Capital Value

Year End	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2010 adjusted £m <sup>(3)</sup>
At 2002/03 prices <sup>(1)</sup>	1,847	1,929	1,994	2,042	2,095	2,136	N/A
Actual/ <i>expected</i> outturn prices <sup>(2)</sup>	1,956	2,091	2,265	2,408	2,461	2,584	2,524

- 29% growth in RCV 2005-10 – highest percentage increase of any quoted water company
- Growth in RCV significantly exceeding growth in net debt (excluding effect of 2006 capital return)

<sup>(1)</sup> Source: OFWAT

<sup>(2)</sup> Source: South West Water, assuming RPI at March 2010 +3%

<sup>(3)</sup> Source: South West Water, adjusted for logging up/down, AMP5 capital advancement, land sales and COPI adjustments in Ofwat PR09 Draft Determination

## South West Water

### *Delivering K4: Preparing for K5 - I*

- OFWAT K4 efficiency target achieved
  - energy savings target achieved (Megawatt Challenge)
- OFWAT leakage target met every year
  - impact of exceptionally cold winter successfully managed
  - leakage performance amongst the best in the industry
- 2008 drinking water quality – 99.96%
- 2008 step change reduction in waste water related pollution incidents
- No hosepipe bans or drought orders – 13th consecutive summer



## South West Water

### *Delivering K4: Preparing for K5 - II*

- Customer debt - overall debt collection stable
  - improved collections from recent billing offsetting some slower collection of older debt
  - less exposure than peers to large industrial customers
  - 'WaterCare' assisting vulnerable customers
- Early implementation of K5 efficiency platform
  - organisational restructuring (£5m cost expected in 2009/10)
  - PUROS project underway
- Supplier capital contracts for K5 at preferred bidder status

## South West Water

### *PR09 Draft Determination*

- Average annual price limits lower than SWW Final Business Plan reflecting inter alia Ofwat's assumptions on:
  - lower cost of capital
  - lower capital and operating cost assumptions
- Headline 4.5% post tax real cost of capital
  - cost of equity 7.1% real
  - cost of debt 3.6% real
  - assumed gearing 57.5% debt/RCV
- Implies c £400m finance required in K5
  - c75% is to refinance existing debt

## South West Water

### PR09 Draft Determination

- **Customers**
  - Average bill decreases 1.3% pa before inflation
  - 81% domestic customers metered by 2015
  - discoloured water targeted with investment
  - targeted programmes to deal with odours at sewage treatment works and sewage flooding
- **Environment** – £676m investment (2007/08 prices)
  - protect and maintain improvements made over the last 20 years through increased levels of capital maintenance expenditure
  - further improvements to meet EU Directives
  - investment to deliver opex savings and reduced carbon footprint
- **Investors** – headline 4.5% post tax real rate of return
  - efficiently financed asset base
  - capital incentive scheme ratio better than industry average
- *Efficiencies proposed – c. 3.5% pa opex efficiencies off base costs from 2010/11; 6% capex efficiencies*

## South West Water Price Review Timetable

19 December 2008	OFWAT published draft capital baseline
7 April 2009	Companies submitted final business plans
23 July 2009	Draft price limits published by OFWAT
<i>26 November 2009</i>	<i>Final price limits published by OFWAT</i>
<i>January 2010</i>	<i>Accept price limits or seek Competition Commission referral</i>

## South West Water

### *PR09 Draft Determination Summary*

- The Draft Determination is a draft
  - representations made to Ofwat in September
  - key components can change in the Final Determination
- Logging up/IDoK potential for K5
  - Water Framework Directive
  - revised Bathing Water Directive
  - adoption of private sewers

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# Viridor

## Viridor

### Financial Performance Summary<sup>(1)</sup>

	For the half year ended 30 September			Full Year
	2009 £m	2008 £m	Change %	2008/09 £m
Turnover <sup>(2)</sup>	309.8	282.9	9.5	528.0
EBITDA	55.0	55.1	-	105.2
PBITA	32.6	33.1	(1.5)	63.5
PBITA plus joint ventures <sup>(3)</sup>	33.7	33.4	0.9	64.9
PBT	22.2	19.4	14.4	39.9

- **PBITA down 1.5%**
  - H1 2009/10 much weaker economy than H1 2008/09
  - closure of Beddingham landfill site beginning 2009/10 (£4.4m profit contribution full year 2008/09)
- **PBITA decline offset by growth in joint ventures, as flagged**
- **PBT up 14.4%**

<sup>(1)</sup> Including IFRIC 12 'Service concession arrangements'

<sup>(2)</sup> Including landfill tax

<sup>(3)</sup> Interest on shareholder loans plus share of PAT

## Viridor

### 2009/10 H1 Financial Highlights

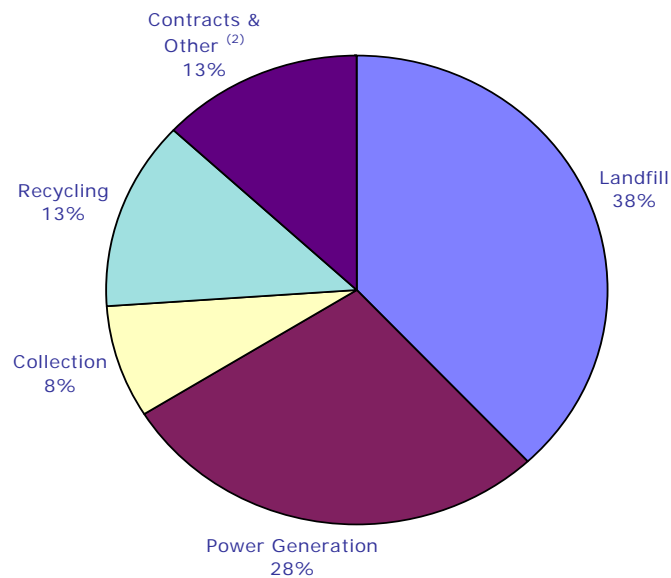
- Revenue increased by £26.9m (10%) to £309.8m
  - acquisitions of London Recycling and Intercontinental Recycling plus Greater Manchester project accounted for £42.4m
  - existing business decreased by £15.5m (including decrease in landfill tax of £2.4m)
- EBITDA decreased by £0.1m to £55.0m
- PBITA decreased by £0.5m (2%) to £32.6m
- Joint ventures (Lakeside and VLGM) interest receivable on shareholder loans £1.2m (H1 2008/09 - £0.3m) and share of loss after tax £(0.1)m (H1 2008/09 - Nil)
- PBITA plus joint ventures increased by £0.3m (1%) to £33.7m
- PBT increased by £2.8m (14%) to £22.2m
- Capex £26.4m (H1 2008/09 - £36.5m)



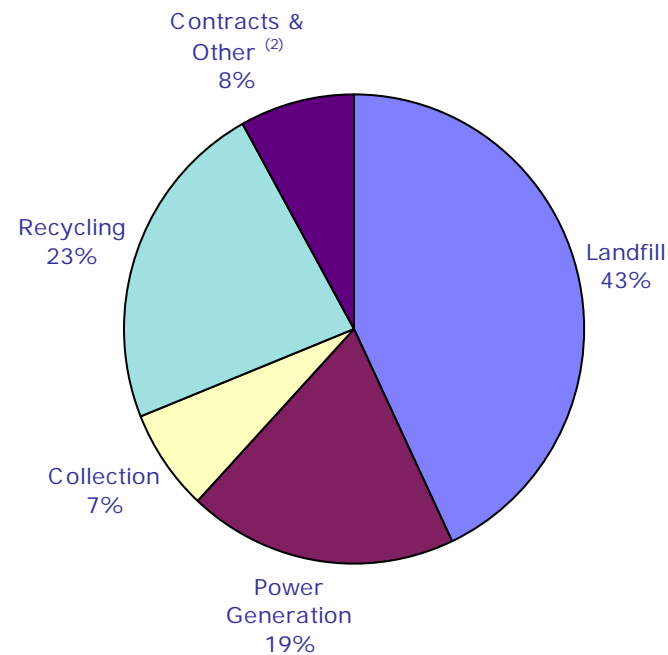
# Viridor

## Profit Contribution by Segment <sup>(1)</sup>

Half Year Ended 30 September 2009



Half Year Ended 30 September 2008



- **Business successfully diversified**

<sup>(1)</sup> Contribution before intangibles and overheads (incl pensions); excludes joint ventures

<sup>(2)</sup> "Contracts" include West Sussex PFI, Greater Manchester sub-contract, other civic amenity contracts and sludge contracts and "Other" includes asset disposals

## Viridor

### *Operational Highlights – Landfill*

- Total volumes decreased by 0.4m tonnes or 17% to 2.1m tonnes
  - excluding site closures the decrease is 0.3m tonnes or 13%
  - decrease is primarily third party industrial and commercial (recession related)
  - domestic slightly down but Viridor collected volumes maintained
- Average gate fees increased by 4.4% (to £21.68 per tonne)
  - margin per tonne increased to £6.35
- Consented landfill capacity fell from 81m cubic metres at 31 March 2009 to 78m cubic metres at 30 September 2009 reflecting usage in the period

## Viridor

### *Operational Highlights - Contracts and Collection*

- **Contracts** profits well ahead
  - continued good performance in West Sussex PFI and around 10 other municipal contracts
  - sludge contracts back in profit
  - impact of Greater Manchester sub-contract profit
  
- **Collection** profits up with enhanced margins more than offsetting volumes 7% down on last year (recession related)

## Viridor

### Operational Highlights – Power Generation

- Total landfill gas power generation increased by 11% to 273GWh reflecting capacity brought on at 2008/09 year end
- Average price up 25% to £82MWh (H1 2008/09 - £66MWh)
  - ROC-able electricity output (brown energy component) sold forward to March 2010 at May 2008 forward prices
  - current market prices are substantially lower than this
- Total capacity<sup>(1)</sup> 102MW at 30 September 2009 (85MW 30 September 2008, 101MW at 31 March 2009)
  - 62% ROCs, 38% NFFO at 30 September 2009

<sup>(1)</sup> Excludes 3 MW sub-contract in Suffolk

## Viridor

### *Operational Highlights – Recycling*

- Overall recycling revenues per tonne back to H1 2008/09 levels (after the deterioration in H2 2008/09) with some variations by product
  - glass and plastics ahead
  - metal and paper behind
  - recycle very economical compared to virgin materials
- Recycling volumes down 10% half year on half year to 688kt, primarily reflecting domestic economic conditions
- Chancellor's April 2009 Budget announcement enhances long-term economics of recycling
  - landfill tax to increase by £8 per year from current £40 per tonne to £72 per tonne in 2013/14

## Viridor

### *Recycling Companies Acquired H1 2009/10*

- **London Recycling Limited**

- acquired in June for £10.6m cash consideration (plus £1.8m debt)
- HQ in London, E16
- full range of recycling operations, including collection fleet, 'WEEE' facility, paper processing, confidential destruction, MRF, waste auditing
- handles c50kt material pa

- **Intercontinental Recycling Limited**

- acquired in July for £4.2m cash consideration (plus £3.9m debt)
- HQ in Skelmersdale, Lancs
- converts HDPE and PET plastic bottles collected from MRFs to pellet or flake
- handles c40kt plastics waste pa

## Viridor

### *PPP/PFI Pipeline*

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- Preferred bidder for **Oxfordshire PPP** (September 2009)
- One of last two for **Cheshire PFI**
- Viridor continues to bid selectively for other contracts

## Viridor *Renewable Energy Summary*

Waste currently 30% of UK Renewables. Low cost, base load, distributed. Scope for significant further growth. Chancellor's April 2009 Budget announced increasing EIB support for UK renewables. Planning approval is a lengthy process, often involving appeals

- **Landfill gas**
  - 102 MW (as at 30 September 2009)
- **Lakeside EfW** joint venture with Grundon Waste Management being commissioned
  - 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
- **Bolton EfW** facility (part of GMW PFI) already operational (120kt pa and 9MW)
- **Exeter EfW**
  - 60kt pa, 3MW
  - planning permission achieved
- **Runcorn/Ineos Chlor CHP** (planning permission achieved September 2008; 750kt pa, 120MW, Phases I and II)
  - preliminary works under way
- Other possible long-term **EfW** sites include
  - Trident Park, **Cardiff** (turned down locally; to be appealed)
  - **Dunbar** (turned down locally; to be appealed)
  - **Ardley** (near Oxford; turned down locally; to be appealed)
- 6 planned **Anaerobic Digestion** (AD) plants
  - **Greater Manchester**: planning permission achieved for 4 ADs (totalling 430kt pa, 8MW)
  - **Walpole**, Somerset: planning permission achieved
  - **Beddington**, Croydon: planning permission achieved





# **Pennon Group Plc**

## Pennon Group Plc

### Summary

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- Strategy clearly focused on water and sewerage services and waste management
- **South West Water**
  - successfully delivering K4
  - Final Determination from OFWAT due 26 November
  - platform for K5 in place
- **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 diversion, recycling and renewable energy targets
- Well funded with efficient long-term financing
- Group businesses well positioned in the current economic slow-down



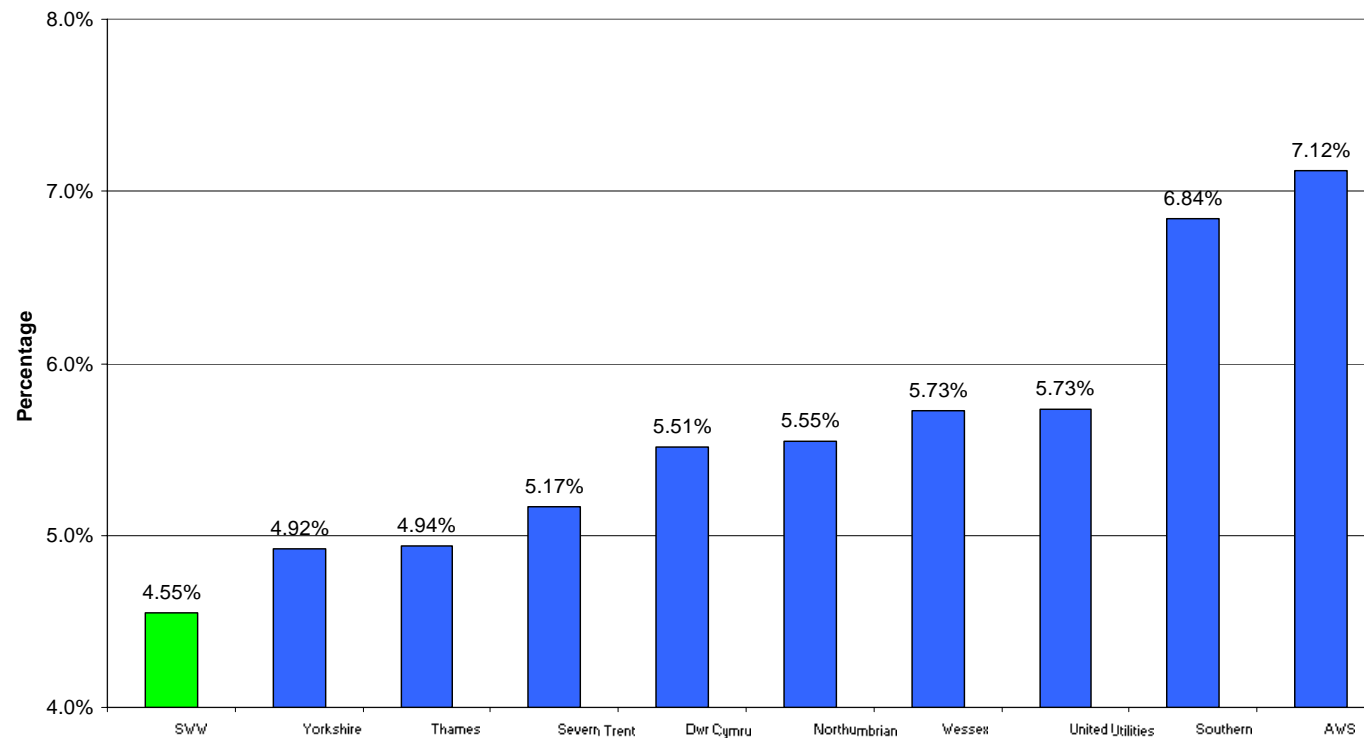
# Pennon Group Plc

## Appendices

# Water Industry

## 2008/09 Average Interest Rate

Water Industry 2008/09 Average Interest Rate on Net Debt



Source: Pennon calculation based on company Annual Reports

Basis: Net interest payable (excluding pensions net interest/average net debt)

## Viridor

### *IFRIC 12 'Service Concession Arrangements'*

- Requirement of International Accounting Standards Board (IASB)
- Revenue from 'Service concession arrangements' split between
  - construction
  - operations
  - financing
- Capitalisation of interest during construction phase not permitted
- Tends to bring profits forward
  - PBT impact on H1 2008/09 £1.1m (West Sussex only) and on H1 2009/10 £1.2m (West Sussex and Greater Manchester), all included in above numbers
  - but no impact on underlying cashflow
- Affects only West Sussex PFI and Greater Manchester Waste PFI joint venture (VLGM)

## Viridor

### Greater Manchester Waste PFI

- 25 year contract signed by Viridor/Laing consortium 8 April 2009 and now operational
- The UK's largest ever combined waste and renewable energy project
  - 1.3m tonnes pa of waste
  - total potential energy generation approaching 130MW (including Runcorn Phases I and II)<sup>(1)</sup>
- Total PFI construction cost of £405m and an additional £235m for the associated Energy from Waste/Combined Heat and Power ('EfW/CHP') plant at Runcorn (Phase I)
- Viridor investing £85m plus possible further mezzanine debt of up to £40m in 2010
- In addition, Viridor has secured 100% of Phase II of planned EfW/CHP facility at Runcorn
  - significant upside given rising landfill tax, LATS and the shortage of competing capacity in the North West
- Profit streams for Viridor
  - sub-contract
  - interest receivable on shareholder loans in SPVs
  - share of PAT in SPVs
- Runcorn Phase II longer-term opportunity

<sup>(1)</sup> Plus 9MW existing capacity at Bolton EfW plant