NORTHUMBRIAN WATER living water | ESSEX&SUFFOLK WATER living water

DETAILED GUIDE TO OUR FINANCES

2018

WHAT THE MONEY FROM CUSTOMER BILLS DELIVERS

Northumbrian Water (NW) provides water and sewerage services in the north east of England. Essex & Suffolk Water (ESW) provides water services only in the south east. We use the cash we collect from customer bills to:

- Run the operations efficiently day-to-day, maintain and operate our equipment, pay our staff and supply chain partners and meet the energy costs of running our assets. This is known as operational expenditure (Opex).

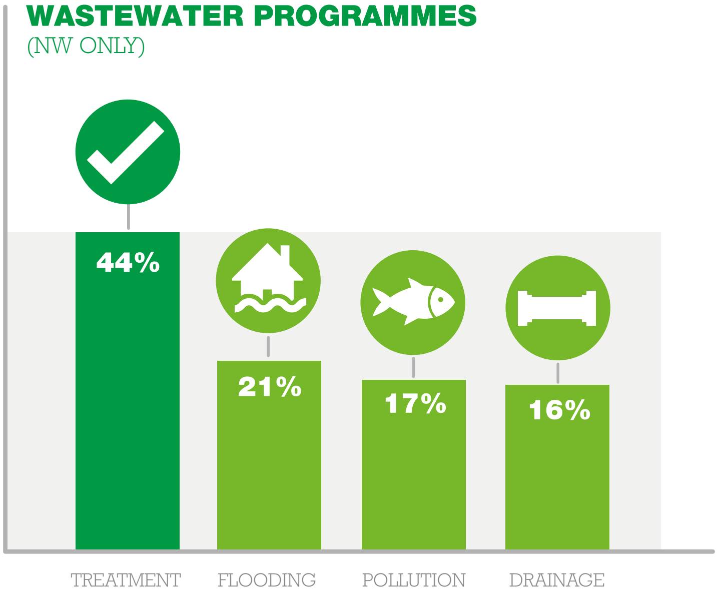
- Build new assets and buy new equipment to improve our water and wastewater services. This could include things such as laying new pipes or sewers, building or renewing treatment works, or optimising our renewable energy sources. This investment is known as capital expenditure (Capex).

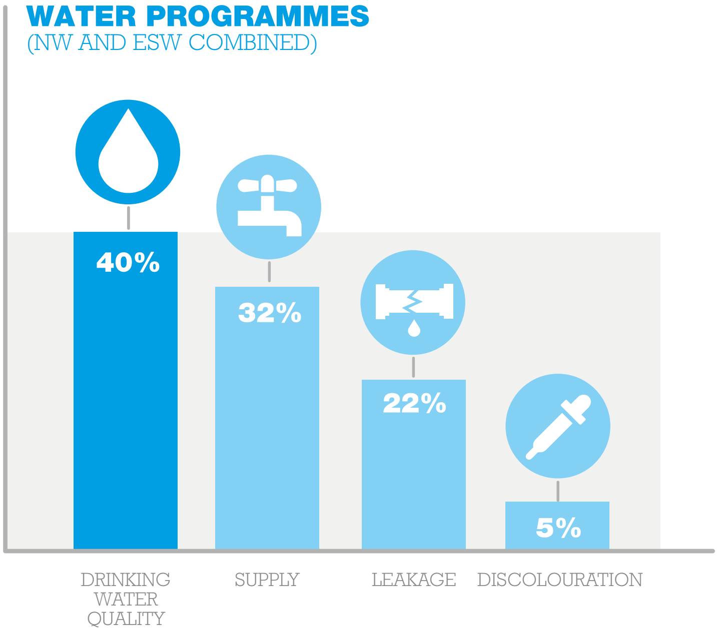
Opex and Capex together give us our total expenditure (Totex). In the period 2015-20 our revenue will allow us to spend Totex of around £2.7bn (in 2012/13 prices) (Opex c.£1.5bn and Capex c.£1.2bn).

SOME OF THE HEADLINES OF OUR CAPEX PLAN FOR 2015-20 INCLUDE:

Our Capex programme helps us to give great service to our customers. In 2015-2020, about three quarters of our Capex investment will go towards maintaining our large asset base and a quarter will go towards improving our levels of service. These enhancements will be particularly targeted at reducing the risk of property flooding and at improving environmental performance.

The graphs below show the expected split of our investment between our main programmes.





Within these programmes investment is prioritised across the wide range of our types of assets to make sure that our structures and equipment perform efficiently and minimise the risk of service failure. Capex in 2015-20 will be split between the water (46%) and wastewater services (40%) (NW only). The remainder (14%) is invested in support services to operations such as the maintenance of our vehicle fleet, IT systems and ensuring security at our operational sites.

MANY OF OUR LARGER INVESTMENT SCHEMES ARE LOCATED IN THE NORTH EAST OF ENGLAND OVER THE 2015-20 PERIOD, AND SOME SPECIFIC EXAMPLES INCLUDE:

- The delivery of large programmes of water pipe and sewer rehabilitation.
- A large refurbishment project at Horsley Water Treatment Works.
- Improvement to flow management at Whitburn.
- Upgrade of our sewage treatment works at Aycliffe to support local growth.
- Replacement of large process equipment at Howdon sewage treatment works.
- Energy efficiency initiatives at our Bran Sands site.

MINIMISING THE IMPACT FOR CUSTOMER BILLS

In 2017/18, as in most years, we spend more than the cash we collect in bills, and we make this difference up via borrowings. Our spend last year totalled c.£743m.

This enables the significant cost of the long-term investment being made to be spread over the period which the assets will be used. Importantly, this spreads the costs over today's and future customers, rather than being a cost to our current customers.

CATAGORY	DESCRIPTION	COST
Day-to-day operations	For c.£1.10 a day (NW) and 69p a day (ESW), we provide fantastic quality water to our c4.5m customers. We then take away wastewater, clean and treat it and return it to the environment. We have a network of nearly 26,000 km of water mains and nearly 30,000 km of sewers (NW only).	£347m
Financing	We pay interest on our debt and, as mentioned above, we keep customer bills low by spreading these costs over a long period. We also pay a dividend to our shareholders when the company meets it targets.	£221m
Long-term investments	Net of any large capital contributions we spend around £1m per business day improving our assets and equipment. We plan and phase our investment programme in such a way as to try and maintain low customer bills.	£175m
		£743m

BORROWINGS AND INTEREST

Given we are investing approximately £1m per business day in new assets and equipment, we boost the money raised annually from our customers through their bills by borrowing money from banks and debt markets – in 2017/18 this amounted to c.£175m net of repaying maturing debt.

We do this in a controlled and sustainable fashion, so as to deliver our significant network investment without leading to a significant increase in customer bills, by spreading the financing cost of our investment and managing the borrowings over long periods of time. This means that both current and future customer help pay for the investment, which means bills are fairer and are more stable and sustainable for customers.

We periodically issue bonds to the debt markets and finance our activities and investments by short-term bank loans (less than five years) until we build up enough new debt to allow us to convert into a longer term bond issue. Our bonds are publicly listed on the UK Stock Exchange and are sold directly to pension funds and other large institutional investors to whom we pay interest each year. The bonds benefit from our strong investment grade credit ratings which helps reduce the rate of interest we pay, ensuring that our financing costs remain as efficient as possible.

Our credit ratings are assigned by Moody's and Standard & Poor's and we remain committed to maintaining our strong investment grade ratings of Baa1/BBB+. These strong credit ratings enable us to obtain financing at the most competitive and attractive interest rates, and the benefits of low funding costs flows into customer bills.

By maintaining a well-balanced debt portfolio we are able to effectively manage risks of adverse movements in inflation and interest rates and minimise volatility on customer bills.

Our total borrowings at 31 March 2018 amounted to £2.9bn.

TAX

Another significant cost to the business is taxes. For example, in 2017/18 we made total tax payments of approximately £102m. This mainly covered business rates, PAYE, National Insurance and corporation tax.

We are fully transparent about our tax arrangements and publish our Tax Strategy on our website.

Our business plan includes an allowance for the corporation tax we expect to pay, just like any other operating cost. The plan contains our estimate of tax payments that reflect the benefit of tax reliefs that are available to us and known future rates of tax. This helps us to keep the cost of customers' bills down.

We pay corporation tax on our profits after taking into account reliefs that are available to all companies under the UK tax system. The calculation of our taxable profits includes deductions for interest on our borrowings, capital allowances on money we invest in improving our infrastructure networks, and tax losses made available to us by other group companies. Tax is paid in four instalments based on the current tax charge in our financial statements.

The capital investment we make brings benefits to the regions in which we operate. Our investment has been running at more than £200m a year over the last five years. This is likely to increase over the coming five year period 2020-25 and is a significant factor in determining how much tax we pay now and in the future. The capital allowances system results in an acceleration of tax relief and, while it helps save the company tax in the present, it will result in tax being paid in the future because the benefit of the investment is realised over time.

The availability of capital allowances in 2017/18 resulted in customer bills, on average, being lowered by approximately £8 for customers of ESW and £15 for customers of NW.

SHAREHOLDER DIVIDENDS AND RETURNS

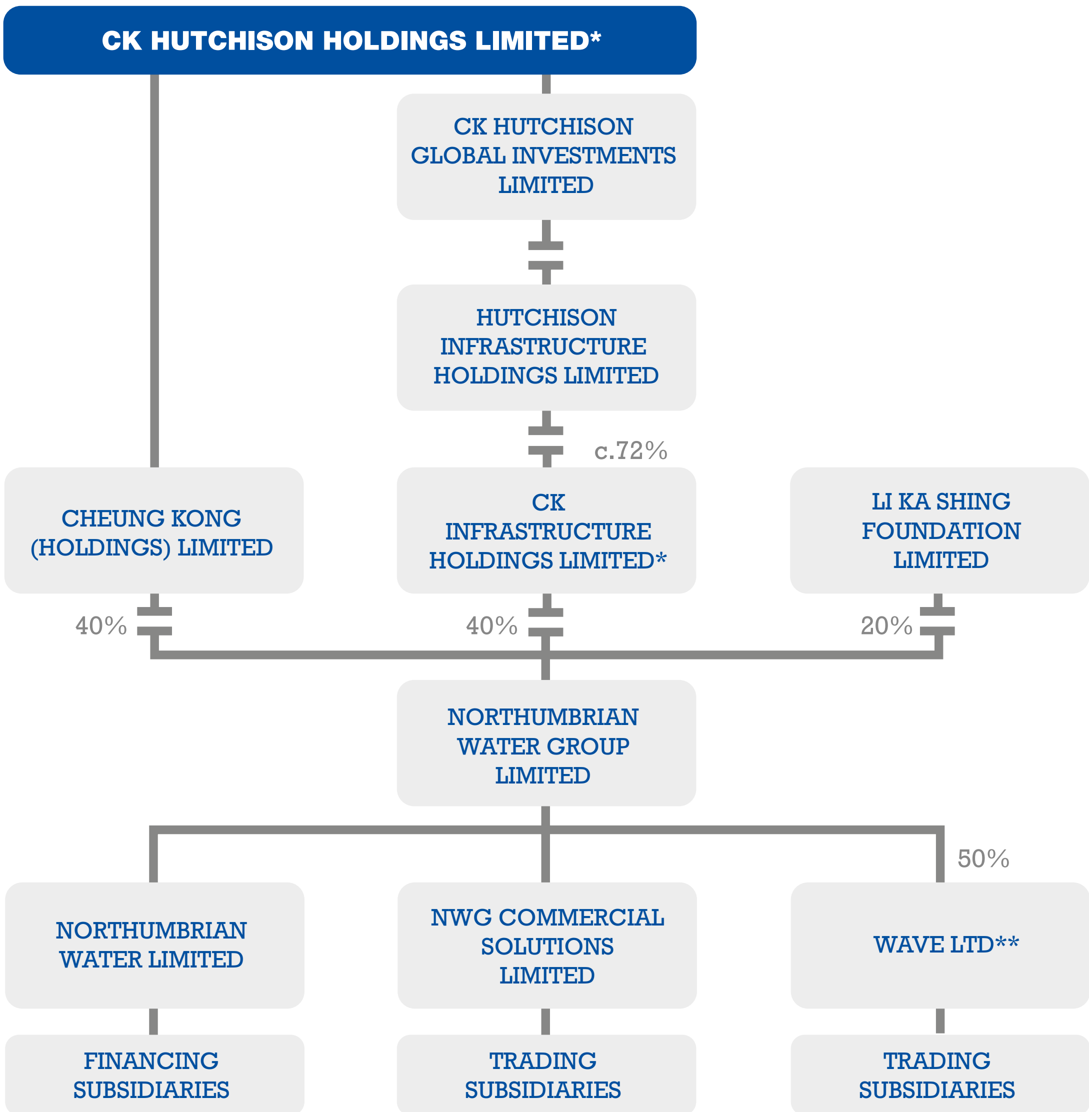
The profit we generate is driven by how efficiently we can run the business to deliver our key regulatory outcomes. After deducting operating costs, financing costs and tax from our revenues we are left with our profit. Profits can be either distributed or retained and reinvested in the business.

Our shareholders have provided all the necessary capital and financial backing required to run the business and in return they receive a dividend return on the capital they have invested. The dividents we can pay are driven by our financial and operational performance, the level of service provided to our customers, and employees interests, so the returns our shareholders receive are not guaranteed from one year to the next. There are many significant risks associated with the business, and these are importantly not largely borne by customers but by the shareholders.

We make sure the dividends are set at a level which is sustainable, remains consistent with our strong investment grade credit ratings and allows us to maintain our significant investment programmes.

Northumbrian Water Limited (NWL) is one company within the wider Northumbrian Water Group Limited (NWGL) Group. NWGL is owned by a consortium of three shareholders:

- CK Infrastructure Holdings Limited
- Cheung Kong (Holdings) Limited
- Li Ka Shing Foundation Limited



* Companies listed on the Hong Kong Stock Exchange

As shown in the group structure table above, given CK Hutchison Holdings Limited (CKHH) has holdings in two of our shareholders, we regard CKHH as the ultimate parent undertaking and controlling party of NWGL and, therefore NWL.

Each of the companies in the Group serve their own function, but this means that any dividend paid by NWL flows to NWGL as its immediate parent company. Distributions to our three shareholders are then made by NWGL.

IN THE YEAR ENDED 31 MARCH 2018:

- NWL paid dividends of £125.4m to NWGL.
- £223.1m was distributed to the shareholders as a return on their £2.2bn investment in NWGL through a combination of dividends and interest.