

Managing a sustainable business

Sir John Egan

Chairman



I am pleased to report today on a second successive year of encouraging progress. Despite the impact of the current economic environment on consumption and bad debts, and our already announced increase in investment in infrastructure renewals, Tony Wray, our Chief Executive, and his team delivered stable group profit before interest, tax and exceptional items. That's because we continue to deliver on our plans to raise standards and keep down charges through our focus on continuous improvement in all our processes.

I congratulate Tony and all employees on achieving upper quartile performance in 14 of our 20 Key Performance Indicators. I would like to thank our dedicated employees who have embraced our tools and techniques for continuous improvement and risen to the challenge.

Our KPI achievements are being driven by end to end process design improvements created by good leadership and training. Audits and high quality two way communications ensure continuous improvements.

Further productivity gains will flow throughout the next five years from continued process improvements supported by better telecoms technology and IT systems, and with flexible working practices to enable our better trained staff to operate effectively in this new environment.

Now we aim to have the lowest possible water bills in the UK. The cost of all Severn Trent water and waste activities is on average around 84p per day, per household, and we hope to hold that over the next five years to an increase of 4% above inflation, less than 1% per year.

In addition we will continue to grow Severn Trent Services across the world by operating at the forefront of new technology and services as a leading supplier of water and waste water treatment solutions.

Group results

Group profit from continuing operations before tax, gains/losses on financial instruments and exceptional items was £273.5 million (2008: £292.2 million). Group profit from continuing operations before tax was £167.6 million (2008: £192.4 million).

The board is proposing a final dividend of 41.05p (2008: 41.29p) to be paid on 31 July 2009. This would give a total dividend for the year of 67.34p per ordinary share, an increase of 2.6%.

Corporate responsibility

Corporate responsibility must be at the heart of the way we develop, manage and operate Severn Trent for long term sustainable benefit.

We are increasing our focus on water efficiency and reducing our carbon footprint. This involves improving our own efficient use of water and energy and engaging with our customers and the wider community to influence all our behaviours. We have a target of generating 30% of our gross electricity requirements from renewable sources by 2013 and are working on longer term targets to support our 25 year plan.

In 2008/09 we improved our group performance on our health and safety KPI of lost time incidents per 100,000 hours by 29%.

Closure of regulatory investigations

I am pleased to report we finally resolved our legacy issues in July 2008.

More than four years of intensive time and energy has been invested by this board and the management team putting our organisation back into the positive position our customers, regulators, shareholders and employees deserve.

Board

Martin Houston stepped down as a non-executive director of Severn Trent Plc and Severn Trent Water Limited with effect from 23 January 2009. I thank him for his contribution to Severn Trent since 2003 and we wish him well for the future.

Gordon Fryett, Director of Property at Tesco, has been appointed to the boards of Severn Trent Plc and Severn Trent Water Limited from 1 July 2009. His experience in managing capital projects and customer service will, I believe, enable him to contribute greatly to your board.

We have reviewed our governance framework to further encourage robust board room practices to ensure challenge and delivery. See page 24 for more details.

Outlook

We continue to drive performance improvements across Severn Trent Water. We have accelerated some of our improvement plans and expect to incur around £20 million of restructuring costs in 2009/10 which is planned to deliver around £5 million of additional operating cost efficiencies in 2009/10, beyond our previous plans and further cost efficiencies in AMP5.

The capital programme is proceeding according to plan. We continue to expect to deliver on our regulatory commitments and anticipate total capital expenditure (UK GAAP, net of grants, contributions and other income) of £2.6 billion for the AMP4 period. The three key areas we are focused on are:

- accelerating our renewable energy programme to deliver greater operational efficiency, enhance our natural hedge to energy costs and reduce our carbon footprint,
- to engage with our supply chain to further our early start contracting strategy, delivering benefits in the AMP5 investment programme, and
- investments in economically enhancing technology and locations, principally the construction of the new Severn Trent Centre.

In April 2009 we submitted our Final Business Plan to Ofwat. We believe it is a high quality, holistic and balanced plan that has customers at its heart, is supported by all the key stakeholders and will enable a fair and appropriate return for our investors. The plan proposes a capital programme of £2.6 billion (net of efficiencies, grants and contributions at 2007/08 prices), challenging efficiencies and an assumed weighted average cost of capital of 5%.

In Severn Trent Services, the market for all three areas of activity still provides the opportunity for growth. We are working to a focused growth strategy, capitalising on organic and other growth opportunities in the downturn economy by building on our brand recognition and reputation, our strong market positions, our international scale and our advanced technologies.

The group has a strong liquidity position and is funded for its investment and cash flow needs for up to the next two years.

Delivering continuous improvement



Tony Wray
Chief Executive



In 2008/09, we delivered what we set out to do. We continued to focus on water and to improve our performance across the group.

Delivering continuous improvement across our group

Last year I talked about the revitalisation of Severn Trent and our plans to continue building on the improvements we had been making. This year we have been delivering continuous improvement throughout our businesses and making it part of the way we work every day.

Our approach of always challenging ourselves to do better is designed to ensure that we take our businesses forward in a responsible and sustainable way and one that delivers for all our stakeholders.

Delivering continuous improvement in Severn Trent Water

We said to our customers that we would make fewer mistakes, deal with their calls more effectively and reduce the number of causes of complaint in our business. We said to Ofwat and the Environment Agency that we would meet our leakage targets, deliver improved security of supply and reduce pollution incidents. We said to our investors that we would continue to deliver operating (opex) and capital (capex) efficiencies and maintain our progressive dividend. We said to our stakeholders that we would operate to the highest standards of governance. We said to our people that we would continue to improve what it's like to work for Severn Trent. We said we would do these things and we have done them, in line with our ongoing commitment to be the best water and waste water company, with the highest standards, the lowest charges and great people.

In 2008/09, we continued to improve our performance across the board. The 20 Key Performance Indicators (KPIs) remain the primary basis on which we measure and demonstrate this continuous improvement. They are indicators we identified as important to our customers, regulators, employees and shareholders. I am pleased to report that we are now achieving upper quartile performance in 14 of our KPIs, with 5 at median and 1 at lower quartile.

The professionalism and commitment of our people has enabled our achievements. We have given and intend to continue to give our people the encouragement, training, tools and techniques to ensure it is a fundamental everyday part of the way we work, finding ever safer, better, faster ways of delivering our Key Strategic Intentions. As set out in our 25 year Strategic Direction Statement we are becoming ever more customer focused and ambitious for efficiency improvements that help produce lower charges and drive process improvements that help raise standards. In support of these, we continue to commit to improvements designed to attract, retain, develop and reward our great people.

Over the last 12 months we have also been working on our fifth Price Review (PR09), for the period 2010-15 (AMP5) undertaken by Ofwat. We believe preparations for PR09 have gone well. There

is still a way to go in the regulatory process, but we have what we believe to be a high quality, holistic and balanced plan that has customers at its heart, is supported by all the key stakeholders and should enable a fair and appropriate return for our investors. We talk more about our plan on page 6 of this report.

Delivering continuous improvement in Severn Trent Services

Continuous improvement is at the heart of Severn Trent Services, our international water and waste water solutions business. It is the engine driving the Severn Trent Services growth plan focused on four key strategic initiatives: continuing the geographic expansion of products and services, expanding the scope of operating services around the world, enhancing products and operations to improve effectiveness and efficiency, and continuing to develop new technologies that are at the forefront of water and waste water solutions.

Looking ahead

As Severn Trent Water progresses into the final year of AMP4, we are driving performance improvements across the business. These improvements, measured by our 20 KPIs, are designed to deliver higher standards and efficiencies; enabling us to meet the challenges and opportunities of the current economic environment and provide the momentum for delivery of our PR09 plan.

We are very aware of the challenging economic climate and what that means for our customers, for our supply chain and for our future funding.

We are also very conscious of our corporate responsibilities, not least in playing our part to address the increasing challenges of climate change through our water resources, our waste processing, our energy use and our engagement with our communities. We are committed to achieving carbon reductions through our renewable and energy efficiency programmes which are intended to exceed the government targets to 2015.

In the future, the nature of our industry is bound to change. We can't be sure exactly how, but we can and will play our part in shaping developments – for example around competition in the UK regulated industry. We have clear ideas about how it might best be developed in a way that both benefits customers and addresses regional water supply imbalances. We are actively discussing these ideas with Ofwat and other interested parties. Whatever the future holds, we will refuse to accept the status quo and intend to focus on water, on our core skills, on aligning ourselves around our key processes, and having excellent relationships with our key stakeholders.

In Severn Trent Services we will continue to build on the improvements we have made this year. Our focus will be on growth opportunities through our four key strategic initiatives and driving continuous improvement in the business.

Severn Trent is a high quality business whose investment programme drives strong growth prospects. The management team has a clear and focused strategy and is engaged in the single minded pursuit of higher standards as the means to achieve both higher levels of customer satisfaction, and also sustained strong financial returns to shareholders.