

Severn Trent Water

Our vision for Severn Trent Water is to be the best water and waste water company in the UK, achieving the highest standards, with the lowest possible charges, through great people.

We provide water and sewerage services to over 3.7 million households and businesses across the Midlands and mid Wales. That's over 8 million people.

Our business is streamlined and organised around our three key processes:

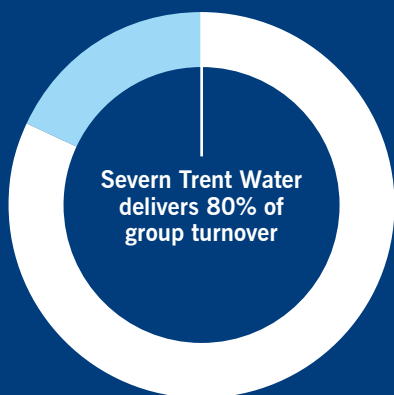
- > water
- > waste water
- > customer relations

Our strategic direction revolves around eight Key Strategic Intentions (KSIs). We focus on delivering continuously improving performance against 20 Key Performance Indicators (KPIs).

With business aligned around driving up standards, driving down costs and developing great people, we have been focusing on improving our operational performance on all fronts.

We report on our performance against our KSIs and KPIs in the following pages.

Turnover in Severn Trent Water was £1,324.9 million in 2008/09, up 4.7% on 2007/08. Profit before interest, tax and exceptional items was £456.0 million.



2009	£1,324.9m
2008	£1,265.3m

Turnover up 4.7%

Business highlights

Profit*
£456.0m (2008: £456.4m)

* before interest, tax and exceptional items

Cash and facilities

	Cash and cash equivalents	Committed facilities	Total
2009	£648m	£500m	£1,148 million
2008	£654m	£500m	£1,154 million

Funded for at least the next two years

Operating performance

KPI performance in upper quartile

2009	14
2008	10

Delivering against our KPIs

We measure our performance and progress against 20 Key Performance Indicators. Our aim is to achieve upper quartile performance across our 20 KPIs.

Our 20 KPIs are the result of a detailed and thorough examination of the key aspects of Severn Trent Water's performance. This includes benchmarking against comparable companies in the water and sewerage sector and other companies with similar characteristics in other sectors. We use a range of publicly available and internally generated data to identify the population that we should compare ourselves to. This process involves a number of judgments to ensure we used appropriately comparable data points for each measure.

Throughout 2008/09, we have been measuring ourselves against our KPIs and the updated benchmarks we established last year. The results are presented here.

We are committed to continually review and reset our KPI targets and expectations, in line with our Strategic Direction Statement.

We reward our people based on the 20 KPIs.

Reduction in pollution incidents

27%

Reduction in lost time incidents

30%

Reduction in unplanned interruptions to supply

67%

Reduction in written customer complaints

41%

Basis
Key performance indicator

MAT **Lost time incidents per 100,000 hrs worked²**

QR **Employee motivation %³**

MAT **Water quality (test failure rate) ppm¹³**

MAT **Customer written complaints per 1,000 properties^{1,5}**

MAT **First time call resolution for billing %⁶**

MAT **Unplanned interruptions > 6 hours per 1,000 properties^{1,7}**

NPR **Properties at risk of low pressure per 1,000 properties^{8,9}**

MAT **First time job resolution %⁶**

QR **Non performance against regulatory obligations %^{6,12}**

ATD **Capex (Gross) vs final determination %¹⁰**

MAT **Capital process quality (no defects per £100k)⁶**

Debtor days^{8,10}

MAT **Opex vs final determination (UK GAAP) £m¹⁰**

MAT **Cost to serve per property – £¹¹**

MAT **Pollution incidents (cat 1, 2 and 3) per 1,000 properties⁴**

MAT **Sewer flooding incidents – other causes per 1,000 properties¹**

PPS **Sewage treatment works – breach of consents %⁴**

Security of supply⁸

MAT **Net energy use – kWh/MI⁶**

MLE **Leakage MI/d¹**

Sewage treatment works compliance with consents

100%

Compliance with water quality standards

99.98%

2007/08 Performance	2008/09 Performance	2008/09 Quartile	At a glance	Know more
0.61	0.43	Upper		16
77%	83%	Upper		15
240.1	200.4	Upper		10
10.90	6.44	Upper		12
85%	88%	Upper		12
21.86	7.29	Lower		10
0.46	1.21	Upper		10
85%	96%	Upper		12
15%	10%	Median		14
1.7%	5.0%	Upper		13
0.03	0.00	Upper		14
37.4	33.1	Median		14
480.9	500.9	Median		13
236.82	236.53	Upper		14
0.11	0.08	Upper		11
0.21	0.17	Median		11
0.0%	0.0%	Upper		11
95	98	Median		10
608	622	Upper		11
491	492	Upper		10

Key

- Improved
- Maintained high standards
- No change
- Page numbers to related articles

Notes:

All measures are for the period to 31 March 2009, except as stated.

MAT = Moving Annual Total

QR = Quarterly Review

NPR = Number of properties on register

ATD = AMP4 to date

PPS = Percentage of population served

MLE = Maximum Likelihood Estimate

1. As reported in June Return to Ofwat. Performance figures are provisional at this stage as the June Return will be submitted to Ofwat on 12 June 2009.
2. Actual performance across all employees and agency staff.
3. Performance based on quarterly survey of 10% of permanent employees.
4. Measure for calendar year to 31 December 2008.
5. Performance excludes properties billed by other water companies.
6. Actual performance based on internal data.
7. 2008 performance excludes impact of Summer 2007 flooding. 2008 performance is 184.5 if impact of Summer 2007 flooding included.
8. Measure as at 31 March 2009.
9. 2009 and 2008 performance includes impact of new pressure loggers installed in 2007/08. Excluding pressure loggers, 2009 performance is 0.005 (2008: 0.06) as there has been a significant reduction in reactive identification.
10. Actual performance based on audited UK GAAP financial statements for the year ended 31 March 2009 and expressed in absolute terms.
11. Actual performance based on audited regulatory accounts for the year ended 31 March 2009.
12. Measure expressed as percentage non performance against regulatory obligations.
13. Measure now expressed as test failure rate (parts per million). 2008 performance restated accordingly.



Saving water in schools

Our water efficiency plans include working with our customers to reduce water usage by using water more effectively and eliminating waste. This enables them to save money and reduce impact on the environment. In 2008/09 we have been working with schools to audit their water use, identify opportunities to save water and provide educational resources to help change attitudes and behaviours towards

water use. Following the audit we devise a programme of work that repairs faulty equipment in the school and fits new water efficient devices wherever it is possible and economic to do so. Typical water usage reduction is around 15% and any investment in equipment is generally paid back in 19 months. To date we have completed 169 audits of our 600 school programme, which will end in March 2010.



For further information on this aspect of our business, visit www.severntrent.com/corporateresponsibility

As we progress into the final year of AMP4, the results and performance we have delivered over the past 12 months positions us well for the future. We have performed well in our KPIs and we continue to improve in line with our commitment to highest standards, lowest possible charges and great people.

Focus on Corporate responsibility

Corporate responsibility (CR) must be at the heart of the way we develop, manage and operate for long term sustainable benefit and the way we strive for highest standards, lowest possible charges and great people. In 2008/09, we focused on aligning our CR activities even more closely to the fundamental objectives of our business, our eight Key Strategic Intentions (KSIs). Because all areas of our business are linked closely to our CR agenda we have not included a separate section in this review. We do, however, recognise that a number of our stakeholders are particularly interested in understanding more about some of the key CR issues we are addressing. We have therefore produced a separate CR summary report which is available from our website, alongside additional online data and information. Visit www.severntrent.com/corporateresponsibility.

Focus on highest standards

This first section looks at how we have been improving and performing in water, waste and customer service.

KS1: providing a continuous supply of quality water

We have a number of projects and also KPIs that contribute to ensuring we have the highest standards in our water services.

Water quality

This year we continued to achieve one of the best records in the industry at 99.98% compliance with the regulatory standards set by the Drinking Water Inspectorate.

Our KPI now measures compliance with regulatory samples taken along the whole process from reservoir to tap. This is a more challenging measure which enables us to gain a broader and deeper understanding and allow us to drive water quality even higher through more effective long term solutions.

Unplanned interruptions

We significantly improved our KPI performance from last year by reducing the number of unplanned interruptions by 67% after excluding the effect of flooding at The Mythe Water Treatment Works in July 2007. Our KPI for unplanned interruptions to supply is based on Ofwat's DG3 level of service. In 2008/09, around

25,000 properties experienced unplanned interruptions to supply on this measure, compared to around 195,000 properties in 2007/08 (due to exceptional weather that year). This represents less than 1% of the properties connected to our network, compared to 5.7% in 2007/08.

By analysing the problems we had in 2007, we have been able to focus on improving our operational procedures and response times and aim to continue to look for ways to drive up our performance in this area.

Low pressure

We have installed 4,000 permanent pressure loggers throughout our distribution network to identify more points of low pressure and their root causes.

In the short term, as expected, this has resulted in us identifying more properties at risk, putting pressure on our KPI performance. This year we have identified and rectified over 9,000 properties at risk. We have 4,142 properties on the register and we intend to address these in the coming year. This compares to 1,546 properties in 2007/08 and represents around 0.12% of the properties we serve.

Maintaining security of supply

We replaced our raw water storage measure with a new security of supply KPI. This is a more complete measure of our ability to supply treated water to customers as opposed to the amount of raw water storage we have and is based on the Ofwat security of supply index.

We remain on track to deliver in line with our written undertaking to Ofwat on Security of Supply Index and recorded a performance this year of 98.

We are making good progress on our major scheme at Frankley Water Treatment Works, due to be commissioned in autumn 2009. The scheme will enable us to pump up to 120 megalitres a day (Ml/d) from the river Severn into the works.

Meeting our leakage target

Our leakage was 492 Ml/d in 2008/09. For the second year running and despite the coldest winter for eight years, we have met our leakage target of 500 Ml/d set by Ofwat. In 2008/09, we found and fixed 39,000 leaks, a similar number to 2007/08.

With increased focus on water efficiency, being able to reduce leakage becomes ever more important for our customers, for the environment and for our business. We have succeeded as a result of better network maintenance, better response times to finding and fixing leaks and a better understanding of where water is used.

Each year we invest in maintaining, repairing and modernising our extensive water network, some of which is over 100 years old. In AMP4 we set a target of 1,100 km of mains to be renewed over five years. We have already achieved this target and are planning to deliver 1,230 km at a cost of 3% more than the amount assumed in the Ofwat determination.



Putting fats, oils and grease to good use

At the heart of our vision for corporate responsibility are projects that benefit our communities, environment, customers and business. A great example is our project with the charity Community Service Volunteers (CSV) 'Grease Lightening'. This trial project involves doorstep collections of fats, oils and grease (FOG) from homes

that may usually put these blockage causing substances down the drain. The FOG collected is used for biofuel and the money generated reinvested by CSV. Our goal is a reduction in the number of sewer blockages in this area. This will reduce community impact, our costs and help us to keep our bills as low as possible for all customers.

Improving flood protection at our sites

Following the floods in 2007, we have provided additional flood protection at four water treatment sites. At The Mythe Water Treatment Works, the temporary flood barriers remain in place while we seek planning permission for permanent flood defences. We are also seeking planning permission for an additional pipeline to bring extra supply into the Gloucester area. We continue to liaise closely with the Gloucestershire scrutiny committee.

Promoting the responsible use of water

Water efficiency plays a key part in our water resources planning. In addition to saving water in our own business, we have worked on helping our customers reduce the water they use. For example, we have run workshops with our major use customers to help them identify ways to save water and reduce their bills. We also have a range of programmes to provide schools and households with water saving devices and water saving advice, such as our Be Smart education programme. Through this scheme, employees work as mentors with 50 schools each year using an education pack focused on water efficiency.

KSI: Dealing effectively with waste water

Waste water standards have been improving over the last year and the KPIs and investments shown below are key examples of our progress.

Looking after the environment

We place great emphasis on our environmental responsibilities. How we abstract water, manage waste water discharges, operate over 1,000 sewage treatment sites, 54,000 km of sewers, over 3,600 sewage pumping stations and how we manage resources all have a huge potential impact on the local environment. We have a responsibility to make the best use of our resources.

100% compliance at our sewage treatment works

In 2008, all our sewage treatment works again complied with the discharge consents issued to them by the Environment Agency. This consistently high level of compliance is amongst the best in the industry and demonstrates our continuously improving performance in line with compliance standards that get higher year after year.

Fewer pollution incidents

For pollution incidents, we achieved 0.08 per 1,000 properties in 2008. Pollution incidents in this calendar year were significantly down 25% to 313, from 417 in 2007. Of the total recorded, eight were in the more serious categories 1 and 2 (categorised by the Environment Agency), compared with 13 in 2007. In line with the 13 point plan we agreed with the Environment Agency and Ofwat to improve our environmental performance in relation to pollution, we have heightened awareness and improved our processes in order to be able to prevent, identify and tackle pollution incidents more quickly and effectively.

Reduced sewer flooding

We performed better than last year against our KPI measure for sewer flooding – other causes per 1,000 properties. There is still more to do and we have a specific improvement plan for this area, including encouraging our customers not to put fats, oils and grease down the drain as well as carrying out targeted cleansing of our network. Sewer flooding can also be caused by overloaded sewers. Properties flooded in this way are put onto flooding registers and solutions are investigated. In agreement with Ofwat, we have now bought our methodology in line with the rest of the water industry and as a result the number of properties on the register in our region has come down significantly in 2008/09.

To tackle the many complexities surrounding flooding in the most effective way, we work closely with all concerned, including local authorities, the community and the Environment Agency.

Investing in waste water improvements

We invest heavily in every aspect of our waste water process and network. In 2008/09, we invested £300 million in this part of our business and currently have around 600 schemes underway. Minworth Sewage Treatment Works is our biggest ongoing scheme and one of the largest in the industry. The work has progressed well and is nearing completion and is intended to enable us to achieve higher standards more efficiently ahead of the new effluent standards which come into force in March 2010. Other examples include improvements at Leicester, Stoke-on-Trent and Derby Sewage Treatment Works as well as the completion of our £18 million investment to build a 21st century sewer network for Kenilworth.

We are working closely with government and agencies on the requirement for us to take ownership of private sewers in our region. This will grow our sewer network by around 50%.

KSI: Minimising our carbon footprint

Responsible use of energy

Our net energy use KPI measures how much energy (net of renewable energy generated by us) we consume per megalitre of water supplied or waste water treated. Our net energy use remained broadly in line with last year, at 622 kWh/MI during this year. Although we have succeeded in continuing to decrease our energy use, our generation of renewable energy was held back, notably at Minworth Sewage Treatment Works, where our investment in improving effluent quality at the site has reduced the amount of biogas we have been able to produce there this year.



Renewable energy

We have ambitious plans to expand our approach to renewable energy and have a target to generate 30% of our energy from renewable sources by 2013. The measures to achieve this include increasing use of our two established methods: hydro power and combined heat and power (CHP) using biogas from our sewage treatment works. We are also developing new methods: wind energy and biomass energy crops.

We have invested substantial time and resource into both these methods and are confident of their potential to help us significantly increase our generation of renewable energy. We intend to have our first energy crop digester operational by April 2010.

In 2008/09, we undertook a major piece of work to calculate our carbon emissions for the AMP4 period and on into AMP5. Despite the continued upward pressures of providing water to more people and meeting higher water quality standards which requires more energy, when we take into account both our investment in renewable technologies and energy efficiency, we have been successful in avoiding significant growth in energy consumption over the last five years.

Looking ahead to the next AMP where we face continued upward pressures, our net greenhouse gas emissions are forecast to remain virtually unchanged between 2009/10 and 2014/15, as a result of our energy strategy.

KSI: Responding to customers' needs

Customer service standards have also seen very positive improvements in the last 12 months.

Resolving jobs first time

Our aim is to resolve jobs on the customer's first call to us. In 2008/09 we achieved 96% first time job resolution, compared with 85% in 2007/08.

This performance improvement was delivered through our 24/7 Customer Operations Service Centre at Coventry and was based upon improved customer service and operational processes.

Building on last year's progress, we continued to improve our performance in customer service and refine our processes to find and fix operational problems as quickly and effectively as possible and we are now achieving upper quartile performance.

Reducing customer complaints

We succeeded in reducing written complaints by 41%, from 45,710 in 2007/08 to 27,066 in 2008/09. This is based on written customer complaints per 1,000 properties, and improves on last year's reduction of 34%.

Better call handling

In 2008/09 we have achieved 88% for our first time call resolution for billing, improving on last year's results of 85%. We are developing the capability of all our teams through a comprehensive upskilling programme, coupled with our continuous improvement programme.

Improving all customer service standards

Alongside our KPI performance measures we have also improved our performance across Ofwat's DG measures, achieving better results in DG6 (response to written billing queries), DG7 (response to written complaints), DG8 (meter readings) and DG9 (customer satisfaction with telephone calls).

This year we fitted 44,331 meters through our free meter option scheme which we continue to promote to our customers.

In addition, we have invested in our website to improve it further to become a genuine customer service centre. The facility to manage 'your account' online is now live, enabling customers to quickly and easily view and pay bills, update details, submit meter readings and much more at a time that's convenient for them. This is part of our ambition to enable our customers to interact with us whenever they need to and in whichever way best suits them – email, website, phone, letter or text message.

Looking ahead, our focus will be to keep improving. We want to continue getting more out of our systems and we want our people to continue getting better and better at what they do.

Addressing the needs of vulnerable customers

While we actively pursue those who are able but unwilling to pay their bills, we offer flexibility to those who genuinely struggle to pay. As a result of the downturn in the economy, we are finding more people need help. We have created a dedicated team to actively seek out customers who might need help, working together with organisations such as the Citizens Advice Bureau and Age Concern.

The Severn Trent Trust Fund is an independent trust set up to help customers in serious financial hardship. The amount of money in the Trust Fund has increased this year by £1 million to £5.5 million. We also continue to promote our WaterSure tariff to cap charges for vulnerable customers who have a water meter.

Along with the rest of the water industry we have teamed up with the Home Office and local police constabularies in supporting their distraction burglary initiative. We know that bogus callers use water companies as a reason to gain entry to people's homes and we continue to promote our password protection scheme to all of our customers to reassure them they can check the genuine identity of doorstep callers at anytime.

New connections

Our new connections team manages, from application to delivery, the connections of customers to water and waste water services.

In 2008/09 the economic climate has resulted in a decline in the level of activity undertaken. This has been most significant in the provision of services to developers. In response to these external pressures we have rationalised our department to a single operating base at our offices in Leicester Water Centre. These changes continue to build upon improvements in our performance, with connections completed within 21 working days increasing from 86% in 2007/08 to 90% in 2008/09.

Developing a sustainable service for customers

Serving customers also means looking after their long term interests as well as their immediate concerns. We continue to maintain the serviceability of our assets. This means carrying out the work necessary to make sure our water and sewerage systems deliver reliable service in the future for customers and the environment. It takes into consideration above ground and below ground water and sewerage assets. Our most recent assessment shows that we have made progress, and we aim to continue to do so.

Focus on lowest charges

We are committed to keep bills as low as possible for our customers. Managing our operational and capital costs is a key contributor to this.

KSI: Having the lowest possible charges

Financial performance

The past year has seen an unprecedented period of disruption to financial markets, leading to the so called 'credit crunch' and wider economic recession. The first half of the year saw increased RPI inflation, peaking at 5% in September, with a rapid fall in the second half. Annual RPI inflation at March 2009 was negative 0.4%.

This volatility has presented a number of challenges. The economics of the Ofwat regulatory framework are explicitly linked to RPI, with Ofwat's final determination for both total opex and capex set in 2002/03 prices and adjusted by the relevant inflation index each year (RPI for opex, COPI, a construction price index, for capex).

We faced rising costs in the first half of the year which we worked hard to contain, while seeking to obtain value from falling rates in the latter half. In a business such as Severn Trent Water where there are long lead times on procured items, particularly on the capital investment programme, this challenge has been difficult. Over the short term, therefore, our cost base does not quickly follow the headline RPI or COPI index.

Investing in our network

Year after year, we invest in improving the quality, resilience and maintenance of our network. During 2008/09, we invested £130 million (net of grants and contributions received) in maintaining our infrastructure network. Capital expenditure, excluding spending on infrastructure maintenance (and net of grants and contributions received), was £476 million. Gross capital expenditure (including infrastructure maintenance expenditure) increased to £635 million.

We are meeting our obligations on investments and making them more efficiently.

Our capex (gross) vs final determination KPI measures our performance on managing the financial aspects of the delivery of our investment programme. This measures the percentage variance between our capital expenditure to meet our obligations for AMP4 and Ofwat's final determination.

This is a continuation of our work in 2007/08 to smooth the so called investment rollercoaster, where investment rises steeply in years two, three and four of the AMP cycle before falling off sharply in year five. Smoothing this out so that there is a steady amount of investment throughout the five years is beneficial for our contractors, because it allows them to plan their resources more easily and cost effectively, and for us, because we can gain from efficiencies.

Whilst we continue to be on track to meet our regulatory obligations and capital expenditure targets in monetary terms, the recent rapid reduction in COPI is likely to lead to a lower than anticipated regulatory capital value cap as we proceed into the final year of AMP4. We remain focused on the successful delivery of the absolute levels of expenditure previously announced, although this may result in an overall efficiency of less than the previously announced 6%.

As we move into the final year of AMP4, we continue to progress a number of return enhancing investments that will provide value over the longer term. These include further renewable energy generation, the early development of capital plans for AMP5 and the new Severn Trent Centre in Coventry. In all cases, our focus is on delivering sustainable efficiencies, lowering the cost of our operations and therefore providing value for our customers.

Managing our operating costs

Despite the economic pressures, we remain on track with our opex vs final determination KPI, which measures the variance between our latest formal forecast of operating costs and Ofwat's final determination for AMP4. The recent rapid reduction in RPI has led to a lower than anticipated baseline final determination for 2008/09, but we have delivered an outcome this year that is in line with the absolute levels of expenditure previously targeted.

As we proceed into the final year of AMP4, the recent rapid reduction in RPI is likely to have a significant negative impact on the anticipated baseline final determination. We have however accelerated some of our improvement plans and expect to incur around £20 million of restructuring costs in 2009/10 which will deliver around £5 million of additional operating cost savings in 2009/10 beyond our previous plans and further cost efficiencies in AMP5. We remain focused on the successful delivery of our plans and we continue our efforts to identify and pursue additional opportunities in this lower inflation environment.

Capital Process Quality

Our capital process quality KPI is now in place and is working well. We achieved zero defects on handover per £100,000 spend, a reduction on last year's 0.03.

The capital process quality measure assesses our delivery of high quality services.

Cost to serve a property

Our KPI, cost to serve per property, measures the total cost (including operating costs, depreciation, infrastructure renewals and third party costs) associated with serving a single property. During 2008/09, we continued to maintain a cost base that supports our position of having some of the lowest bills in the industry.

Managing trade debt

We continue to manage our trade debt as efficiently as possible. Despite the downturn in the economy, our debtor days performance improved from 37.4 days in 2007/08 to 33.1 days. This improvement is a result of enhancements made to our debt management process, including more customers signing up to our water direct scheme to make payments directly from their benefits and an increase in the range and volume of outbound message campaigns encouraging customers in debt to contact us and agree payment plans.

Despite our improved debtor days performance overall, the challenging economic conditions have seen an increase in customer insolvencies and greater difficulty in collecting debt over one year old. As a result, we increased our bad debt charge and it now represents around 2.3% of turnover, up from around 1.9% last year.

KSI: Promoting an effective regulatory regime

Performance against our regulatory obligations

In 2008/09, we improved our performance against our regulatory obligations KPI, reducing the number of areas with significant issues to 10%. This was a significant improvement on the 15% we achieved in 2007/08.

Promoting effective regulation

We have played an active part in developments in the regulatory framework and been active in supporting and exploring the development of competition in the industry. We have engaged with the Cave Review on Competition and Innovation and the Walker Review of Charges. In particular, we believe a competition model based on water trading could work and we are currently looking at how this might be developed in order to help address the balance of water supply and demand on a national basis. This may help to reduce the need for additional infrastructure in some parts of the country where water supplies are low and therefore keep costs as low as possible for all customers.

This is one of the recommendations of the Cave Review. Cave also recommends the separation of retail activity and retail competition for non households. We believe that retail competition is only likely to bring substantial benefits if it is coupled with competition for resources and should not therefore be pursued as an end in itself.

We have also spoken at events and responded to consultation documents on a wide range of regulatory and competition issues with the aim of encouraging the development of the framework to meet the new challenges facing the industry.

We continue to engage with the Environment Agency to explore the trade-offs between the environmental benefits of improving river water quality and the increased energy use this improvement involves. Our aim is to safeguard the needs of the environment and address climate change while keeping our bills as low as possible for our customers.

KSI: Maintaining investor confidence

The interests of our customers and our investors are inextricably linked, we need access to finance to maintain and improve our services to customers, and lower financing costs mean lower bills. In the current economic environment, both customers and investors are placing increasing value on stability.

As we look forward, the continuing large capital investment programme will drive further borrowing requirements, with our Final Business Plan anticipating a borrowing requirement of around £200 million a year on average over AMP5. The future visibility of returns and cash flow are important in sustaining investor confidence in Severn Trent Water and the wider water sector. A key element in this is the setting of an appropriate cost of capital which ensures that water remains sufficiently attractive over the long term to both debt and equity investors to secure financing for our planned investment programme. Our Final Business Plan assumes a cost of capital of 5.0% real, post tax, consistent with maintaining an appropriate credit rating to allow the company to raise the funds it requires to finance future investment at a reasonable rate and deliver an appropriate return to equity investors. The component parts of the assumed cost of capital are real post tax cost of equity of 7.7% (AMP4 7.7%), real post tax cost of debt of 3.3% (AMP4 3.0%) and 60% gearing (AMP4 55%).

The successful execution of our plans in the current AMP4 period, and the basis of our PRO9 Final Business Plan submission to Ofwat underpin our ability to:

- deliver a sustainable and progressive dividend to our equity investors, and
- maintain an appropriate financial structure, including sustaining a strong investment grade credit rating, which can absorb the impact of business cycle changes and enable the funding of our long term investment plan.



Coventry is undergoing a £9.4 billion transformation and Severn Trent is a key part of our exciting future.

Councillor Gary Ridley,
cabinet member for
city development

Focus on great people

KSI: Having the right skills to deliver

We are committed to improving continuously the engagement, skills and working environment of our people. Below are examples of how our work programmes and KPIs contribute to improvements in this area.

Increasing employee motivation

In 2008/09, we achieved our stretching KPI employee motivation target of 83% improving on last year's 77%. We measure this KPI through an annual employee survey and three mini surveys to gain a clear ongoing measure of staff morale and motivation.

This excellent performance has been achieved in a year of continued emphasis on the key enablers that drive our commitment to highest standards, lowest possible charges and great people. These enablers are upskilling, simple processes that work, an improved workplace, improved technology that works, and being paid for doing the right things for our customers.

Developing the skills of our people

We have focused on establishing one way of working for all our people and giving everyone the encouragement, tools and techniques to work that way. To this end, we have been increasing the skills of our managers and of the workforce.

We have formal succession and talent management reviews through the year. This process reaches across the organisation so that we can identify and develop talent to help people achieve their potential.

Improving our management skills

In 2008, we launched the Line Manager Journey to clarify roles and equip managers with the right skills, tools and techniques to be able to get the best out of their teams. From the Chief Executive to the most junior manager, all our managers now have one common process of managing performance.

We have launched a leadership model and rolled out a behavioural model for all employees. It is part of our commitment to develop a modern workplace, where people treat each other in a supportive, adult to adult way and share and develop improvement plans to achieve both business and personal goals.

Creating a diverse workforce

We are committed to improving the diversity of our workforce. Building on the work we have already done, in 2008 we set up a Diversity Working Group and developed an action plan in line with our stated belief that a diverse and inclusive culture is a key factor to a successful business. During the year we commissioned some benchmarking work to better understand our diversity performance and identify areas for improvement. Our key diversity statistics are available on our website and in our Corporate Responsibility Summary report.

Simple processes that work

We have introduced lean management practices across our water, waste water and other business areas. As a result, our people, in water treatment works, sewage depots, call centres, have been able to connect what they do on a day by day basis to our overall strategic direction and KPIs. And critically, they have been given the encouragement, training and tools to start making their own improvements with the support of their managers. This in turn has resulted in cost reductions, improvements in customer service and higher engagement levels among our workforce.

We are identifying and fixing issues faster, more efficiently and more fundamentally, getting more things right first time, eliminating waste from our processes. As a result, our performance is improving, on interruptions to supply, on leakages, on reducing energy use and more. To date, around 1,500 of our 5,624 people have been introduced to the tools and techniques and are now using them in their day to day work. Building on our successes this year, we will continue to invest in our safer, better, faster way of working throughout the business. We are developing lean change champions and an academy of experts to help ensure this way of working continues to be our way of working. Alongside our training in process improvement we continue to invest in developing the technical and professional qualifications of our people through apprenticeships and continuous learning.

An improved workplace

We are investing in our workplace to reflect the quality of the way we work, creating great environments for great people.

Our property portfolio includes 7,000 sites across the 21,000 km² Severn Trent Water region. As reported last year, we have been working to a strategy of creating a portfolio of workspace for the business at the right cost, the right quality, of the right amount in the right location and held for the right period of time.

This includes the development of the new Severn Trent Centre in Coventry, which is progressing well, with a number of key milestones being achieved in 2008/09. Severn Trent Centre is part of the programme of workplace improvements to set new standards for our working environments and with plans to implement them across all of our remaining sites.

Improved technology that works

In 2008/09, we aligned our IT investment to our eight KSIs and focused it on helping us provide our day to day business services more efficiently and effectively. We also reorganised the IT team around service delivery, development and strategy on the supply side and around our core business groups on the demand side.

The key objective is to ensure that IT supports our business as effectively as possible. To this end, we are investing in technology to improve key processes that enable us to work better together and improve our performance in water, waste water, customer relations and our finance, HR and procurement functions. A key element of



Above all, we intend to make sure we are constantly looking at the long term stewardship of the business to ensure we continuously improve standards, keep on lowering costs and further develop our great people in the years ahead.

this investment is our SAP programme and the process improvement it will deliver. We have completed the detailed design for this programme and have begun the implementation phase. We are also looking at how to implement new technology to support a far more flexible and mobile workforce and set of working practices, so that our people can work as effectively as possible from wherever they need to be.

Improving health and safety

Creating a safe place to work is at the heart of our commitment to creating a great place to work. We continually focus on improving safety, quality and standards across the organisation.

Reducing lost time incidents

In 2008/09, we improved our performance on our health and safety KPI of lost time incidents per 100,000 hours by 30% – down to 0.43, compared with 0.61 in 2007/08. In achieving this significant improvement, we beat our measure of 0.51. Our RIDDOR (Reporting of Injuries, Diseases and Dangerous Occurrences (Regulations)) rate is 0.33, a 39% improvement on our 2007/08 rate of 0.54.

Demonstrating safety improvement plans

Last year, we set out a 10 point strategy plan on safety, quality and standards that are important to us. This year, we have been cascading the plan through the organisation, working closely with line managers and teams to produce their own safety improvement action plans reflecting the 10 points.

Our Safe and Unsafe Acts behaviour management system is very much an active part of the way we build behavioural safety into our everyday business. Work in this area is active and continuing well with more safety discussions taking place.

In 2008/09, we had four British Safety Council audits at a variety of facilities. One site received five stars, the highest grade, and three received four stars. We also entered 19 of our business areas for Royal Society for the Prevention of Accidents safety awards. 17 business areas received a range of awards, with an overall company Gold Award for safety improvements.

Comprehensive site safety review

We completed a comprehensive health and safety process review of the engineering and operational assets at all our water and waste water sites in 2007/08. In total we surveyed 6,646 sites. During 2008/09, we carried out a wide range of improvements prioritising work based on the level of risk.

Our engineering standards organisation continues to look at asset safety. We have been working on more unified standards for the engineering, safety and design of our future assets. A substantial proportion of the new design templates for AMP5 contracts are now in place.

Safety for suppliers

During the year, we held five supply chain forums for health and safety and quality management. We ran three for contractor health and safety, one at the quality working day for suppliers and one for excavation contractors on the risks of high voltage cable strikes. Over 100 supplier companies have attended one or more of these forums across the year.

Working as one team with our suppliers

We are investing in ever stronger relationships with our contractors and suppliers. We aim to manage the whole supply chain responsibly, from suppliers through to customers.

We make sure we are working with responsible suppliers, based on their health and safety, environment, ethics and human rights track record. We are also looking at identifying areas where our suppliers will be able to help us achieve some of our strategic objectives, such as reducing our carbon footprint.

Our award winning two year supply chain management programme with Nottingham Trent University, draws participants from throughout our business and our contractors and suppliers. The programme allows our employees, contractors and suppliers to work together on areas of joint interest, in a positive environment to deliver business benefits. Key outputs from this programme have already been implemented in the company this year or are part of our strategy around AMP5.

Looking ahead

We intend to continue to deliver on our promises and to build on the wide ranging performance improvements we have achieved in 2008/09 against our 20 KPIs and in line with our eight KSIs.

We believe we have submitted a high quality Final Business Plan for PRO9 that balances the interests of all stakeholders: customers, employees, suppliers, economic and environmental regulators, and investors. In the coming months, we look forward to continuing our preparations for AMP5, including working towards final determination of our Plan.

We intend to continue working closely with everyone concerned on regulatory reforms, notably competition and the adoption of private sewers. We welcome these changes and will make sure we are in the best position to address these reforms for our customers and our shareholders.

In these challenging economic times where quality, prudence and long term thinking are at a premium, we aim to apply our robust funding strategy in order to continue securing the finance we need to fund investment over the next year and beyond.

Above all, we intend to make sure we are constantly looking at the long term stewardship of the business to ensure we continuously improve standards, keep on lowering costs and further develop our great people in the years ahead.

Tony Wray

Chief Executive
Severn Trent Water