

# Our performance in 2016/17

## Financial performance

### Highlights

	Year ended	
	31 March 2017	31 March 2016
Continuing operations		
Revenue	<b>£1,704.0m</b>	£1,730.0m
Underlying operating profit <sup>(1)</sup>	<b>£622.9m</b>	£604.1m
Operating profit	<b>£605.5m</b>	£567.9m
Total dividend per ordinary share (pence)	<b>38.87p</b>	38.45p
RCV gearing <sup>(2)</sup>	<b>61%</b>	61%

(1) Underlying profit measures have been provided to give a more representative view of business performance and are defined in the underlying profit measure tables on pages 44 to 45.

(2) Regulatory capital value or RCV gearing calculated as group net debt/United Utilities Water's RCV (outturn prices).

### Revenue

Revenue was down £26 million, at £1,704 million, reflecting the impact of our Water Plus JV, which completed on the 1 June 2016, partly offset by our allowed regulatory revenue changes.

With regard to Ofwat's revenue correction mechanism, relating to the 2014/15 financial year, we have £9.5 million to return to customers. As we have previously indicated, we propose to return the £9.5 million to customers through revenue reductions of c£3 million in 2017/18, c£3 million in 2018/19 and c£3 million in 2019/20 to help aid a smoother bill profile.

Separately, consistent with Ofwat's annual wholesale revenue forecasting incentive mechanism (WRFIM), we will also be reducing 2017/18 revenue by £7 million as actual volumes in 2015/16 were higher than our assumptions, increasing revenue by 0.4 per cent.

### Operating profit

Underlying operating profit at £623 million was £19 million higher than last year. This reflects our allowed regulatory revenue changes, a reduction in infrastructure renewals expenditure, an improvement in our bad debt charges and a small reduction in the remaining cost base, partly offset by the accounting impact of our Water Plus JV. The JV completed on 1 June 2016 and, from that date, its contribution is no longer included within operating profit and is, instead, included within the share of profits of joint ventures line in the income statement. However, as expected, due to start-up costs, our share of 2016/17 losses of the Water Plus JV was around £2 million.

Reported operating profit increased by £38 million, to £606 million, reflecting the increase in underlying operating profit, along with a reduction in adjusted items. Adjusted items for 2016/17 amounted to £17 million, £10 million of which related to restructuring costs. Adjusted items in the prior year amounted to £36 million, £25 million of which related to the water quality incident in summer 2015.

### Investment income and finance expense

The underlying net finance expense of £237 million was £36 million higher than last year, mainly due to the impact of higher RPI inflation on the group's index-linked debt, particularly on the portion of index-linked debt with a three-month lag. Interest on non index-linked debt of £108 million was £4 million lower than last year, due to the lower rates locked in on our interest rate swaps. The indexation of the principal on our index-linked debt amounted to a net charge in the income statement of £81 million, compared with a net charge of £38 million last year. As at 31 March 2017, the group had approximately £3.6 billion of index-linked debt at an average real rate of 1.3 per cent.

The higher RPI inflation charge compared with last year contributed to the group's average underlying interest rate of 3.8 per cent being higher than the rate of 3.4 per cent for the year ended 31 March 2016. The average underlying interest rate represents the underlying net finance expense divided by average debt.

Reported net finance expense of £189 million was lower than the £219 million expense in 2015/16. This £30 million decrease principally reflects a change in the fair value gains and losses on debt and derivative instruments, from a £26 million loss in 2015/16 to a £24 million gain in 2016/17. The fair value gain in the current year is due to the net receipts on swaps and debt under fair value option and gains on our electricity swap portfolio due to an increase in the market price of electricity. Losses in the prior year were largely due to a decrease in medium-term interest rates, which impact our derivatives hedging interest rates. The group uses these swaps to fix interest rates on a substantial proportion of its debt to better match the financing cash flows allowed by Ofwat at each price review. The group has fixed the substantial majority of its non index-linked debt for the 2015-20 regulatory period.

### Profit before tax

Underlying profit before tax was £389 million, £19 million lower than last year, as the £19 million increase in underlying operating profit was more than offset by the £36 million increase in underlying net finance expense. This underlying measure reflects the adjusting items, as outlined in the operating profit section above, and other items such as fair value movements in respect of debt and derivative instruments, as outlined in the underlying profit measures table on pages 44 to 45.

Reported profit before tax significantly increased by £89 million to £442 million, due in most part to fair value movements and the increase in reported operating profit, as well as a £22 million profit on disposal of the non-household retail business.

### Tax

In addition to corporation tax, the group pays and bears further annual economic contributions, typically of around £140 million per annum, in the form of business rates, employer's national insurance contributions, environmental taxes and other regulatory service fees such as water abstraction charges.

In 2016/17, we paid corporation tax of £42 million, which represents an effective cash tax rate on underlying profits of 11 per cent, which is 9 per cent lower than the headline rate of corporation tax of 20 per cent. Consistent with prior years, the key reconciling item to the headline rate was allowable tax deductions on capital investment. We have expressed the effective cash tax rate in terms of underlying profits as this measure excludes fair value movements on debt and derivative instruments and thereby enables a medium-term cash tax rate forecast. We would expect the average cash tax rate on underlying profits through to the end of the current regulatory period in March 2020 to be around 15 per cent. The key risk to sustaining this rate is any unexpected changes in tax legislation or practice and, as necessary, we would actively engage with the relevant authorities in order to manage this risk.

The current tax charge was £54 million in 2016/17, compared with £53 million in the previous year. There were current tax credits of £23 million in 2016/17 and £9 million in 2015/16, following agreement of prior years' tax matters; in addition to UK tax, the current year figure also included the release of a provision in relation to agreed historic overseas tax matters.

For 2016/17, the group recognised a deferred tax charge of £28 million, compared with a charge of £19 million for 2015/16. In addition, in 2016/17 the group recognised a deferred tax charge of £7 million relating to prior years' tax matters, compared with a charge of £6 million in 2015/16. In 2016/17, the group also recognised a deferred tax credit of £58 million relating to the enacted reduction in the headline rate of corporation tax from 18 per cent to 17 per cent from 1 April 2020. This compares to a deferred tax credit of £112 million in 2015/16 when the enacted reduction in the headline rate of corporation tax from 1 April 2020 was reduced from 20 per cent to 18 per cent.

The total tax charge for 2016/17 was £9 million as compared to a total tax credit of £44 million for 2015/16, the main difference being the £54 million reduction in the deferred tax credit relating to changes in tax rates. For both periods, the total underlying tax effective rate was in line with the headline rate (currently at 20 per cent) and subject to any legislative or tax practice changes, we would expect this to continue for the medium-term.

## Profit after tax

Underlying profit after tax of £313 million was £12 million lower than last year, principally reflecting the £19 million decrease in underlying profit before tax partly offset by lower underlying tax on lower profits. Reported profit after tax was higher at £434 million, compared with £398 million in the previous year, as the £89 million increase in the reported profit before tax was partly offset by the £53 million higher tax charge.

## Earnings per share

Underlying earnings per share decreased from 47.7 pence to 46.0 pence. This underlying measure is derived from underlying profit after tax. Basic earnings per share increased from 58.3 pence to 63.6 pence, for the same reasons that increased profit after tax.

## Dividend per share

The board has proposed a final dividend of 25.92 pence per ordinary share in respect of the year ended 31 March 2017. Taken together with the interim dividend of 12.95 pence per ordinary share, paid in February, this produces a total dividend per ordinary share for 2016/17 of 38.87 pence. This is an increase of 1.1 per cent, compared with the dividend relating to last year, in line with the group's dividend policy of targeting a growth rate of at least RPI inflation each year through to 2020. The inflationary increase of 1.1 per cent is based on the RPI element included within the allowed regulated revenue increase for the 2016/17 financial year (i.e. the movement in RPI between November 2014 and November 2015).

The final dividend is expected to be paid on 4 August 2017 to shareholders on the register at the close of business on 23 June 2017. The ex-dividend date is 22 June 2017.

In light of the Financial Reporting Lab's report entitled 'Disclosure of dividends – policy and practice', which provided best practice guidance, we enhance our dividend policy disclosure, as outlined below.

**Dividend policy** – a growth rate target of at least RPI inflation each year through to 2020.

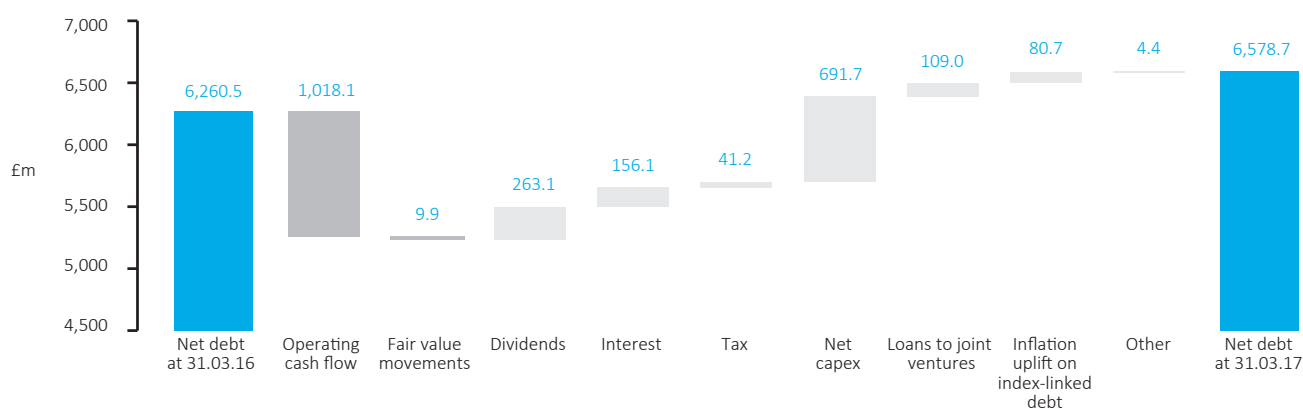
**Policy period** – the dividend policy aligns with the five-year regulatory period which runs from 1 April 2015 to 31 March 2020.

**Policy approval process** – the dividend policy was considered and approved by the United Utilities group board in January 2015, as part of a comprehensive review of the 2015-20 regulatory final determination in the context of a detailed business planning process, with due regard for the group's financial metrics, credit ratings and long-term financial stability, and is reviewed at least annually.

**Distributable reserves** – as at 31 March 2017, the company had distributable reserves of £3,184 million. The total external dividends relating to the 2016/17 financial year amounted to £265 million. The company distributable reserves support over 12 times this annual dividend.

**Financing headroom** – supporting the group's cash flow, United Utilities adopts a funding/liquidity headroom policy of having available resources to cover the next 15-24 months of projected cash outflows.

## Summary of net debt movement



# Our performance in 2016/17

**Cash flows from subsidiaries** – the directors consider that the group’s principal operating subsidiary, United Utilities Water Limited (UUV), has sufficient resources to pay dividends to United Utilities Group PLC for the duration of the current dividend policy period to support the external payment of dividends to shareholders.

**Financial stability** – the water industry has invested significant capital since privatisation in 1989 to improve services for customers and provide environmental benefits, a large part of which is driven by legislation. Water companies have typically raised borrowings to help fund the capital investment programme. Part of total expenditure is additive to the regulatory capital value, or RCV, on which water companies earn a return allowed by the economic regulator, Ofwat. RCV gearing is useful in assessing a company’s financial stability in the UK water industry and is one of the key credit metrics that the credit rating agencies focus on. United Utilities has had a relatively stable RCV gearing level over the last five years, always comfortably within its target range of 55 per cent to 65 per cent, supporting a solid A3 credit rating for UUV with Moody’s. RCV gearing at 31 March 2017 was 61 per cent and the movement in net debt is outlined in the cash flow section below.

**Dividend sustainability** – in approving the policy, the board is satisfied that across the current regulatory period, the projected dividend is adequately covered by underlying profit after tax. Separately, the executive directors’ long-term remuneration plan is directly linked to a measure of sustainable dividends. Whilst specific targets are not disclosed in advance, for commercial sensitivity reasons, there is a major focus on the creation of strong earnings that ensure the sustainability of dividends.

**Viability statement** – the dividend policy is underpinned by the group’s long-term viability statement (contained within the group’s annual report and financial statements). Assurance supporting this statement is provided by the review of: the group’s key financial measures; the key credit financial metrics; the group’s liquidity position; the contingent liabilities of the group; and the key risks of the group together with the associated mitigating actions.

**Annual dividend approval process** – the group places significant emphasis on strong corporate governance, and before declaring interim and proposing final dividends, the United Utilities group board undertakes a comprehensive assessment of the group’s key financial metrics.

## Policy sustainability

### 2015-20

- › The policy is considered by the board to be robust to reasonable changes in assumptions, such as inflation, opex, capex and interest rates
- › Extreme economic, regulatory, political or operational events, which could lead to a significant deterioration in the group’s financial metrics during the policy period, may present risks to policy sustainability

### 2020-25

- › A dividend policy for the 2020-25 period will be formulated after Ofwat announces the outcome of the regulatory price review (currently expected in December 2019)

## Cash flow

Net cash generated from continuing operating activities for the year ended 31 March 2017 was £821 million, compared with £686 million in the previous year. This increase mainly reflects a switch between cash generated from operating activities and cash used in investing activities largely due to the accounting treatment of our Water Plus JV. The group’s net capital expenditure was £692 million, principally in the

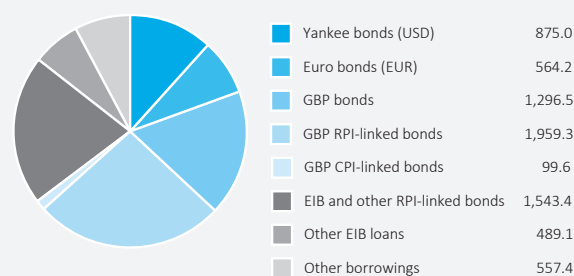
regulated water and wastewater investment programmes. This excludes infrastructure renewals expenditure which is treated as an operating cost under IFRS. Cash flow capex differs from regulatory capex, since regulatory capex is based on capital work done in the period, rather than actual cash spent.

Net debt including derivatives at 31 March 2017 was £6,579 million, compared with £6,261 million at 31 March 2016. This increase reflects accelerated regulatory capital expenditure, payments of dividends, interest and tax, the inflationary uplift on index-linked debt and loans to joint ventures, partly offset by operating cash flows.

## Fair value of debt

The group’s gross borrowings at 31 March 2017 had a carrying value of £7,385 million. The fair value of these borrowings was £8,603 million. This £1,218 million difference principally reflects the significant fall in real interest rates, compared with the rates at the time we raised a portion of the group’s index-linked debt. This difference has increased from £483 million at 31 March 2016, due primarily to a decrease in credit spreads.

## Gross debt – total carrying value £7,384.5m



## Debt financing and interest rate management

Gearing, measured as group net debt divided by UUV’s shadow (adjusted for actual spend) regulatory capital value, was 61 per cent at 31 March 2017. This is the same gearing as at 31 March 2016 and remains comfortably within our target range of 55 per cent to 65 per cent.

UUV has long-term credit ratings of A3/BBB+ and United Utilities PLC (UU PLC) has long-term credit ratings of Baa1/BBB- from Moody’s Investors Service (Moody’s) and Standard & Poor’s (S&P) Ratings Services respectively. The split rating reflects differing methodologies used by the credit rating agencies. Moody’s has the group’s ratings on a stable outlook, whereas S&P has the group’s ratings on a positive outlook.

The group has access to the international debt capital markets through its €7 billion euro medium-term note (EMTN) programme. The EMTN programme does not represent a funding commitment, with funding dependent on the successful issue of the notes.

Cash and short-term deposits at 31 March 2017 amounted to £248 million. Over 2015-20 we have financing requirements totalling around £2.5 billion to cover refinancing and incremental debt, supporting our five-year investment programme, and we have now raised over £1.7 billion of this requirement.

In April 2016, UUV signed a £250 million index-linked term loan facility with the EIB to support the delivery of UUV’s AMP6 investment programme. As at 31 March 2017, £75 million had been drawn down.

This is an amortising facility with an average loan life of 10 years and a final maturity of 18 years from draw down and is the first tranche of an anticipated £500 million funding package for AMP6 from the EIB, with the second tranche expected to be made available for signature later in the AMP.

In June 2016, UUW's financing subsidiary, United Utilities Water Finance PLC (UUWF), raised c£76 million of term funding, via the issue of €30 million and HKD600 million private placement notes, both with a 15-year maturity, off our EMTN programme. In September 2016, UUWF raised c£53 million of term funding, via the issue of 12-year and 20-year private placement notes, in RPI-linked form, off the group's EMTN programme, at the group's best ever real interest rates. In the second half of 2016/17, UUWF raised a further c£172 million, via the issue of 15-year and 20-year private placement notes, in index-linked form, off our EMTN programme. In response to Ofwat's decision to transition away from RPI inflation linkage, £100 million of this index-linked funding was CPI-linked, these being the first ever CPI-linked notes issued by a UK utility.

In addition, since September 2016, the group has agreed £100 million of new or replacement five-year committed bank facilities and extended a further £100 million for an initial term of five years. The group has headroom to cover its financing needs into 2019.

Long-term borrowings are structured or hedged to match assets and earnings, which are largely in sterling, indexed to UK retail price inflation and subject to regulatory price reviews every five years.

Long-term sterling inflation index-linked debt provides a natural hedge to assets and earnings. At 31 March 2017, approximately 55 per cent of the group's net debt was in index-linked form, representing around 34 per cent of UUW's regulatory capital value, with an average real interest rate of 1.3 per cent. The long-term nature of this funding also provides a good match to the company's long-life infrastructure assets and is a key contributor to the group's average term debt maturity profile, which is around 20 years.

Where nominal debt is raised in a currency other than sterling and/or with a fixed interest rate, the debt is generally swapped to create a floating rate sterling liability for the term of the debt. To manage exposure to medium-term interest rates, the group fixes underlying interest costs on nominal debt out to 10 years on a reducing balance basis. This is supplemented by fixing substantially all remaining floating rate exposure across the forthcoming regulatory period around the time of the price control determination.

In line with this, the group has fixed interest costs for substantially all of its floating rate exposure over the 2015-20 period, locking in an average annual interest rate of around 3.6 per cent (inclusive of credit spreads).

## Liquidity

Short-term liquidity requirements are met from the group's normal operating cash flow and its short-term bank deposits and supported by committed but undrawn credit facilities. The group's €7 billion EMTN programme provides further support.

Available headroom at 31 March 2017 was £699 million based on cash, short-term deposits, committed bank facilities and the undrawn portion of the signed EIB term loan facilities, net of short-term debt as well as committed facilities and term debt falling due within 12 months.

United Utilities believes that it operates a prudent approach to managing banking counterparty risk. Counterparty risk, in relation to both cash deposits and derivatives, is controlled through the use of counterparty credit limits. United Utilities' cash is held in the form of short-term money market deposits with prime commercial banks.

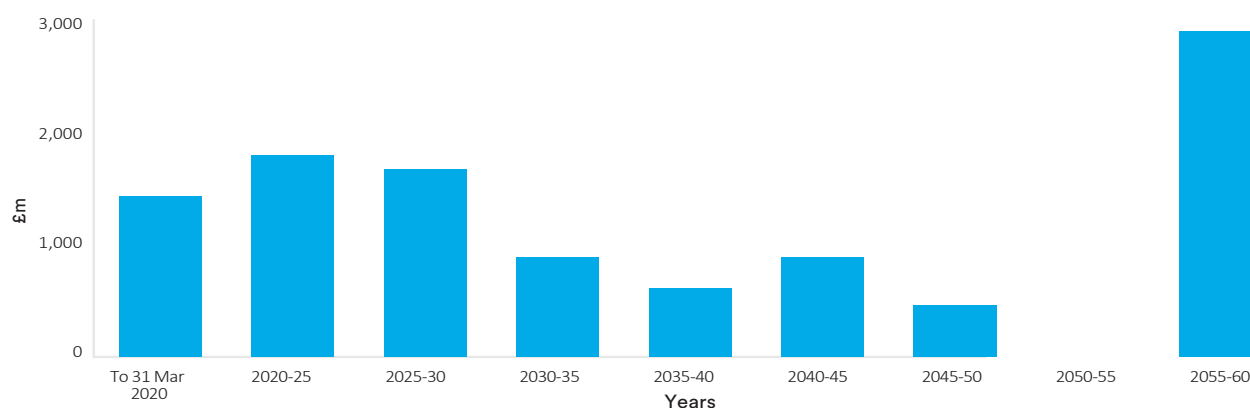
United Utilities operates a bilateral, rather than a syndicated, approach to its core relationship banking facilities. This approach spreads maturities more evenly over a longer time period, thereby reducing refinancing risk and providing the benefit of several renewal points rather than a large single refinancing requirement.

## Pensions

As at 31 March 2017, the group had an IAS 19 net pension surplus of £248 million, compared with a net pension surplus of £275 million at 31 March 2016. This £28 million reduction mainly reflects the impact of a decrease in credit spreads. In contrast, the scheme specific funding basis does not suffer from volatility due to inflation and credit spread movements as it uses a fixed inflation assumption via a blend of the inflation market hedge and the inflation funding mechanism and a prudent, fixed credit spread assumption. Therefore, the recent inflation and credit spread movements have not had a material impact on the deficit calculated on a scheme specific funding basis or the level of deficit repair contributions.

Further detail on pensions is provided in note 18 ('Retirement benefit surplus') of these condensed consolidated financial statements.

## Term debt maturity per regulatory period\*



\*Future repayments of index-linked debt include inflation based on an average annual RPI rate of 3% and an average annual CPI rate of 2%.

# Our performance in 2016/17

## Guide to Alternative Performance Measures (APMs)

The underlying profit measures in the table opposite represent the group's alternative performance measures (APMs) under the definition given by the European Securities and Markets Authority (ESMA). These measures are linked to the group's financial performance as reported under International Financial Reporting Standards (IFRSs) as adopted by the European Union in the group's consolidated income statement, which can be found on page 124. As such, they represent non-GAAP measures.

These APMs are reviewed internally by management and reported to the board, and have been presented in order to provide a more representative view of business performance. The group determines adjusted items in the calculation of its underlying measures against a framework which considers significance by reference to profit before tax, in addition to other qualitative factors such as whether the item is deemed to be within the normal course of business, its assessed frequency of reoccurrence and its volatility which is either outside the control of management and/or not representative of current year performance.

### Alternative performance measure

<b>Water quality incident</b>	A significant water quality incident occurred in the year ended 31 March 2016, the likes of which management would not expect to occur on a frequent basis. As such, this was not considered part of the normal course of business.
<b>Flooding incidents</b>	Two significant flooding incidents in the year ended 31 March 2016 caused extensive damage to localised parts of our infrastructure, resulting in significant levels of remedial operating expenditure and a large claim under the group's insurance cover. Management's view is that these were significant and infrequent events and as such, were not part of the normal course of business.
<b>Non-household retail market reform</b>	The group has incurred significant costs since the year ended 31 March 2015 in preparation of the non-household retail market opening to competition in April 2017. This represents a one-off event and as such, is not considered part of the normal course of business.
<b>Restructuring costs</b>	The group has incurred restructuring costs in the past in relation to a number of discrete underlying events which can cause volatility in the reported results. Management adjusts internally for these costs to provide an underlying view of performance which it views as being more representative of the normal course of business and more comparable period to period.
<b>Net fair value losses on debt and derivative instruments</b>	Fair value movements on debt and derivatives can be both very significant and volatile from one period to the next. These movements are determined by macro economic factors which are outside the control of management and these instruments are purely held for funding and hedging purposes (not for trading purposes). Taking these factors into account, management believes it is useful to adjust for this to provide a more representative view of performance.
<b>Interest on swaps and debt under fair value option</b>	Net fair value losses on debt and derivative instruments includes interest on swaps and debt under fair value option. In adjusting for the former, it is appropriate to add back interest on swaps and debt under fair value option to provide a view of the group's cost of debt which is better aligned to the return on capital it earns through revenue.
<b>Net pension interest (income)/expense</b>	This item can be very volatile from one period to the next and it is a direct function of the extent to which the pension scheme is in an accounting deficit or surplus position. Management believes it is useful to adjust for this to provide a more representative view of performance which is better aligned to the return on capital it earns through revenue.
<b>Capitalised borrowing costs</b>	The accounting standards allow for the capitalisation of borrowing costs in the cost of qualifying assets. Management believes it is appropriate to adjust for these significant costs to provide a representative cost of borrowings and current year performance which is better aligned to the return on capital it earns through revenue.
<b>Profit on disposal of business</b>	This relates to the disposal of the group's non-household retail business during the year ended 31 March 2017 which represents a significant one-off event and as such is not considered part of the normal course of business.
<b>Deferred tax credit-change in tax rate</b>	The deferred tax impact from changes to the corporation tax rate announced by HMRC represent both significant and volatile impacts which are outside the control of management. Management adjusts for this to provide a more representative view of current year performance.
<b>Agreement of prior years' tax matters</b>	The agreement of prior years' tax matters can be significant, volatile and often related to the final settlement of numerous prior year periods. Management adjusts for this to provide a more representative view of current year performance.
<b>Tax in respect of adjustments to underlying profit before tax</b>	Management adjusts for the tax impacts of the above adjusted items to provide a more representative view of current year performance.

## Underlying profit

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
<b>Operating profit</b>		
<b>Operating profit per published results</b>	<b>605.5</b>	567.9
Water quality incident	-	24.8
Flooding incidents (net of expected insurance proceeds)	1.5	(0.6)
Business retail market reform <sup>(1)</sup>	5.8	11.1
Restructuring costs	10.1	0.9
<b>Underlying operating profit</b>	<b>622.9</b>	604.1
<b>Net finance expense</b>	<b>£m</b>	<b>£m</b>
Finance expense	(202.7)	(224.4)
Investment income	13.7	5.0
<b>Net finance expense per published results</b>	<b>(189.0)</b>	(219.4)
Adjustments:		
Net fair value (gains)/losses on debt and derivative instruments	(24.3)	26.3
Interest on swaps and debt under fair value option	15.4	16.5
Net pension interest income	(10.2)	(3.1)
Adjustment for capitalised borrowing costs	(29.2)	(21.3)
<b>Underlying net finance expense</b>	<b>(237.3)</b>	(201.0)
<b>Profit before tax</b>	<b>£m</b>	<b>£m</b>
<b>Share of profits of joint ventures</b>	<b>3.8</b>	5.0
<b>Profit before tax per published results</b>	<b>442.4</b>	353.5
Adjustments:		
Water quality incident	-	24.8
Flooding incidents	1.5	(0.6)
Business retail market reform <sup>(1)</sup>	5.8	11.1
Restructuring costs	10.1	0.9
Net fair value (gains)/losses on debt and derivative instruments	(24.3)	26.3
Interest on swaps and debt under fair value option	15.4	16.5
Net pension interest income	(10.2)	(3.1)
Capitalised borrowing costs	(29.2)	(21.3)
Profit on disposal of business	(22.1)	-
<b>Underlying profit before tax</b>	<b>389.4</b>	408.1
<b>Profit after tax</b>	<b>£m</b>	<b>£m</b>
<b>Underlying profit before tax</b>	<b>389.4</b>	408.1
Reported tax (charge)/credit	(8.5)	44.0
Deferred tax credit – change in tax rate	(58.2)	(112.5)
Agreement of prior years' tax matters	(15.5)	(3.4)
Tax in respect of adjustments to underlying profit before tax	6.2	(10.9)
<b>Underlying profit after tax</b>	<b>313.4</b>	325.3
<b>Earnings per share</b>	<b>£m</b>	<b>£m</b>
Profit after tax per published results (a)	433.9	397.5
Underlying profit after tax (b)	313.4	325.3
Weighted average number of shares in issue, in millions (c)	681.9m	681.9m
Earnings per share per published results, in pence (a/c)	63.6p	58.3p
<b>Underlying earnings per share, in pence (b/c)</b>	<b>46.0p</b>	47.7p
<b>Dividend per share</b>	<b>38.87p</b>	38.45p

(1) Relates to market reform restructuring costs incurred preparing the business for open competition in the business retail market.