Chair and Chief Executive Officer's review

Sir David Higgins
Chair

Steve Mogford
Chief Executive Officer

We are helping over 200,000 households currently struggling with their bills, and maintaining a high level of service for customers.

We are earning higher outperformance thanks to strong operational performance against customer outcome delivery incentives as well as financial outperformance.

As a responsible company, we are sharing our success with customers, like we did in 2010–20, by investing an additional £765 million to help accelerate further enhancements for customers and the environment.

Our team has sustained a strong level of operational performance this year, delivering value for all our stakeholders. Customer satisfaction and employee engagement remain high, and we have achieved our best ever performance against customer outcome delivery incentives (ODIs). We are on track to deliver our environmental improvement programme for the 2020–25 regulatory period (AMP7), which will improve river and bathing water quality in the North West, and have made good progress against our carbon pledges. We are upper quartile across a suite of environmental, social and governance (ESG) indices, and our robust balance sheet provides long-term financial resilience.

Helping customers struggling with bills

Many people across the country are facing real challenges as we emerge from a global pandemic and are faced with significant rises in the cost of living. We serve many of the most deprived areas in England and Wales, so it is more important than ever that we are doing what we can to help customers.

Our average household bill for 2022/23 is not increasing, and we are offering more support than ever before through our extensive range of affordability and vulnerability schemes, helping over 200,000 households this year and providing around £280 million(1) of affordability support over AMP7.

There is still more we would like to be able to do, and we are a passionate supporter of the Consumer Council for Water's drive to introduce a national social tariff, which would help deliver a more equitable sharing of support for customers struggling to pay their bill regardless of where they live in the country.

Sustained high levels of operational and environmental performance

We were a sector-leading company on outcome delivery in Ofwat's Service Delivery Report for 2020/21, with nine of 11 outcomes(2) being at or better than target, and were recognised as a top performer on supply interruptions and pollution incidents – two areas where we are now seeing the benefits of targeted investment we made in AMP6. On the two outcomes(2) where our performance was poorer than target we have plans in place to improve this.

Our customer ODI performance has been strong across the board this year, meeting or beating over 80 per cent of our performance commitments. Based on our anticipated reward this year, we will have earned rewards in both the first two years of AMP7 against Ofwat's customer satisfaction measure, C-MeX, and we have achieved our lowest ever level of written complaints this year.

We were pleased to achieve a 4 star rating in the 2020 Environmental Performance Assessment from the Environment Agency (EA), meaning we were categorised as an industry-leading company in the most recent annual assessment by the EA, taking into account performance across a broad range of environmental metrics. It reflected our best ever performance, and we were the first water company to achieve green status across all measures since 2015.

We continue to be at the sector frontier on pollution performance, having reduced overall pollution by a third since the start of the AMP. Our treatment works compliance remains strong and we expect to remain green on this measure in the EA's assessment for 2021.

(1) 50 per cent company funded.

(2) Excluding per capita consumption, which Ofwat will be revisiting at the next price review once there is a better understanding of the impact of COVID-19 and any enduring effects.

(3) On a real, RPI/CPIH blended basis.

Performance improvements earning outperformance

We earned a reported return on regulated equity (RoRE) of 7.9 per cent for 2021/22[3], driven by our continued improvements in operational performance together with high levels of inflation, which increases financing outperformance, and tax outperformance.

Underlying RoRE is slightly lower at 7.7 per cent, and excludes the tax that will be recovered through the regulatory sharing mechanism.

Cumulative RoRE for the first two years of AMP7 is 6.2 per cent on both a reported and underlying basis.

Our strong performance this year earned a £25 million reward against customer ODIs[2], the highest annual reward we have achieved to date. We anticipate earning total customer ODI rewards over AMP7 of £200 million, a third higher than we estimated in last year's report.

We consistently issue debt at efficient rates, and we earned financing outperformance of 1.6 per cent of regulated equity this year. We also performed strongly on tax as a result of optimising government tax incentives. The economic environment as we emerge from a global pandemic, as well as the war in Ukraine, has driven higher costs in our supply chain and we are starting to see significant cost increases in power and chemicals. We continue to seek efficiencies and exploit technology and innovation to help us deliver our total expenditure (totex) efficiently.

Sharing our success with customers

As a responsible company it is right that we should share our success with customers, and we feel the best way for us to create more value for customers and other stakeholders is through investing to accelerate improvements in performance. This is in line with the approach we have taken historically, sharing over £600 million over the 2010–20 period.

We have increased the investment we are making by a further £400 million meaning that, over the 2020–25 period, we are investing £765 million beyond the scope of our final determination allowance to help us accelerate environmental and customer outcomes.

Investing to improve service for customers

£250 million of the additional investment is helping us deliver further improvements to service for customers and better performance against our customer ODIs.

As mentioned above, our performance has been strong across the majority of our customer outcomes, but this investment is targeted at delivering sustainable improvements for customers in two specific areas where we want to do better – sewer flooding and water quality (specifically discolouration).

It includes investment in Dynamic Network Management (DNM), an advancement of Systems Thinking in our wastewater network that will help us reduce sewer flooding and pollution incidents using real-time performance data from a network of sensors to enable predictive and preventative optimisation.

Investing outperformance for environmental improvements

A further £250 million of the additional investment is being used to deliver environmental outcomes. This includes delivering elements of the new Environment Act requirements earlier, and improving the health of rivers across the North West.

In July 2021, we launched a collaborative partnership with The Rivers Trust, a first for any water company in the United Kingdom. To help kickstart a river revival in the North West we published 'Better Rivers: Better North West', our plan to improve the health of rivers across our region in the next three years. We are delivering improvements that support at least a one-third sustainable reduction in the number of spills recorded from our storm overflows between 2020 and 2025, with all storm overflows monitored by 2023 and real-time data on their operation made publicly available. Our plans will lead to 184 kilometres of improved waterways across the region. We also continue to engage with the ongoing industry-wide investigations by Ofwat and the EA into possible unpermitted sewage discharges.

The remaining £265 million of the £765 million of additional investment is for projects where regulatory allowances and mechanisms have been secured, much of which will deliver further environmental benefits. For example, around £90 million will fund a project in Bolton that is part of our Water Industry National Environment Programme (WINEP), and £65 million will go towards supporting the country's green economic recovery in the wake of the pandemic.

Long-term investment needs for the environment

Protecting and enhancing the natural environment has always been a key priority for us and many of our stakeholders. In the last 12 months this has received increased public interest, particularly the health of rivers and the part the water industry can play in helping to improve this.

New and emerging requirements reflect the increased importance being given by the Government to the environmental agenda and we share the Government's ambitious improvement plans.

Read more about **our £765 million investment** on page 71

Read more about **Dynamic Network Management** on page 43

Read more about **our Better Rivers: Better North West plan** on page 67

£280m
affordability support being provided over 2020–25, helping 200,000 households in the North West

£765m
additional investment being made over 2020–25 to deliver customer and environmental improvements

£25m
net reward earned this year against customer ODIs[1], the highest we have achieved in any year to date

"The North West is home to some beautiful natural landscapes and we take our role in protecting them very seriously. We have published our plan to help improve the health of our rivers over the next three years."

Read our TCFD and TNFD disclosures on pages 86 to 99

Read more about our financial risk management policies on pages 242 to 249

Read more about our approach to diversity and inclusion on pages 44 to 45

The Environment Act 2021 introduces several new challenges for the sector, including a requirement for water companies to secure a progressive but very substantial reduction in the average number of spills from storm overflows, and controlling nutrient pollution by reducing phosphate release from wastewater treatment works. The Industrial Emissions Directive broadens the scope of activities covered by compliance requirements, and the EA's recent interpretation of Farming Rules for Water restricts the application of biosolids to land in certain areas at certain times, requiring more storage capacity or alternative means of disposal.

We have delivered significant improvements in environmental performance in recent years, and through our original plans for AMP7 we will deliver further improvements, with good progress already having been made. The additional investment we are making will help accelerate improvements, but there is more that the industry will need to do.

Specific targets for the next regulatory period have not yet been agreed, but it is already clear that there is an ambition to deliver a fundamental change in the way drainage network systems were originally configured. The investment needed to deliver these changes will be significant for the industry as a whole, but particularly for the North West, where we have a much higher proportion of combined sewers. We are working with the Government and regulators to determine how these bold ambitions can be met and by when, recognising that the pace of change must consider customer affordability.

Resilience to climate change and population growth remains a material issue for many stakeholders, even more so since COP26, and this is something that will need to be addressed by water companies both regionally and nationally. Our Systems Thinking approach and investment are helping to deliver increased resilience across the North West, and longer term we are involved in strategic planning for a national water transfer scheme.

We have committed to achieve net zero by 2030 with six pledges to reduce our carbon footprint, underpinned by ambitious science-based targets for reducing our greenhouse gas emissions, and we are making good progress against these. We are linking executive remuneration more tightly to our carbon commitments with four targets added to the Long Term Plan, and in this year's report we also include nature-related financial disclosures.

Haweswater Aqueduct Resilience Programme (HARP)

We have continued to develop HARP, an industry-first Direct Procurement for Customers (DPC) programme to design and build six replacement tunnel sections of the Haweswater Aqueduct, which transports water from Cumbria to Manchester.

We have undertaken extensive market engagement throughout the process – challenging for a project of this scale during the pandemic – and used innovative ways to manage stakeholder engagement, including the use of digital channels and a virtual exhibition giving people access to information and the ability to ask questions remotely.

We developed the initial design following extensive ground investigation work to plot the best route, and planning applications have all been submitted with decisions expected later this year. During early 2022, we have been finalising tender documents, and we expect to start procurement in the summer of 2022.

Strong financial performance in a turbulent economic climate

We have delivered another good financial performance this year, underpinned by a strong balance sheet.

Underlying earnings per share is 53.8 pence, a decrease of 4 per cent primarily due to the inflationary impact on our underlying net finance expense. With inflation increasing, this impacts interest charges and therefore earnings, but our regulatory capital value will benefit from higher indexation. This higher finance expense is partially offset by a tax credit following a review of our innovation-related capital expenditure.

Reported earnings per share is (8.3) pence, with the difference mainly due to a one-off deferred taxation charge which occurs from a restatement of the liability following a change in the headline rate of corporation tax from 19 per cent to 25 per cent, effective from 1 April 2023. Adjusting items are outlined in the reconciliation table on pages 82 and 83.

The board has proposed a final dividend of 29.0 pence per ordinary share, taking the total dividend for 2021/22 to 43.5 pence. This is an increase of 0.6 per cent*, in line with our AMP7 policy of targeting an annual growth rate of CPIH inflation through to 2025.

Our balance sheet remains one of the strongest in the sector as a result of the responsible and prudent approach we take to financial risk management. Gearing, measured as net debt to regulatory capital value, is 61 per cent, remaining comfortably within our target range of 55 to 65 per cent. This supports United Utilities Water Limited's A3 credit rating with Moody's, and at year end we have liquidity to February 2025, giving us a high level of flexibility and resilience.

While we are not immune to the effects of the current high inflation environment, our risk management policies have been effective at helping to shield us in certain areas. Our fully funded, low dependency pension schemes protect employees and shareholders from the risk and deficit repair contributions that come with having a large pension deficit.

* The dividend increase is based on the CPIH element included within allowed regulated revenue for the 2021/22 financial year (i.e. the movement in CPIH between November 2019 and November 2020).

Our energy hedging policy locked in commodity prices on the majority of our estimated power consumption for AMP7 prior to the recent significant increases. We have over 90 per cent of our AMP7 base capital programme on contract under target price arrangements, with sharing of cost overruns incentivising our partners to deliver within budget.

Supported by a diverse and highly motivated workforce

We pride ourselves on being a quality employer, and are committed to maintaining a diverse and inclusive team of people, recruiting from every part of our community. We scored equal to the UK high performance norm with 87 per cent employee engagement this year, are rated 4.6 out of five by Glassdoor, and were the leading utility company in The Inclusive Top 50 UK Employers List 2021/22.

We believe in the importance of developing younger generations to keep the talent pool flowing. We have active graduate and apprentice schemes, including 30 green apprentices helping us work towards our climate and environmental ambitions. We support young people not in education, employment or training (NEETs), as well as being part of the Government's Kickstart Scheme providing opportunities to unemployed 16–24 year olds claiming universal credit.

Our commitment to health, safety and wellbeing has been recognised with our tenth consecutive Royal Society for the Prevention of Accidents (RoSPA) gold standard medal, meaning we have achieved the RoSPA President's award.

Outlook

We have continued a momentum of performance improvement in recent years, giving us confidence in our ability to continue to create value for customers, the environment, and other stakeholders.

The additional investment we are making will help us deliver even more sustainable improvements in customer and environmental performance, and to get ahead of the requirements coming into force through the Environment Act.

Our Systems Thinking approach, digital advancements, and financial risk management give us robust long-term resilience.

Thank you to our stakeholders

We are grateful to our employees for their continued hard work, and as we look forward at the many new challenges we and the rest of the sector will be meeting in the next AMP and beyond, we are delighted to have such a great team behind us. We would also like to extend our gratitude to our customers and other stakeholders for their continued support.

Sir David Higgins
Chair

Steve Mogford
Chief Executive Officer

The strategic report on pages 14 to 109 was approved at a meeting of the board on 25 May 2022 and signed on its behalf by Steve Mogford, Chief Executive Officer.

Read more about **our performance in 2021/22** on pages 52 to 83

Integrated Report and TCFD disclosure

This annual report contains information consistent with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and is an Integrated Report prepared and presented in accordance with the International <IR> Framework published by the International Integrated Reporting Council in December 2013, as applicable to the year ended 31 March 2022. The board, which is responsible for the integrity of this report, has considered the preparation and presentation of this report and concluded that it has been prepared and presented in accordance with the <IR> Framework.

Materiality

Our annual report and financial statements aim to meet the information needs of our investors to help them make informed decisions regarding their participation – for example, whether to buy, hold or sell our shares or bonds, whether to engage with management on issues, and how to vote their shares. We have included information that we believe is material to these decisions, which is presented in a way that we believe is fair, balanced and understandable. We engage with – and recognise that this report will be read by – a wide variety of other stakeholders including customers, suppliers, employees, analysts, regulators, community bodies, politicians, non-governmental organisations, and devolved authorities. Where we believe that a topic is material to a large number of them, which is assessed in part through a matrix approach to stakeholder materiality as set out on pages 34 and 35, we either include it in this report or refer the reader to other reports and information (such as our regulatory reports, customer communications, or corporate responsibility web pages). We believe this approach meets the requirements of company law, the UK Corporate Governance Code, IFRS and the International <IR> Framework, and that we go beyond those requirements where we feel it is particularly helpful to do so and where that can be done without making the report unnecessarily lengthy or difficult to read.