Chairman and Chief Executive Officer's review

We have responded well to the challenges of a year that has been dominated by the impact of COVID-19 in maintaining service and support so critical to customers in the North West. Our operational performance has been strong, building on the improvements we delivered in the previous regulatory period and providing us with a great start to achieving our targets for the new 2020–25 price review period (AMP7).

This has been an unprecedented year in which we have had to adapt our operations to protect customers, employees and supply chain partners from the impact of COVID-19.

We responded well to the challenges and delivered our best ever year of operational performance for customers and the environment. Customer satisfaction remains high and we have made a strong start against our customer outcome delivery incentives (ODIs). This year has seen us reduce leakage to its lowest ever level and supply interruptions to customers have been halved. We are on track to achieve the maximum 4 star rating in the Environment Agency's assessment for 2020, and have reduced environmental pollution incidents by around a third.

Our operational performance has been strong against key metrics and we are pleased to have met or exceeded over 80 per cent of our performance commitments for year 1 of AMP7. In those areas where we have fallen short of our target – such as sewer flooding – we are innovating and investing in new technology in order to improve performance and service to customers over the longer term.

We witnessed further variability in weather conditions now characteristic of climate change. Our region experienced a hot, dry spring that, coupled with people spending more time at home, resulted in a high level of demand for water. We continued to encourage customers to save water through water efficiency programmes, helping them to preserve this precious resource and save money on their bills. Throughout this period we maintained supplies to customers, demonstrating the benefits of our Systems Thinking approach and supported by the investment we made in previous regulatory periods to enhance the resilience of our services.

We have a deep and strong relationship with the environment and communities of the North West. Our plans ensure we protect and improve the natural environment and for many years we have been at the forefront of addressing climate change. We are proud to be a signatory to the UN's Race to Zero campaign and we are delivering against all of our six carbon pledges. Our purpose drives us to make a real, positive contribution to the communities we serve through everything we do, and our investment programme plays a significant role in supporting the north west economy.

This excellent start to the delivery of our AMP7 plans provides a strong platform for us to play our full part in the economic recovery of the communities we serve as the country emerges from the COVID-19 pandemic.

Maintaining excellent service to customers while supporting our employees

Our continued focus on delivering the best service to customers has never been more important. We delivered significant and sustainable improvements over AMP6 and we ended the period as a leading water and wastewater company. The way Ofwat measures customer satisfaction in AMP7 has changed, with C-MeX measuring household customer satisfaction and D-MeX measuring developer satisfaction. Despite a challenging operating environment, customer satisfaction remains high, earning us an outperformance payment for both C-MeX and D-MeX and positioning us in the sector upper quartile for all-round customer satisfaction.

The impact of COVID-19 has led to many customers facing increasing financial hardship. At the start of the pandemic we saw an increase in the number of customers needing affordability support and the initiatives we put in place in AMP6 enabled us to respond swiftly and effectively. We were the first water company to secure support and regulatory approval for an extension to the scale and scope of our social tariff, providing an additional £15 million to help a further 45,000 customers. We had to consider the appropriateness of continuing our normal billing and collection activities and the most suitable means of engagement. As part of our COVID-19 response, we proactively encouraged customers to contact us if they had been impacted financially by the pandemic. We carried out targeted activities aligned to specific customer segments and changes in customer behaviour to engage with customers, ensuring they knew they could talk to us about their water bill, and highlighting alternative ways to pay.

We could not have delivered such great service to customers during this time without highly engaged and motivated colleagues right across the organisation who demonstrate tremendous resilience and adaptability to deliver for a region hard hit by the pandemic. To keep employees safe, early on in the year we moved 60 per cent of our workforce to home working and the remainder continued working at our COVID-19 secure facilities. We have continued to work in this way in line with the government roadmap out of lockdown, while defining and shaping the way for future working. Our employee engagement score this year positioned us above the norm for UK high-performing companies – a remarkable score given the past year and testimony to the cohesiveness of the United Utilities team.

Transforming into a digital utility

Through our Systems Thinking approach we make use of technology, automation and machine intelligence to deliver better performance for customers and the environment.

Through implementation of Dynamic Network Management – an example of the most advanced form of Systems Thinking in the water sector – we are shifting from reactive management of our wastewater network to using a web of sensors that will provide near real-time performance information. This new digital capability will optimise performance in a predictive and preventative way, delivering greater efficiency, improved service to customers and helping to enhance the environment.

We recognise the benefits to be gained through building digital skills among our workforce, and our purpose-built technical training academy, established in 2014, has provided skills development and certification to over 2,800 colleagues. The focus on digital skills means that we have the in-house ability to develop and deploy breakthrough technologies at pace and efficiently.

We make extensive use of apps, many of which are developed in-house, to create digital capability for our field and customer-facing teams. Our new voids app, aimed at unbilled but occupied properties, has helped us to earn the maximum customer ODI outperformance payment on voids this year as well as securing future year benefits of a further £24 million over AMP7.

Delivering a robust financial performance

We have delivered another year of robust financial performance, supported by the strength of our balance sheet.

Underlying earnings per share is 56.2 pence, a decrease of 21 per cent but more than covering the dividend for the year. The anticipated decrease is due to lower allowed regulatory revenue in the first year of the new regulatory period, and an increase in infrastructure renewals expenditure due to planned work to optimise the performance of our network, higher depreciation reflecting continued investment in the asset base and a slight increase in the remaining cost base.

This is partly offset by a decrease in the underlying net finance expense reflecting lower inflation applied to our index-linked debt. We have simplified our approach to alternative performance measures (APMs) this year and are no longer, as a matter of course, adjusting our underlying earnings for restructuring costs, net pension interest, capitalised borrowing costs and prior years' tax matters. This brings our approach more in line with peers and therefore makes cross-company comparisons easier.

Reported earnings per share is 66.5 pence per share, which is higher than the underlying figure, mainly due to fair value movements. Adjusting items are outlined in the reconciliation table on pages 82 to 83 and reflect our change in approach to APMs with prior year numbers re-presented for comparability.

The board has proposed a final dividend of 28.83 pence per ordinary share, taking the total dividend for 2020/21 to 43.24 pence. This is an increase of 1.5 per cent, in line with our policy in this regulatory period of targeting an annual growth rate of CPIH inflation through to 2025.

£21m

net customer ODI reward achieved in 2020/21

£300m

extension to our AMP7 final determination

Chairman and Chief Executive Officer's review

Our balance sheet continues to be one of the strongest in the sector, with low customer debtor risk, net debt to regulatory capital value within our target range and a pension scheme that is fully funded on a low dependency basis.

Given the uncertainty created by the COVID-19 pandemic, the recoverability of household debtors has been a key area of focus. It has been an area of focus for us for most of the last decade, during which we have managed the position robustly. This manifests itself in the balance reducing from £115 million in 2016 to £78 million in 2021. Our net debtor balance as at 31 March 2021 is the lowest it has been for five years and is one of the best managed positions in the sector. Knowing this gives us added confidence as we emerge from the pandemic.

We have retained our policy of targeting gearing of 55–65 per cent, measured as net debt to regulatory capital value, for this new regulatory period and at 62 per cent, our gearing remains within this target range. During the year, we changed our definition of net debt to exclude the impact of derivatives that are not hedging specific debt instruments. This provides a better reflection of the debt balances we are contractually obliged to repay and is more consistent with the approach taken by credit rating agencies and the regulatory economics. Our gearing policy is supportive of United Utilities Water Limited's A3 credit rating with Moody's and we have liquidity extending out to August 2023. This provides us with resilience and financial flexibility as we progress through AMP7 and demonstrates our prudent and responsible approach to financial risk management.

We have eliminated our pension funding deficit on a low-dependency basis and our pension position is in surplus on an IAS 19 basis. Having no pension funding deficit puts us at an underlying advantage versus most other companies in the sector, as well as against many companies in the Financial Times Stock Exchange (FTSE), that continue to make cash contributions into their pension schemes to achieve a fully-funded position. We are proud to have already achieved this, protecting employees past and present and shareholders from the risk of a large pension deficit.

In November 2020, we published our new sustainable finance framework, which allows us to raise financing based on our strong environmental, social and governance (ESG) credentials. This replaces the green funding we have previously secured through the European Investment Bank (EIB), which is no longer available post-Brexit. We issued our debut sustainable bond in January 2021 and were extremely pleased by the high level of interest. As a result, we secured not only our lowest ever coupon at that particular maturity, but also the lowest ever coupon for any UK corporate at that maturity, locking in financing outperformance.

Good start to the new regulatory period (AMP7)

We are performing well against the principal areas of our regulatory contract for AMP7 despite many targets getting tougher.

Our accelerated investment strategy and digital transformation is delivering value across the breadth of our customer ODIs. The £21 million outperformance payment earned this year is ten times the performance we delivered in the first year of AMP6. The net reward earned this year will be reflected in an increase to revenues earned in 2022/23. This provides a great platform for continued delivery against our customer ODIs for the remainder of the AMP and gives us the confidence to target a cumulative outperformance payment of around £150 million for the 2020–25 period.

Thanks to our good performance in AMP6, we started AMP7 at a total expenditure (totex) run rate which supports delivery of our AMP7 scope within our final determination totex allowance. Since accepting our final determination, our investment plan has been extended by a further £300 million, which we expect to be fully remunerated through regulatory mechanisms, with this expenditure extending our environmental programme, accelerating our digital transformation and exploiting spend to save opportunities. While we continue to seek efficiencies in the delivery of totex, as we have demonstrated through the £300 million extension to our totex plans, we will invest totex where we are confident we can deliver improved customer or environmental outcomes and better customer ODI performance.

On financing performance, we have consistently issued debt at efficient rates that compare favourably with the industry average, thanks to our leading treasury management, clear and transparent financial risk management policies, and ability to act swiftly to access pockets of opportunity as they arise. This delivered significant financing outperformance during AMP6 and the rates we have already locked in for AMP7 compare favourably with the price review assumptions.

ESG at our heart

Our purpose drives us to deliver our services in an environmentally sustainable, economically beneficial and socially responsible manner and what we do creates a deep connection with the stakeholders we serve. We have a long-standing commitment to deliver against our ESG objectives and we have a strong track record of doing so. We are also looking to our supply chain partners to adopt these values and objectives via the United Supply Chain (USC) initiative, a fundamental step change as to how we engage with them in AMP7 and into AMP8.

Having achieved our climate change objectives up to 2020, reducing greenhouse gas emission by 73 per cent, we made six carbon pledges and have made good progress against them all. From October of this year, 100 per cent of our electricity will be sourced from renewable technologies and we have set ambitious science-based scope 3 emissions targets that have been submitted for endorsement by the Science Based Targets initiative (SBTi).

Our Catchment Systems Thinking (CaST) approach continues to mature. We have been working with the Environment Agency (EA) and other stakeholders to develop a north west natural capital baseline and once this process is complete, we will engage with other partners across the region to drive a consistent approach to delivering greater natural capital value. This year, we pledged a £300,000 CaST Fund, for which charities and community groups are able to bid, to boost the idea of working collaboratively to address the challenges facing the environment.

We are in a unique position to make a real, positive contribution to society and have an ambitious and innovative approach to addressing affordability and vulnerability. We have an extensive range of schemes available to help customers and around 200,000 are currently benefiting from that help. We are providing more customers than ever with access to Priority Services in times of need, with over 133,000 now on our register. We have committed to providing £71 million in financial support over AMP7, and have accelerated payments this year to provide much needed assistance to households struggling as a result of the economic impact of the pandemic. During the early stages of the pandemic, recognising the importance of cash flow to businesses, we took swift action to accelerate payment terms with suppliers, paying them within seven days where possible.

We want fantastic people from a range of different backgrounds and life experiences to enable us to deliver a great public service, and we are committed to creating a diverse and inclusive workforce, reaching and recruiting from every part of our community. We were delighted to be one of the top one per cent of 15,000 companies across Europe in the Financial Times' Statista Survey for Diversity and Inclusion Leadership and to achieve inclusion in the Bloomberg Gender Equality Index.

We operate in a manner that aims to maintain high ethical standards of business conduct and corporate governance. We have attained World Class status on the Dow Jones Sustainability Index for the 14th consecutive year. We were delighted to retain the Fair Tax Mark independent certification which recognises our commitment to paying our fair share of tax and acting in an open and transparent manner in relation to our tax affairs. We continue to focus on our long-term financial resilience, supported by our strong balance sheet and prudent approach to financial risk management, maintaining a responsible level of gearing and well-controlled pension position for many years.

Outlook

We started the new regulatory period as one of the sector's best performers and have delivered further improvements this year, giving us the confidence that we will continue to be able to meet our targets across AMP7. Our transformation to a digital utility is helping us operate more efficiently and deliver better service to customers while protecting and improving the natural environment. Although it remains uncertain how the country will emerge from the COVID-19 pandemic, we have proven to be resilient over this period and will continue to rise to the challenges that lie ahead, playing our part in the recovery of the north west economy.

Grateful to our stakeholders for their support

We would like to express our gratitude to our highly engaged and motivated employees and supply chain partners who have shown great resilience and adaptability in continuing to deliver excellent performance over such a challenging period, and we extend our thanks to customers, shareholders and other stakeholders for their continued support.

Sir David Higgins
Chairman

Steve Mogford
Chief Executive Officer

The strategic report on pages 14 to 109 was approved at a meeting of the board on 26 May 2021 and signed on its behalf by Steve Mogford, Chief Executive Officer.

INTEGRATED REPORT AND TCFD DISCLOSURE

This annual report contains information in line 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. 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, sell or hold 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 page 27, 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.

Read more about our performance in 2020/21 on pages 52 to 83