

BENCHMARKING COSTS IS KEY TO ACCELERATING IMPROVED RETURNS FOR INVESTORS ACQUIRING WATER COMPANIES



“Water companies can no longer rely on incremental customer charges to improve returns and value for investors; they are under increasing pressure to drive out inefficiencies and work within reduced capital and operating cost constraints.” Weng Lee - Partner, Head of Infrastructure Investment

An analysis of the Draft Determinations indicates that UK water companies appear to have been dealt a very tough hand of cards by Ofwat.

The water companies' business plans asked for price rises of between 0% and 27% per annum above RPI between 2010 and 2015. Ofwat has proposed increases of between -14% to 0% per annum above RPI for the same five years. For most companies the cut back is about a 12% swing, but for some it is as much as 32%.

With the imminent final determinations, can water companies meet this performance challenge?

The cost of capital and impact on funding availability

The Weighted Average Cost of Capital at 4.5% for water and sewage companies and 4.9% for water only companies is at the lower end of city analysts' expectations. This will impact

on the returns that existing investors may receive from their existing investment in the business. However, just as critical it impacts on a company's ability to raise new debt in the market or new equity through rights issues to keep funding the massive multi-billion pound investment programmes. These are required to replace and maintain critical assets, as well as keeping pace with customer needs. Any such delays in funding availability may cause some early projects to be deferred, potentially resulting in a slow start to the forthcoming regulatory cycle.

In facing these challenges, the critical question for the owners and executives of any utility company is:

“Can the business successfully achieve both efficiency savings and high performance levels that the same Regulator is demanding?”

Working closely with a number of leading water companies within the UK, EC Harris understands the most effective ways in which owners and investors can balance priorities while driving the operational efficiencies of their business.

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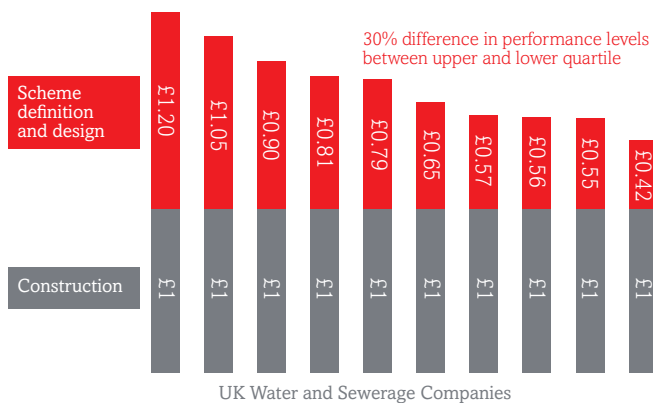
Driving greater capital and operational efficiencies

Across the water sector we estimate that there could be as much as a 30% difference between upper quartile and lower quartile performance on capital delivery in the water sector as demonstrated in the ‘£ in the Ground Analysis.’

- Achieving economies of scale: reducing operating and maintenance cost through aggregation
- Reducing waste: utilising forensic cost assurance techniques.

The best strategy to deliver value to existing and new investors will hinge on achieving increased efficiencies through effective asset management.

What is the £ in the ground worth in the water sector?



EC Harris has developed in-depth benchmarking data and analysis which has assisted investors in identifying the most suitable water companies to acquire or invest in. The data identifies where and how to deliver these elements more efficiently, therefore minimising financial risks and achieving financial sustainability.

When producing a comparable operating cost benchmark of peer performance of water companies, EC Harris has identified ways of achieving 10% reductions on general support costs. By adopting a full solutions based approach, further reductions of over 20% can be achieved.

Using effective models, investors can substantially increase returns by:

- Reducing overheads: horizontally integrating functions across separate business streams
- Reducing capital spend: optimising expenditure through realistic Service Level Agreements, modelling procurement