

# Business review

## Severn Trent Services – Performance

**In 2009/10 we made good progress with positioning our business for sustainable growth. We delivered continued growth in our Operating Services business. We ended the year in Water Purification with a strong order book and a high level of projects in the pipeline. Analytical Services looks forward to starting an important long term contract with Yorkshire Water.**

### Positioning our business for sustainable growth

The backdrop for the year was undoubtedly the economic downturn. Severn Trent Services felt the impact most noticeably in Water Purification and Analytical Services. However, we quickly took action by restructuring selected parts of the business and invested in growth areas. As a result of these actions and others, the order book for Water Purification was at an all time high during the last quarter of the year.

Sometimes, conditions that cause problems in one area of a business provide opportunities elsewhere. This was certainly true for Operating Services, which reported another year of continued growth.

Given the strength of the fundamental drivers of our business, we remained confident the market would turn around. We therefore decided to make use of the slower period to position our company for future growth. We completed the reorganisation of our company into three business groups and four regions. This will help us lower our cost base and be better positioned for global competition. Alongside these efficiencies we made investments to seed new markets and technologies, for instance adding staff in the Middle East and China and progressing new product development projects.

### Focus on our four key strategic growth initiatives

#### Continuing the geographic expansion of our products and services

In Europe, our acquisition of PS Apliclor SA near Barcelona created a European hub from which we can expand our Water Purification business on the continent.

Local product sourcing and hiring of key people in our China branch office has resulted in winning key filtration projects and positioning us to grow profitably.

Our Operating Services business entered new regions where we have a good opportunity to grow. For instance, we extended our strong presence in the UK into Ireland with a joint venture, Severn Trent Response, which has already won one long term contract and also received notice of award for a second.

Expanding the scope of our operating services to existing clients around the world

This has been a successful year, with new business accruing from several large contracts in the US as many municipalities struggled with budget shortfalls and looked to public and private partnerships to help lower their costs. In the City of Prichard, Alabama, a \$1 million contract to operate the waste treatment plant was expanded to a \$6 million contract when we were asked to bid to operate the city's complete package of services, including water, waste water treatment, meter reading and billing.

In the UK, Coast to Coast (C2C) continued to extend its operational services outside of the 25 year contract with the Ministry of Defence.

Severn Trent Select was also awarded a design build contract with a major UK dairy and finished the year as a preferred supplier on another design build contract.

In Italy, we ended the year having been awarded one major waste water design, build and operate contract and as a preferred bidder on another.

#### Enhancing products and operations to improve our effectiveness and efficiency

This year we focused on making our operations more efficient. We saved costs by using centralised sourcing to make combined purchases of similar components from lower cost locations. Also, engineering services are being outsourced to India and assembly for membranes filtration projects is being sourced locally for regional markets.

In our Analytical Services business, we consolidated our facilities, exited unprofitable lines of business and expanded services further.

#### Developing new technologies at the forefront of water and waste water solutions

Year on year, the proportion of sales coming from new products introduced in the last three years has increased by 80%.

We continue to build our innovation capability. In the past year we have rolled out global best practice tools and processes across all product and technology centres of excellence with the goal of improving our new product performance and cycle times. Early benefits include increased visibility and transparency of our product and technology investment programme.

Additionally, we have developed an overarching technology strategy and are now actively carrying this forward through both internal and collaborative development activity. Our product development pipeline is robust.



Prichard Water Tower

### Operating Services

#### – announces it has renewed its public private partnership

We have renewed our public private partnership with the Water Works and Sewer board (the Board) of the City of Prichard, Alabama, through a competitive bid process. Severn Trent is responsible for the complete operation, maintenance and management of the city's water and waste water facilities, collection and distribution systems, meter reading, billing and customer service functions. Shortly after the partnership

started, plant performance was dramatically improved, allowing the board and its engineer to concentrate on capital improvement planning. In the last two years, the Board and citizens of Prichard have benefited from improved operations and performance, including reduced solids inventory; improved discharge quality; the introduction of an asset management programme; identification of capital improvement projects; and the installation of a comprehensive maintenance management programme that schedules predictive and preventive maintenance.

## Performance by business area

### Operating Services

Our Operating Services business has performed well because we are able to operate utility and municipal assets efficiently at a lower cost.

We are one of the leading providers in the US, where we run nearly 400 contracts.

In the UK and Ireland we combined all non-regulated UK businesses under one business unit, Operating Services UK and Ireland, and have worked with approximately 200 commercial and industrial clients during the year.

Also in the UK, we reduced leakage in our C2C Ministry of Defence contract despite the coldest winter in 30 years. We have more than halved leakage since the contract started in 2005.

### Water Purification

A slow start to 2009/10 for our Water Purification business meant we effectively lost a year of expected growth. Cash-strapped municipalities slowed their investment in new equipment and while many orders were delayed, no significant orders were cancelled. However, we restructured the business to lower our cost base. At the same time, we invested in selected growth areas. As a result, and as global markets recovered, our Water Purification business achieved sequential growth during the second half of the year with turnover up 16% and profits up 67% when compared to the first half.

Notable contract wins during the year included a \$15.7 million contract for the world's largest denitrification system in Baltimore, Maryland; a \$7 million contract for the largest reverse osmosis sea water system for an oil refinery in Pakistan; several new contracts in China; and the first deep bed filtration system used for water reuse in Libya for Al Hadba (Tripoli).

We ended the year with the highest order book in Severn Trent Services' history and our key project pipeline continues to grow.

### Analytical Services

During the year we undertook a significant restructure of our business. This has repositioned the business with a lower cost base and a more resilient business platform.

We received formal notification of UKAS (United Kingdom Accreditation Service) accreditation for our newly constructed Wakefield facility, which will serve our new 10 year contract with Yorkshire Water. We have introduced new technologies to offer more methodologies, lower costs and faster output. We have also expanded our services to include on site testing and operator self monitoring, both growth areas.

## We are committed to conducting our business in a responsible way

We continue working to build corporate responsibility into our strategy and embed it in our culture.

Our health and safety performance continues to improve. This year we reduced the number of lost time incidents per 100,000 hours worked by 22%, maintaining one of the best rates in our industry. Two Operating Services businesses in the UK received awards from the Royal Society for the Prevention of Accidents. C2C received the Gold award and Integra received the Silver award.

In 2009/10 we introduced a new health and safety handbook, offering support and training for all employees, in several languages.

Our success depends on all of our employees. During the year we implemented a change management programme entitled 'Blueprint for growth' to help employees understand our core values, objectives, Key Performance Indicators, and the role they play in helping our company improve and grow.

We commissioned our second independent Employee Engagement Survey in 2009/10 with employee engagement increasing four percentage points from the previous survey.

We take carbon management seriously and continued to look at ways to reduce our energy consumption. For the second consecutive year we produced Site Energy Management Plans for five of our US sites and six of our UK sites. Implementing these plans has led to reductions in energy use and lower costs.

## Outlook for the future

In our Operating Services business we will continue to find more cost efficiencies and move into new areas as part of our plans to grow the business year on year. A change in legislation in Italy around the awarding of contracts is expected to yield more opportunities. Increased growth is expected in the Middle East/ North Africa region, where we have a strong pipeline of prospects.

We start the financial year with a very strong order book and pipeline in our Water Purification business. We will continue lowering our cost base, focusing on our regional operations and delivering new products in this market, such as MicroDynamics® ultraviolet disinfection, BALPURE® ballast water treatment, and OMNIPURE Series 55® marine/offshore sewage treatment.

Performance in Analytical Services is expected to improve as a result of the lower cost base, the innovations being brought into the business and a greater number of long term contracts, including Yorkshire Water.

While the strength and pace of the economic recovery continues to be uncertain, we believe the continuing growth of the market is sustainable because of the strength of its fundamental drivers. We will therefore continue implementing our growth strategy, focusing on our four key initiatives.



Routine analysis being carried out on concentrated samples

### Analytical services

#### – opens new accredited laboratory in Wakefield

In March 2009, Severn Trent Services secured a 10 year contract for delivery of water and waste water analysis to Yorkshire Water. Since the contract win, we have constructed a brand new facility in Wakefield in Yorkshire. The laboratory will deliver an extensive range of water and waste water

analysis for Yorkshire Water, but will also service other customers in the region and provide back-up facilities for our two other water laboratories, offering Utility customers a more robust service. The laboratory went into full operation on 1 April 2010 and is able to handle in excess of a quarter of a million samples per year.