Tear Sheet:

United Utilities PLC

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Primary contact

Gustav B Rydevik
London
44-20-7176-1282
gustav.rydevik
@spglobal.com

Secondary contact

Aarti Sakhuja
London
44-20-7176-3715
aarti.sakhuja
@spglobal.com

United Utilities PLC's (UU's) results show a decline in revenue and EBITDA, resulting from inflation timing differences between revenues and costs along with lower volumes and margins. Margins were depressed by a significant increase in the prices of power and chemicals as well as labor costs. In combination with the debt increase of roughly 8%, driven by high inflation, this means that the company's ratio of funds from operations (FFO) to debt, at 2.8%, is below our threshold of 9%. Nonetheless, due to the cost-of-debt outperformance, also related to inflationary impact, UU's return on regulated equity is its highest ever at 11.0%. Despite the nominal increase in debt, inflation has helped to slightly reduce regulatory gearing to 58% from 59% at the end of 2022 via an increase in regulated capital. With increasing political and public scrutiny, UU achieved its best leakage performance while also having reduced storm overflow activations by almost 40% since 2020. It had no serious pollution events during the year and 83% of all performance commitments were delivered.

We expect financial metrics will remain depressed in fiscals 2023 and 2024 (ending March 31). However, we still expect to see a return to metrics commensurate with our 'BBB+' rating by fiscal 2025, that is FFO to debt above 9%. We expect that as inflationary pressures recede, financial metrics will strengthen relatively quickly. We have already seen a downward trend in power prices, which UU has 90% hedged for fiscal 2024, and a normalization of chemical prices, two major factors affecting margins. Associated non-cash debt indexation costs will also decline in line with inflation and will boost the group's FFO.

Recent Research

- EMEA Utilities Outlook 2023: United Kingdom: Tailwinds For Energy, Cross-Currents For Water, Jan. 24, 2023
- Industry Top Trends 2023: EMEA Utilities, Jan. 23, 2023
- High Level Of Index-Linked Debt Exacerbates Effect Of Inflation On U.K. Water Companies, Dec. 1, 2022

Company Description

With a regulatory capital value of £14 billion as of March 31, 2023, United Utilities Water (UUW) is the second-largest water and sewerage company in the U.K. after Thames Water. Its parent, UU, is listed on the London Stock Exchange. It is a monopoly supplier of water and wastewater services to about 3 million households and 200,000 businesses in northwest England and generates annual EBITDA of about £1 billion. UU has a joint venture with Severn Trent to operate in the competitive non-household retail business segment. It has minimal unregulated activity.

Outlook

The stable outlook on UU reflects our expectation that the group's strong operating performance will continue, while maintaining debt to EBITDA below 9x. Although we expect FFO to debt to be below the current ratings threshold for the next two years, we expect it will recover to above 9% by fiscal 2025. The stable outlook also assumes no political or regulatory interference that could prevent UUW from passing on inflation to customers.

Downside scenario

We could lower the ratings on UU and UUW if FFO to debt does not seem likely to recover to above 9%, the level we view as commensurate with the current ratings, by March 2025. If we see debt to EBITDA increasing above 9x we could also take a negative rating action. This could happen if inflation has a worse-than-forecast impact on credit metrics, through higher inputs or financing costs.

We could also lower the rating if UUW's operational performance deteriorates significantly, thereby reducing "outcome delivery incentives" rewards, or if we consider the regulatory outcome for UUW for the next regulatory period, AMP8, will lead to less favorable operating conditions.

Upside scenario

We see limited upside to our ratings on UUW and UU before the end of AMP7 (ending March 31, 2025), given that we expect credit metrics to be below target for fiscals 2023 and 2024 and that the group faces inflationary pressures while it delivers a significant capital program during the rest of AMP7.

However, we would consider raising the ratings if adjusted FFO to debt exceeded 11% and debt to EBITDA stayed sustainably below 7x, while the group continued to demonstrate above-average operating performance.

Key Metrics

United Utilities PLC--Forecast summary

Period ending	Mar-31-2019	Mar-31-2020	Mar-31-2021	Mar-31-2022	Mar-31-2023	Mar-31-2024	Mar-31-2025
(Mil. GBP)							
EBITDA	1,040	1,126	1,034	1,024	860	1,060-1,090	1,080-1,120
Funds from operations (FFO)	769	820	795	637	229	610-630	730-750
Capital expenditure (capex)	627	645	639	627	689	530-550	390-410
Dividends	274	285	292	296	301	330-360	330-360
Debt	7,027	7,241	7,285	7,556	8,182	8,050-8,150	8,000-8,200
Adjusted ratios							
Debt/EBITDA (x)	6.8	6.4	7.0	7.4	9.5	7-8	7-8
FFO/debt (%)	10.9	11.3	10.9	8.4	2.8	7.5-8.5	8.5-9.5

United Utilities PLC--Forecast summary

DCF/debt (%)	(1.0)	(1.6)	(0.9)	0.1	(2.6)	(0.5)-0.5	1-2

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. GBP--pound sterling.

Financial Summary

United Utilities PLC--Financial Summary

Period ending	Mar-31-2018	Mar-31-2019	Mar-31-2020	Mar-31-2021	Mar-31-2022	Mar-31-2023
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (mil.)	GBP	GBP	GBP	GBP	GBP	GBP
Revenues	1,736	1,819	1,859	1,808	1,863	1,824
EBITDA	1,028	1,040	1,126	1,034	1,024	860
Funds from operations (FFO)	708	769	820	795	637	229
Interest expense	284	241	256	189	379	650
Cash interest paid	147	145	149	137	122	118
Operating cash flow (OCF)	820	836	815	866	934	788
Capital expenditure	711	627	645	639	627	689
Free operating cash flow (FOCF)	109	209	170	227	308	99
Discretionary cash flow (DCF)	(161)	(69)	(117)	(69)	6	(209)
Cash and short-term investments	510	339	528	744	241	340
Gross available cash	510	339	528	744	241	340
Debt	6,871	7,027	7,241	7,285	7,556	8,182
Common equity	2,951	3,111	2,962	3,031	2,957	2,509
Adjusted ratios						
EBITDA margin (%)	59.2	57.2	60.5	57.2	55.0	47.1
Return on capital (%)	6.8	6.6	6.0	5.8	5.8	4.2
EBITDA interest coverage (x)	3.6	4.3	4.4	5.5	2.7	1.3
FFO cash interest coverage (x)	5.8	6.3	6.5	6.8	6.2	2.9
Debt/EBITDA (x)	6.7	6.8	6.4	7.0	7.4	9.5
FFO/debt (%)	10.3	10.9	11.3	10.9	8.4	2.8
OCF/debt (%)	11.9	11.9	11.3	11.9	12.4	9.6
FOCF/debt (%)	1.6	3.0	2.3	3.1	4.1	1.2
DCF/debt (%)	(2.4)	(1.0)	(1.6)	(0.9)	0.1	(2.6)

Peer Comparison

United Utilities PLC--Peer Comparisons

	United Utilities PLC	Severn Trent PLC	Northumbrian Water Ltd.
Foreign currency issuer credit rating	BBB/Stable/NR	BBB/Stable/A-2	BBB/Stable/--
Local currency issuer credit rating	BBB/Stable/NR	BBB/Stable/A-2	BBB/Stable/--
Period	Annual	Annual	Annual
Period ending	2023-03-31	2023-03-31	2022-03-31
Mil.	GBP	GBP	GBP
Revenue	1,824	2,165	827
EBITDA	860	929	351
Funds from operations (FFO)	229	509	191
Interest	650	423	160
Cash interest paid	118	209	107
Operating cash flow (OCF)	788	506	229
Capital expenditure	689	700	231
Free operating cash flow (FOCF)	99	(194)	(1)
Discretionary cash flow (DCF)	(209)	(457)	(94)
Cash and short-term investments	340	16	111
Gross available cash	340	16	123
Debt	8,182	7,539	3,452
Equity	2,509	971	394
EBITDA margin (%)	47.1	42.9	42.4
Return on capital (%)	4.2	6.2	5.2
EBITDA interest coverage (x)	1.3	2.2	2.2
FFO cash interest coverage (x)	2.9	3.4	2.8
Debt/EBITDA (x)	9.5	8.1	9.8
FFO/debt (%)	2.8	6.8	5.5
OCF/debt (%)	9.6	6.7	6.6
FOCF/debt (%)	1.2	(2.6)	(0.0)
DCF/debt (%)	(2.6)	(6.1)	(2.7)

Environmental, Social, And Governance

ESG Credit Indicators

E-1	E-2	E-3	E-4	E-5	S-1	S-2	S-3	S-4	S-5	G-1	G-2	G-3	G-4	G-5

- N/A	- Social capital	- N/A

N/A—Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Rating Component Scores

Foreign currency issuer credit rating	**BBB/Stable/--**
Business risk	**Excellent**
Country risk	Low
Industry risk	Very Low
Competitive position	Excellent
Financial risk	**Aggressive**
Cash flow/leverage	Aggressive
Anchor	**bbb**
Diversification/portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Positive (+1 notch)
Liquidity	Adequate
Management and governance	Satisfactory
Comparable rating analysis	Neutral
Stand-alone credit profile	**bbb+**
Group credit profile	**bbb+**
Entity status within group	**Core**

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010