

KELDA GROUP STRATEGY REVIEW CONCLUSIONS

Background

The board of Kelda Group plc (Kelda) announced, on 11 April, a wide-ranging review of its strategy and group structure. The review was in response to a board decision to focus aggressively on shareholder value and specifically to address:

- The benefits of separation, subject to regulatory approvals, of the ownership and operation of Yorkshire Water Services Limited's assets.
- The role of the non-water, diversified businesses.
- Returning to shareholders excess capital realised from the implementation of these strategic initiatives.
- The development of Kelda as a provider of operating services to the water industry and the development of business services generally.

Summary Recommendations

Today, the Board announces the conclusions of its review. In outline, subject to shareholder, regulatory and other approvals, the following is proposed:

1. Kelda will focus on its water and waste management operations with a planned disposal of its renewable energy and other environmental services businesses in the UK and Europe.
2. To create a community owned company (Registered Community Asset Mutual, or RCAM) which once established, would negotiate on an arms length basis, to acquire the shares and assets of Yorkshire Water Services Ltd. (YWS) for a total consideration which Kelda believes should be close to the regulated asset value.
3. Following the sale of YWS to the RCAM, the RCAM, acting independently, would implement a procurement strategy which would subject all contestable operational activities to competitive tendering.
4. Under this proposed procurement plan, Kelda expects that the RCAM would award initial operating contracts to Kelda to ensure continuity of service. It is expected that competitive re-tendering would take place over the lifetime of the current price determination in a phased manner.
5. There will be a substantial return of value to Kelda shareholders.
6. The simplification of the Kelda business profile will allow a significant corporate restructuring and reduction in overheads. It is planned that this should provide an opportunity to reduce overheads which, together with the net effect of the disposals, should generate a minimum of £10 million savings in a full year.

BACKGROUND INFORMATION

Structure of the RCAM

Subject to the necessary approvals, it is envisaged that the RCAM would be a company owned by the customers of YWS. It would be 100% debt funded and any surpluses would be returned to customers in the form of improved tariffs, increased services or higher levels of investment.

The RCAM would be established under Industrial and Provident Society legislation. It would be run for the benefit of the Yorkshire community and would have approximately 160 staff. It would have a strong independent board consisting of five non-executive directors (including the chairman) and two executive directors. After the RCAM has been established and is in operation, two of the non-executive directors would be elected by a ballot of customers.

David Perry, currently the senior non-executive director on the board of Kelda has agreed to be chairman of the RCAM. Richard Ackroyd, currently director of capital investment and regulation of Yorkshire Water Services, has agreed to become the managing director of the new company.

David Perry has resigned as a non-executive director of Kelda with effect from today. Richard Ackroyd will stand aside from his current duties from today, in order to act independently on behalf of the proposed RCAM.

Kelda understands that two further independent non-executive directors would be appointed to the board of the RCAM, prior to the implementation of the RCAM proposal, one of whom is expected to have extensive experience outside Kelda.

Financing the RCAM

Subject to negotiations and independent advice, the RCAM would acquire YWS for a total consideration which Kelda believes should be close to the regulated asset value. Kelda and the RCAM would approach existing debt holders to discuss the migration of the existing Kelda debt to the RCAM. The RCAM would need to raise additional debt to fund the total consideration.

A structured security and covenant package including reserves would be established for all debt in the RCAM. This approach should ensure long term financial stability as well as controlling the amount of future additional debt which can be raised.

All parties are working on the basis that all debt will continue to be rated as solid investment grade (A category) and have already held detailed discussions with Fitch IBCA, Moody's and Standard & Poors. These discussions have been encouraging and are continuing.

To avoid prejudicing the position of existing lenders, it is intended that they would all be invited to exchange or amend the outstanding debt such that they benefit from all aspects of the credit structure.

Detailed proposals will be sent to bond holders at the same time as shareholder documents are issued.

The Future Kelda

Following disposals, Kelda will comprise of three principal activities:

1. UK- based operations servicing YWS
2. The US water company Aquarion
3. The investment in Waste Recycling Group plc

Subject to the successful establishment of the RCAM, the UK water services operations will be a non-regulated activity and this will free Kelda to take advantage of significant opportunities in the UK water and waste management market.

The acquisition of Aquarion has made a very promising start and there is potential to significantly expand Kelda's business in the US.

Benefits of the Recommendations

Kelda believes that the recommendations have a number of benefits for customers, shareholders and other stakeholders:

Benefits to Customers

Customers would benefit from the creation of the RCAM as it :

- lowers the relative cost of capital, ultimately bringing the options of improved consumer prices, increased services or higher levels of investment
- provides greater customer ownership and involvement
- provides the mechanism for surpluses generated to be beneficially used for customers.

Benefits to Shareholders

Shareholders would benefit from the recommendations as they :

- deliver a substantial return of capital funded from disposal of water assets to the RCAM and the implementation of an appropriate capital structure at Kelda
- provide continued investment in Kelda - a focused water and waste management facilities management/ outsourcing company
- create the opportunity for further, significant value creation within Kelda.

Benefits to Other Stakeholders

The proposed reorganisation of Kelda offers significant benefits for all stakeholders, namely it:

- aligns ownership of the assets with the interests of consumers, through mutual non-shareholder profit based ownership
- protects Kelda bond holders by placing the debt in a tightly controlled, regulated and well rated RCAM
- maintains all employee rights, involves no new redundancy plans at Kelda and provides growth opportunities within Kelda.

Approvals and Timescales

The implications of the implementation of the RCAM, its constitution, corporate governance and the related procurement plan have been discussed with the Director General of Water Services, who has indicated that it will be subject to a public consultation process, which he will announce in due course.

During this period and before any further public announcements are made, it is expected that the RCAM will be properly constituted, take appropriate independent advice and conclude any contract negotiations it requires to proceed with the transaction.

In addition, the separation of assets and operations and consequent re-organisation are subject to shareholder, bondholder and court approvals through a scheme of arrangement. Full details will be sent to shareholders in August.

It is intended that the Kelda AGM be delayed to coincide with the shareholder meetings required for the transaction and is likely to take place in mid-September followed by financial close in mid-October.

Meetings

There will be a meeting for equity analysts and institutional investors today at 9.30 am at Financial Dynamics, Holborn Gate, 26 Southampton Buildings.

There will be a separate presentation to credit analysts at 2.00pm today at Financial Dynamics, Holborn Gate, 26 Southampton Buildings. Interested parties who cannot attend in person may listen to the presentation by calling-in to 0208 240 8243.

Bondholders seeking further information on the proposals should contact one of the following:

Barclays Capital	Richard Holliday	0207 773 3936
Merrill Lynch	Rebecca Pynt	0207 628 1000

Press Enquiries on 14 June 2000

Kelda Group Corporate Communications

