Delivering sustainable growth

Annual Report and Accounts 2011

Introduction

Who we are

Pennon Group Plc is a company at the top end of the FTSE 250 which owns South West Water Limited and Viridor Limited. The Group has assets of around £4.1 billion and a workforce of over 4,300 people.

Group strategy

Our strategy is to promote the success of the Group for the benefit of our shareholders, customers and other stakeholders through our focus on water and sewerage services, recycling, waste management and renewable energy. We aim to be a pre-eminent provider of customer services to high standards of quality, efficiency and reliability.

What we do

We carry out our business through:

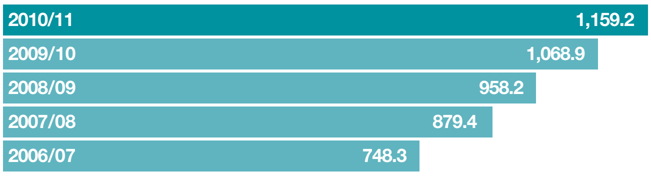
South West Water Limited which provides water and sewerage services in Devon, Cornwall and parts of Dorset and Somerset.

Viridor Limited which is one of the UK's leading recycling, waste management and renewable energy businesses.

To view our online report visit:
pennonannualreport2011.co.uk

Delivering sustainable growth

Revenue £m



£1,159.2m

+8.4%

KPI Profit before tax £m

£188.5m

+1.5%

KPI Underlying* earnings per share pence

42.3p

+3.7%

KPI Dividend per share pence

24.65p

+9.3%

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* Excluding deferred tax. Statutory earnings per share were 48.4p (2009/10 40.4p)

Group at a glance

Pennon Group

Our strategy is to promote the success of the Group for our shareholders, customers and other stakeholders through our focus on water and sewerage services, recycling, waste management and renewable energy. We aim to be a pre-eminent provider of customer services to high standards of quality, efficiency and reliability

Financial highlights

Revenue	Profit before tax
£1,159.2m	£188.5m
+8.4%	+1.5%

KPI Dividend per share pence

2010/11	24.65
2009/10	22.55

KPI Underlying* earnings per share pence

2010/11	42.3
2009/10	40.8

* Excluding deferred tax. Statutory earnings per share were 48.4p (2009/10 40.4p)

Key Group facts

£4.1bn assets

4,300 employees

South West Water…

provides water and sewerage services in Devon, Cornwall and parts of Dorset and Somerset, delivering industry-leading operational performance

Financial highlights

Revenue	Profit before tax
£448.8m	£128.9m
+1.0%	-0.5%

Revenue £m

2010/11	448.8
2009/10	444.2

Profit before tax £m

2010/11	128.9
2009/10	129.5

Viridor…

one of the UK's leading recycling, waste management, and renewable energy businesses. It won the 2010 National Recycling and Waste Management Business of the Year Award

Financial highlights

Revenue	Profit before tax
£712.0m	£62.9m
+13.6%	+14.2%

Revenue £m

2010/11	712.0
2009/10	626.5

Profit before tax £m

2010/11	62.9
2009/10	55.1

Strategy	Highlights of the year	Strategy in action
The Group aims to be a leading provider of high-quality, efficient and trusted services whilst: • having strong corporate responsibility credentials which make a positive impact on communities and the environment • maintaining high standards of ethical business conduct • fostering open and positive relationships with suppliers, customers and other stakeholders • protecting and promoting the interests of all our employees.	Our strategy continued to deliver shareholder value in 2010/11 and we are committed to an annual dividend increase of 4% above inflation at least up to 2014/15 • both businesses delivered a strong performance during the year • the Group has benefited from an exceptionally low cost of finance thanks to its prudent funding and efficient long-term financing • both businesses are well positioned in the current economic conditions.	The Group continues to successfully source additional finance for funding the growth strategies of both subsidiaries Progressive dividend policy Low cost of debt. Further details on page 20

Strategy	Highlights of the year	Strategy in action
South West Water is committed to its vision of 'Pure Water, Pure Service and Pure Environment', underpinned by a strategy of striking the right balance between: • investing to improve service • customer affordability • the needs of stakeholders.	• industry leading performance in tackling leakage • 14th consecutive summer without water restrictions • near perfect drinking water quality at 99.97% • customer satisfaction levels are rising • record percentage (90.3%) of bathing waters achieved EU Guideline (or excellent) standard.	Pure Water – providing safe and reliable water supplies Pure Service – increasing levels of customer satisfaction and maintaining reliability of assets to protect service improvements made over last 20 years Pure Environment – protecting and enhancing the environment Financial Management – outperforming the regulatory contract, rigorously controlling costs and arranging efficient funding. Further details on page 9

Strategy	Highlights of the year	Strategy in action
Viridor's strategy is to grow and add value by: • proactively developing and expanding recycling operations to meet ambitious EU and UK targets • successfully exploiting the huge potential inherent in waste-based renewable energy generation • capitalising on its strong position in landfill waste disposal.	• Viridor delivered strong profit growth thanks to the attractive margins in its expanding recycling and Energy from Waste (EfW) operations • some 46% of profits came from realising the value in waste (recycling and energy recovery) • 25-year PFI waste management contract in Greater Manchester (the largest programme of its kind in Europe) entered its second year of operation • new Lakeside EfW plant operated for its first full year.	Acquiring a growing network of established recycling businesses and progressing major renewable energy schemes in addition to organic growth, is increasing Viridor's presence in these expanding sectors Achieved planning permission for four new strategic EfW plants (including one post year-end and two permissions subject to challenge) Five high-quality strategically located recycling companies acquired for a total of nearly £50 million. Further details on page 15

Adding value for shareholders

It is my pleasure to report on yet another successful year for Pennon Group. South West Water has had a strong start to the new 2010-2015 regulatory contract and Viridor has once again delivered strong profit growth.

Ken Harvey, Chairman, Pennon Group Plc

Dear shareholder

Our Group history shows that we have concentrated on developing and improving our two businesses, South West Water and Viridor. South West Water has delivered greater efficiencies, improved operating standards and provided a better overall service to its customers. Viridor has seen a step-change from being a virtually pure landfill company to a UK-leading recycling and renewable energy business, whilst continuing to benefit from its strong position in landfill. This last year has continued to demonstrate the success of our strategy of focusing on water and sewerage services, recycling, waste management and renewable energy.

Financial review

Our Group revenue rose by 8.4% to £1,159.2 million and our profit before tax increased by 1.5% to £188.5 million[1]. Our underlying[2] earnings per share increased by 3.7% to 42.3p.

The Group has substantial cash resources and undrawn facilities and is well placed in the current financial market conditions.

South West Water's Regulatory Capital Value (RCV) grew by a further 5.8% during 2010/11 to £2.7 billion, building on the 31% increase over the K4 (2005-2010) period which was the highest percentage increase for any quoted UK water company. Viridor's profit before tax at £62.9 million was an increase of 14.2% on the previous year and continues to build upon the growth achieved over the last ten years.

Dividend

The Board is recommending to shareholders a final dividend per share of 17.15p, which represents a 9.9% increase on last year's final dividend. This will result in a total dividend for the year of 24.65p, an increase of 9.3% on the total dividend for 2009/10. This is in line with our previously announced policy to grow the Group dividend by 4% above inflation per annum up to at least the end of 2014/15. This is a reflection of our confidence that Pennon Group is well positioned to continue to deliver strong growth.

I am pleased to say that we will be offering a Scrip Dividend Alternative to shareholders in respect of the final dividend. The timetable for offering the Scrip Dividend Alternative is given on page 114.

Business performance

South West Water's year was characterised by a strong start to the K5 period, when it delivered some £8 million in efficiency savings (nearly twice its 2009/10 achievement). This is being achieved through changing operational ways of working; right-sourcing and innovative contracting arrangements; energy procurement and reduced usage; and the rationalising of administrative and support services. The company also delivered industry-leading operational performance and improved standards of customer service.

Viridor saw its revenues and profit before tax move ahead (by 13.6% and 14.2% respectively) as it concentrated on extracting value from waste. Its results were driven by a successful first full year of operation at the Lakeside Energy from Waste (EfW) plant near Heathrow, a strong second operational year for the Greater Manchester Private Finance Initiative (PFI) waste contract and strong organic growth in recycling backed up by five acquisitions of high quality, strategically aligned recycling businesses.

Group history

1989

Privatisation of the water industry in England and Wales. South West Water Plc, one of ten water and sewerage companies, launched on the London Stock Exchange

Roadford Reservoir completed providing 34,500 megalitres of water storage

1993

Purchase of the first of our waste companies, Haul Waste, for £29 million; later renamed Viridor Waste Management

1995

Blue Circle Waste Management acquired for £71 million

1997

Landfill activities of Terry Adams acquired for £85 million

1998

Plymouth £63 million 'Clean Sweep' scheme completed

1999

Newquay £15 million 'Clean Sweep' scheme completed

KPI Dividend per share pence

2010/11	24.65
2009/10	22.55
2008/09	21.00
2007/08	19.81
2006/07	18.55

24.65p

+9.3%

KPI Underlying earnings per share[1,2] pence

2010/11	42.3
2009/10	40.8
2008/09	36.9
2007/08	36.3
2006/07	30.3

42.3p

+3.7%

This last year has continued to demonstrate the success of our strategy of focusing on water and sewerage services, recycling, waste management and renewable energy.

Health and safety

Measures of the health and safety of all our employees are an important key performance indicator (KPI) for both our businesses. We were pleased to see a significant reduction in the reportable number of incidents within Viridor for 2010/11 but disappointed to see a rise in reportable incidents at South West Water. The Board, together with the Boards of South West Water and Viridor, are totally committed to fostering a culture and working environment where accidents are unacceptable.

Governance

We operate businesses which can and do have a material impact on the environment and communities, and we do take a very responsible approach to environmental, social and governance (ESG) matters. Our sustainable practices not only benefit the communities in which we operate, but also enable our businesses to be more successful. We set out more fully in the Business review and in our Group Corporate responsibility report our commitment to ESG and the improvements we have made in protecting the environment, carbon capture, energy savings and resource recovery, which all contribute to a more sustainable future for everyone. We continue to take into account the views of our shareholders and major institutional groups on key governance issues in reviewing annually our practices, policies and procedures. We have a strong and appropriately experienced Board, with governance structures in place which can and does successfully respond to the challenges we face and enable us to operate in the best interests of our shareholders and other stakeholders.

Our employees

Our success continues to be due to the talent, commitment and sheer hard work of our employees. I would like to thank every one of them for their outstanding contribution yet again, particularly in adapting so effectively to changing cultures and operating environments.

I am also very grateful to my Board colleagues for their support and significant contribution to another successful year.

Outlook

As I have stated above, we are confident that Pennon Group remains well placed for significant long-term growth. South West Water is set to continue outperforming the targets in the Final Determination for the K5 period and to continue to benefit from exceptionally low costs of finance. Viridor is well positioned to gain increasingly from the future operation of a number of current investment projects, including the EfW plant at Runcorn, both phases of which are currently under construction.

I am confident that as our Group businesses continue to exploit future opportunities for further efficiencies and growth, we have the right strategy in place to continue and build upon the success we have achieved to date.

Ken Harvey
Chairman
Pennon Group Plc
22 June 2011

[1] Reflects the application of IFRIC 18 'transfers of assets from customers', effective from 1 July 2009

[2] Underlying earnings per share excludes deferred tax

2002

Torbay £97 million 'Clean Sweep' scheme completed

Sale of Viridor Instrumentation for £104 million and special interim dividend paid to shareholders from the net sale proceeds

2004

Thames Waste Management acquired for £31 million

2005

Lakeside Energy from Waste; a 50:50 joint venture established with Grundon Waste Management

2006

Purchase of Park reservoir

All 144 bathing waters in the South West region achieved 100% compliance for the first time with the EU Mandatory standard

2007

Launch of pioneering customer support scheme 'WaterCare' by South West Water

Grosvenor Waste Management acquired for £81 million

2008

Purchase of Stannon reservoir

2009

Ofwat Final Determination of price limits for K5 period (2010–2015) received by South West Water. Next Determination due in 2014

Greater Manchester PFI contract signed

2010

Completion of £400 million clean water mains rehabilitation programme which saw 5,000 kilometres of water mains relined or replaced over ten years

Delivering on our strategy

With strong results recorded by both businesses in 2010/11, Group Director of Finance David Dupont, South West Water CEO Chris Loughlin and Viridor CEO Colin Drummond discuss a year of achievement and outline their strategic approach to the main challenges they face.

What were the highlights of the year, and how do they reflect the Group strategy?

David Dupont
We saw a solid profit performance in the year. South West Water's profits were stable, despite the reduced rate of return imposed by Ofwat, and Viridor achieved very strong growth driven by its successful recycling activities and the Lakeside Energy from Waste (EfW) and Greater Manchester Waste PFI projects.

We continued to secure further funding for both businesses to finance South West Water's commitments in the current five-year cycle and to enable Viridor to continue its strategy of investing in EfW and recycling assets.

By the year-end we had £825 million of funding in place to support both subsidiaries, reflecting our Group strategy of investing in our utility infrastructure businesses to achieve long-term growth for investors.

Can you explain the decision to set a dividend growth policy of 4% per annum in real terms; higher than any of your peer companies?

DD
Certainly – the decision reflects our confidence that both South West Water and Viridor are pursuing proven sound strategies which will enable them to continue to perform well during the foreseeable future. In addition we've successfully secured funding for South West Water at a significantly lower interest rate than was assumed by Ofwat for the 2010–2015 period and we are pleased to be sharing this benefit with our investors.

South West Water achieved a strong operational performance last year. What were the key highlights and how did you achieve them?

Chris Loughlin
First and foremost we achieved a step-change in operational cost-efficiency, delivering nearly double the savings of the previous year. This coincided with very high levels of operational performance; for example, our water quality is amongst the very best in the industry and our water losses from

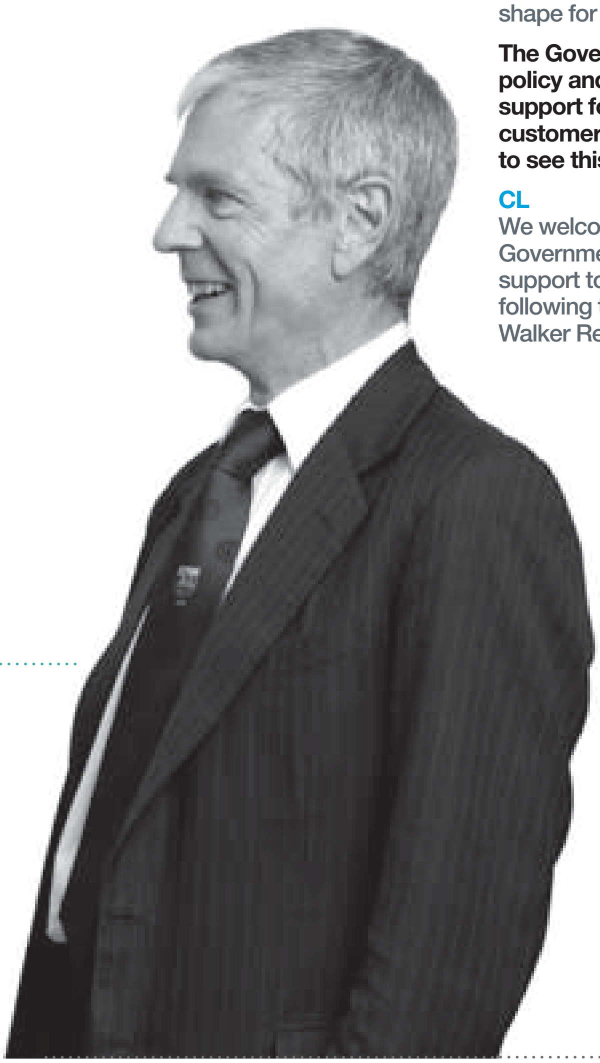
First and foremost, we achieved a step-change in operational cost-efficiency, delivering nearly double the savings of the previous year.

Chris Loughlin, Chief Executive, South West Water

leakage are the lowest in the country, having met the Ofwat target in every single year, despite a record cold spell this winter leading to many frozen pipes.

A new five-year period brings new challenges from Ofwat. How are you delivering against these?

CL
In essence the challenge remains to continue to deliver ever improving customer service and a demanding programme of operational improvements whilst outperforming our commitments financially. Operationally, we have front-loaded our improvement plans. This has given us a flying start to the new five-year period. This is underpinned by our Puros programme which is transforming how we operate our assets and our working practices to make us even more efficient in the future. Financially, our very low cost of borrowing ensures that a continued high level of outperformance is already locked in. In terms of capital expenditure outperformance we are also seeing the benefits of the new long-term contracts we put in place at the end of the last five-year cycle. All in all we are in good shape for the rest of the period.



The Government is reviewing water policy and has already announced support for South West Water customers. How would you like to see this develop?

CL
We welcome the fact that the Government is minded to provide support to South West Water customers following the findings of the independent Walker Review. We'll continue to work with Government and other interested parties in the ongoing consultation process to help achieve the right balance between supporting those facing the most acute financial challenges and ensuring the fairest level of bills for everyone.

Viridor's joint ventures at Lakeside and in Greater Manchester have clearly made a major contribution to this year's results. How are they progressing?

Colin Drummond
Both are going very well. Lakeside's performance during its first full year of operation was even better than expected with a total profit contribution approaching £9 million if you include Viridor sub-contract profits. Our 25-year Greater Manchester Waste PFI contract also performed very strongly during its second full year with 31 of the project's 42 new facilities now completed. We are delivering world-class recycling and waste management solutions to Greater Manchester in an economic manner at a time when our client, like many local authorities across the UK, is facing tough budgetary constraints.

Group Director of Finance David Dupont, South West Water Chief Executive Chris Loughlin and Viridor Chief Executive Colin Drummond

Delivering on our strategy continued

Waste management is changing into a resource recovery business and we are capitalising on, and indeed leading this trend.

Colin Drummond, Chief Executive, Viridor

What are the key trends currently impacting Viridor?

CD
The move away from landfill to more recycling, combined with recovering more energy from waste, is the most important change affecting our industry. Waste management is changing into a resource recovery business. We are capitalising on, and indeed leading, this trend – 46% of Viridor's profits now come from recovering value from waste.

Viridor made five acquisitions during the year. What is your acquisition strategy and how important is it to the growth of the business?

CD
Acquiring businesses that fit our strategy and provide a good payback on the investment has always been central to our growth. Indeed roughly half of the 20% per annum profit growth we have achieved since 2000 has been due to acquisitions (with the other half being organic). Last year the companies we bought were all in recycling and provided us with both the geographic operational synergies we look for in the UK and greater volumes to sell through our international distribution network.

Recycling has been a rollercoaster for the industry – have you managed to de-risk it?

CD
It can be a rollercoaster, but the fact is that if you produce high-quality recyclate, you will find a steady market for it; you can become a built-in part of manufacturers' raw material supply chains. Over the last four years we have invested over £200 million in achieving precisely this and we have many excellent customer relationships throughout the UK, Europe and increasingly with China. There remains the risk of price volatility but this is lessened by recyclate being significantly cheaper than virgin materials.

The year's results were impacted by lower prices for the electricity Viridor generates from landfill gas. What are the prospects for the coming year?

CD
2010/11 prices were still highly profitable for us and were only low in comparison with the prices we locked in during summer 2008 at the historic peak of the market. Prices are currently slowly strengthening and our view, and that of many industry analysts, is that this trend will continue.

The Group performed well in the year with South West Water outperforming Ofwat assumptions and Viridor continuing to build a very strong platform for continued growth.

David Dupont, Group Director of Finance

You have many potential Public Private Partnership (PPP) and EfW projects in development. How are these progressing?

CD
Since summer 2010 we have achieved four major EfW planning permissions – at Cardiff, Dunbar, Ardley and Avonmouth (the Secretary of State's decision is subject to challenge on the latter two). During the year we agreed the second phase of development at the new Runcorn EfW plant, with a circa £200 million investment; the construction programme is fully underway (the first phase is targeted at the Greater Manchester project). We also signed a major 25-year residual waste treatment PPP contract with Oxfordshire County Council which will use our planned Ardley facility. We have a healthy pipeline of other potential projects, with a view to winning an acceptable proportion at satisfactory prices.

What are the key KPIs and environmental measures you use to assess Viridor's performance? Is it really true that being green is good for business?

CD
Being green certainly is good for our business. Our profits have been growing at an average compound rate of 20% per annum since 2001. One of our KPIs relates to the amount of waste recycled, which has grown from around 100,000 tonnes per annum in 2001 to 1.7 million last year. Another KPI is our renewable energy generation capacity, which has increased over the same period from 27MW to 136MW – and we are targeting an annual capacity of at least 300MW in five years' time. Other KPIs relate to the economic and social sustainability of our own business. As I know first-hand from my appearance in Channel 4's 'Undercover Boss', we work in challenging environments; a particular area of focus is therefore the health and safety of our workforce. Whilst we more than met our RIDDOR (a national measure of health and safety incidents) target in 2010, which was also an improvement on our 2009 RIDDOR performance, our over-riding goal remains achieving a zero accident rate.

There is very substantial investment going into Viridor. How will you fund it?

DD
Both the Lakeside and Greater Manchester joint venture projects are funded using project finance, with banks providing over 80% of the necessary funds on a non-recourse basis. New investments are being financed corporately, including £46 million by the year-end in the second phase of the new Runcorn EfW plant. By the year-end we had around £500 million in place for Viridor's ongoing investment needs and we are in talks with other finance providers for additional funding as projects progress.

How do you expect the Group to continue to perform within today's challenging business environment?

DD
The Group performed well in the year with South West Water outperforming Ofwat assumptions and Viridor continuing to build a very strong platform for continued growth. This gives us great confidence that we can continue to deliver in line with expectations, including the dividend policy that we announced a year ago.

Far left: Waste Electrical and Electronic Equipment (WEEE) recycling facility, St Helens

Left: Baled recyclate at Ford Materials Recycling Facility (MRF)

At a glance

South West Water is the water and sewerage company that serves Devon, Cornwall and parts of Dorset and Somerset.

Key facts

1.65m
resident population

15,100km
of water mains

9,300km
of sewers

636
waste water treatment works

Operational highlights

South West Water has made a strong start to the K5 five-year regulatory period:

- industry-leading performance in tackling leakage
- 14th consecutive year without water restrictions
- near perfect drinking water quality at 99.97%
- customer satisfaction levels rose
- record percentage (90.3%) of bathing waters achieving EU Guideline (or excellent) standard.

2010/11 notable achievements

The company has delivered on expectations:

- stable profit before tax despite the reduced rate of return allowed in the 2009 Ofwat price review
- successfully met annual leakage target in spite of the coldest December in England in the last 100 years
- resilient network performance during extreme winter conditions
- step-change in operating efficiencies of £8.4 million – nearly double the total for 2009/10
- working with Government and Ofwat on reducing customer charges following the Government's Walker Review.

Where we operate

• Location of South West Water's reservoirs

Teignmouth beach: the region has the highest number of blue flag beaches in the country

Revenue £m	
2010/11	448.8
2009/10	444.2
2008/09	431.7
2007/08	421.0
2006/07	381.5

£448.8m
+1.0%

KPI Profit before tax £m	
2010/11	128.9
2009/10	129.5
2008/09	116.9
2007/08	116.5
2006/07	98.9

£128.9m
-0.5%

Strategy and performance

Under its 'Pure' vision of 'Pure Water, Pure Service and Pure Environment' South West Water is focused on achieving increased levels of customer service and operational performance whilst at the same time delivering greater efficiency and high levels of social and environmental responsibility.

Strategy	Performance	KPI
Pure Water Providing safe and reliable water supplies	Near perfect drinking water quality. 14th consecutive summer with no water restrictions	Drinking water quality % MZC* Calendar year 2010: 99.97 2009: 99.98 2008: 99.98
Pure Service Increased levels of customer satisfaction	Average level of customer satisfaction up. Complaints falling for the second year running with written complaints down a quarter on 2009/10	Customer satisfaction overall % 2010/11: 80 2009/10: 78 2008/09: 81
Maintaining reliability of assets to protect service improvements made over the last 20 years	Stable serviceability** maintained for all service areas. Resilient network performance in extreme winter weather	
Pure Environment Protecting and enhancing the environment	A record percentage (90.3%) of bathing waters achieved EU Guideline (or excellent) standard	Bathing water quality Guideline % Calendar year 2010: 90.3 2009: 84.0
Financial Management Outperformance of regulatory contract	Front-end loaded efficiency savings of £8.4 million, equal to 5.8% per annum. On track to achieve 5% outperformance on the K5 capital programme (using 2009 Final Determination estimates of Construction Output Price Index)	Operating profit £m 2010/11: 189.8 2009/10: 193.5† 2008/09: 186.6
Efficient funding	Locked-in low cost of borrowing ensures interest outperformance against Final Determination (2010/11 4% on average net debt)	

* Mean Zonal Compliance
** Serviceability is the capacity of a system of assets to deliver a reference level of service to customers and to the environment now and into the future. Serviceability is deemed to be stable when the assessment of trends in a defined set of service and asset performance indicators demonstrates that service is in line with the reference level of service and, by inference, is likely to remain so into the future
† Restated for IFRIC 18

A solid profit performance

At the end of the K4 period South West Water reported that it had a solid platform in place for continued success during the new K5 period. 2010/11 has seen the company already benefit from that robust position to deliver a strong start to K5 both financially and operationally with improved standards of customer service.

Our company-wide 'Pure Water, Pure Service, Pure Environment' vision is the cornerstone of our business and the company's operations.

Business performance
Our strong financial results for 2010/11 saw our profit before tax broadly maintained compared with the previous year, despite the reduced rate of return allowed for the whole industry in the 2009 Ofwat price review. Capital expenditure was also broadly stable at £125.1 million after adjusting for non-recurring items in the prior year (£20.9 million for the substantial K4 water mains rehabilitation programme and £9.7 million advanced K5 expenditure). A strong cash flow performance improved our gearing ratio.

We also consistently have one of the lowest costs of financing of any company in our industry, having successfully used our expertise to ensure ongoing financial outperformance.

A high and improved level of operational performance was achieved during the year despite some of the most extreme winter weather conditions experienced in the South West for many years. Indeed, under these weather conditions, our network demonstrated a good level of resilience due to the company's past investment in infrastructure, which produced tangible results even in a time of extreme stress being placed on our assets. It also illustrated the reliability of our network with our operating assets again achieving a consistent 'stable serviceability' rating.

A step-change in efficiency
A strong start has been made towards achieving targeted operating cost reductions. The company has front-end loaded delivery of efficiencies of 2.8% per annum targeted for the K5 period (2010-2015). Some £8.4 million, equal to 5.8% per annum, of operating efficiencies were delivered in 2010/11. This was achieved through changing operational ways of working; right-sourcing and innovative contracting arrangements; energy procurement and reduced usage; and the rationalising of administration and support services.

South West Water has now purchased 94% of its K5 energy requirements at a lower market price than that assumed in the Final Determination.

Performance on the K5 capital programme, with its increased emphasis on maintenance of existing assets (66% of the K5 total compared with 43% in K4), is being targeted to achieve 5% outperformance of the Final Determination[1]. South West Water continues to deliver capital projects in line with Ofwat, Drinking Water Inspectorate and Environment Agency expectations. Stable serviceability was maintained for all service areas.

Overall customer debt cash collections were stable despite the difficult economic environment with the bad debt charge, as a percentage of revenue, broadly consistent with the prior year.

Pure Water
This year the company again successfully met both its annual and three-year rolling leakage targets and has done so ever since leakage targets were originally set by Ofwat. This was achieved in spite of the coldest December in England in 100 years which caused an exceptional number of burst pipes across the region.

[1] Using 2009 Final Determination estimates of Construction Output Price Index.

KPI Operating profit £m

2010/11	189.8
2009/10	193.5†
2008/09	186.6
2007/08	181.0
2006/07	156.8

£189.8m

KPI Profit before tax £m

2010/11	128.9
2009/10	129.5†
2008/09	116.9
2007/08	116.5
2006/07	98.9

£128.9m

† Restated for IFRIC 18

Bathing water compliance with EU Mandatory and Guideline standards %

Calendar year

Year	Standard	%
2010	Mandatory	96.5
2010	Guideline	90.3
2009	Mandatory	96.5
2009	Guideline	84.0
2008	Mandatory	93.1
2007	Mandatory	97.9
2006	Mandatory	100

Mandatory
Guideline

No data on the EU Guideline standard is available for earlier years due to a change to monitoring against the EU Standard rather than UK Standard by the Environment Agency

Kite surfer at Exmouth beach

A significant proportion of the company's capital programme in 2010/11 was focused on maintaining drinking water quality which remained near perfect with a 99.97% sample mean zonal compliance rate during the 2010 calendar year. Investments made during the year included filtration improvements to a number of water treatment works; security enhancements and climate change adaptations at works; and refurbishment of the Lopwell raw water pumping station.

South West Water has put in place a comprehensive strategy to ensure a continued secure supply of water for the region. 2010 was the 14th consecutive summer with no water restrictions and it is envisaged that there will be no water restrictions in summer 2011 despite the very dry conditions in the year so far. More cost effective than building new reservoirs, the two disused china clay pits acquired in 2006 and 2008 and now converted into Park and Stannon Lakes, represent a significant addition to water resources in Cornwall and further increase the robustness of the company's water supply system. Park Lake became fully operational last year and Stannon Lake will follow this summer. The two lakes are the region's fourth and fifth largest reservoirs (behind Roadford, Wimbleball and Colliford).

Pure Service

South West Water's emphasis on excellent service is delivering tangible improvements for customers and is reflected in reducing levels of contacts (particularly repeat contacts). Customer satisfaction levels are rising. Service improvements undertaken in the past two years to reduce customer complaints are delivering results, with complaint levels falling for the second year running (written complaints down by more than a quarter on 2009/10).

South West Water has welcomed the Government's response to the Walker Review of charging for household water and sewerage services. The proposal for Government to fund a cut from 2013/14 in the average bill of all customers would be especially well received by customers alongside proposals to target help at those in most need by pegging the 'Water Sure' tariff to the lower national average metered bill and allowing us to develop our own social tariff. We will continue to work closely with Government and our regulators throughout the consultation phase to examine the practicality of all options to aid customers.

Regulations laid before Parliament, once they come into effect, will allow for the transfer of private sewers and lateral drains. South West Water has operational plans in place to manage the transfer and a procurement process with suppliers to deliver the service to customers is underway. Incremental costs incurred will need to be funded by future adjustments to price limits.

KPI Drinking Water Quality % Mean Zonal Compliance (MZC)

Calendar year

Year	%
2010	99.97
2009	99.98
2008	99.98
2007	99.95
2006	99.96

99.97% MZC

KPI Population equivalent sanitary compliance %

Calendar year

Year	%
2010	99.55
2009	99.70
2008	99.50
2007	99.70
2006	99.61

99.55%

A solid profit performance continued

Pure Environment

As the UK's premier tourist region, the quality of the South West's seas and beaches is particularly high profile. In 2010 a record percentage (90.3%) of our bathing waters achieved EU Guideline (excellent) standard, up from 84.0% in 2009, while 96.5% passed the Mandatory (minimum) standard, the same as in the previous year. The South West region also features the highest proportion of high quality rivers in England.

This summer South West Water will also be launching a new real time information website, 'Beach Live' updating visitors on any potential risk to bathing water quality at around 25 of the most popular beaches in our region caused by storm overflows operating after heavy rain. The website will be one of the first in Europe to offer this service to beach users on a daily basis.

Our programmes to achieve energy efficiency and carbon reduction targets have made good progress this year. The energy awareness campaign, 'PowerDown', working with the Energy Savings Trust, has been very successful in cutting energy use. The 'PowerDown' scheme has been recognised externally, being the Business Award winner of the Devon Environmental Business Initiative. The combined energy volume reductions target of 3GWh has been met from these activities.

We have also made good progress in the development of our renewable energy systems, with major overhauls and control system replacements for our larger sewage gas combined heat and power plants to give improved reliability and increased outputs. Our larger investment programme for new hydroelectric capacity has included a number of innovative, cost-effective solutions.

South West Water is working to integrate into all its business operations more sustainable ways of working that support the company's climate change adaptation programme.

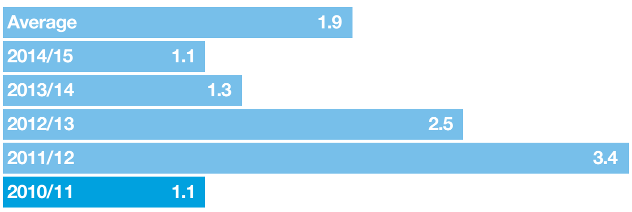
An important achievement for the company during the year was the receipt of Emissions Measurement and Reduction certification. This can only be achieved by organisations that have not only made credible carbon reductions over the past three years but also have robust plans in place to make more reductions in the future.

South West Water has embarked on an innovative programme of work called 'Upstream Thinking' to improve raw water quality in a sustainable way. This initiative – seen as best practice in the industry – seeks to improve the quality of water that feeds into treatment plants from the main moorland sources of Dartmoor and Exmoor by helping to re-establish the wetlands that naturally cleanse water by slowing the flows on their downhill journey to rivers and reservoirs. Receiving better quality water at the company's plants reduces the work required to cleanse it for human consumption, lowers the quantities of chemicals the company has to use and increases the cost-effectiveness of its operations. Work to re-wet uplands, restore grasslands and revise farming practices is underway and by working with farmers, environmental bodies and statutory bodies, the company also aims to achieve multiple environmental benefits.

Our employees

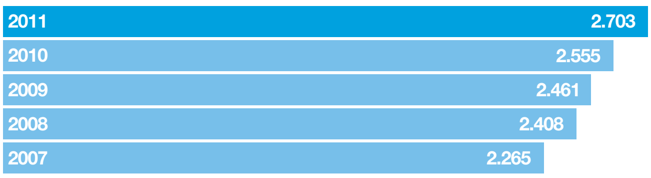
Our employees are the foundation of our success. It is one of our core values that our people matter and we have programmes in place to both support the progress of employees and to ensure their safety at work. Examples of these include a Post Graduate Certificate in Management developed with the University of Exeter's Business School, the 'GROW' staff development programme providing training in personal growth and business strategy and two programmes launched during the year that are designed to keep our employees safe at work – one concentrating on behavioural health and safety training and the other on ensuring safe driving habits.

'K' factors for the period 2010-2015 % above RPI



KPI **Regulatory Capital Value** £bn

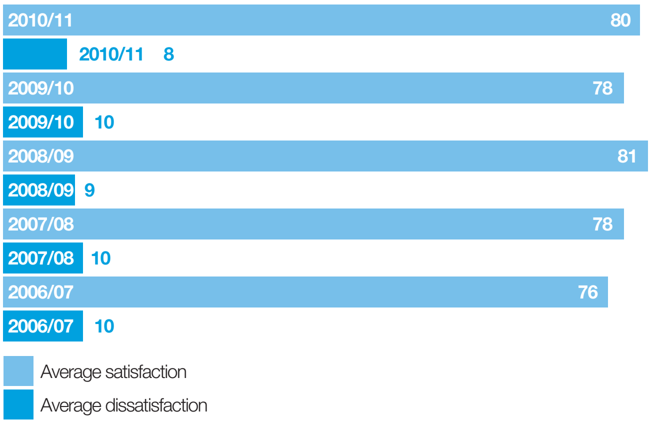
as at 31 March



£2.703bn

+5.8%

KPI Customer satisfaction overall %



The commitment and professionalism of our employees have been essential ingredients in achieving this year's success.

We are confident that the continued outstanding performance of our employees, with all the support we can give them, will ensure another good year of operations in 2011/12.

Key relationships

Regulators and others

South West Water has a wide range of contacts with its environmental and regulatory stakeholders involving many different functions within the company. Central processes are also in place so that we can be confident that stakeholder contacts are dealing with the people most able to assist them, that consultations and information requests are handled in the most efficient manner and that information given to stakeholders is of high quality and consistent. The company contributes to national policy on developing issues through its membership of Water UK, the industry trade body, and we work with the Consumer Council for Water to ensure that customers' issues and concerns are addressed and a full understanding of the company's activities is maintained.

Procurement and suppliers

Our procurement strategy is focused on partnering and strategic alliances with 60 key suppliers who account for the large majority of expenditure. We include all aspects of sustainability in our procurement processes and this is a central theme of our procurement strategy for our supply chains and support of the regional economy. With the start of the K5 regulatory period we introduced an innovative 'mixed economy' model to source our capital programme. This means using a significant number of smaller local contractors to provide specialised services as well as long-term relationships with more major supply chain partners. No supplier (revenue) accounts for more than 5% revenue and South West Water sources all its purchases from competitive markets.

Focus for K5

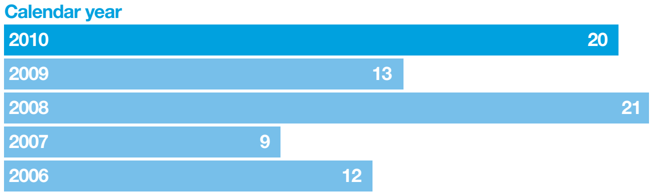
The focus for K5 is to continue to strike the right balance for investors, customers and other stakeholders. We have already delivered substantial efficiencies over the last two decades and will continue to focus on delivering further efficiency while satisfying regulatory demands and improving services to customers.

Our plan for K5:

- targets outperformance of the regulatory contract
- continues to control costs rigorously
- delivers investment through increased capital maintenance that will secure operating cost savings and protect the service improvements made over the last 20 years whilst preparing for future increased investment requirements.

KPI RIDDOR accident and incident rates per 1,000 employees

Calendar year



At a glance

Viridor is one of the UK's leading and fastest-growing recycling, waste management and renewable energy businesses. It won the National Recycling and Waste Management Business of the Year Award in 2010.

Key facts

324
operating facilities

26
Materials Recycling Facilities (MRFs)

34
Landfill gas power plants

3
Energy from Waste (EfW) plants

8.3
million tonnes of material handled in 2010/11

Operational highlights

Viridor achieved significant increases in revenues and profit in 2010/11 as it:

- grew the contribution to profits of recovering the value in waste to 46% (as landfill fell to 23% from 69% in 2001)
- had a successful first full year of operation at its Lakeside joint venture Energy from Waste plant
- managed the second successful year of operations of its Greater Manchester PFI contract
- increased its total renewable energy production capacity to 136MW.

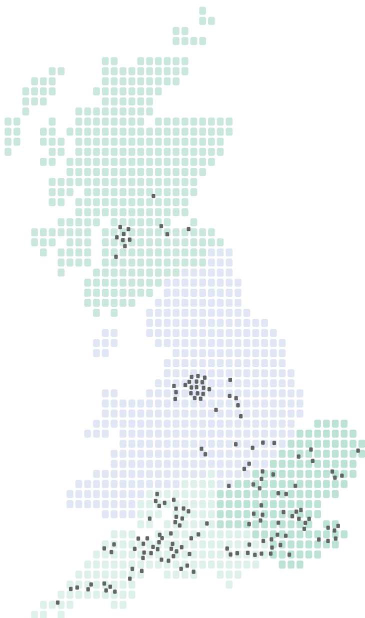
2010/11 notable achievements

During the year Viridor:

- acquired five high-quality recycling businesses, strategically sited to complement existing UK operations and international recyclate sales
- achieved profit margins per tonne on its high-quality recyclate appreciably greater than landfill
- by the year-end had completed 31 of the 42 new facilities for the Greater Manchester joint venture contract
- commenced Phase II in the construction of the new combined heat and power EfW plant at Runcorn
- achieved planning permission for four new EfW plants (one after the year-end and two subject to challenge)
- was named the National Recycling and Waste Management Business of the Year at the National Recycling Awards.

Where we operate

Viridor has a fast-growing network of recycling, waste management and renewable energy operations across the UK, with current strengths in the South West; South East and North of England; East Anglia; South East Wales; and Scotland. The company sells its high-quality recyclate internationally, with established relationships across Europe and in emerging markets including China and India.



Glass recycling process line,Salmon Pastures, Sheffield

Revenue £m

2010/11	712.0
2009/10	626.5
2008/09	528.0
2007/08	455.1
2006/07	367.7

£712.0m
+13.6%

Operating profit plus joint ventures £m

2010/11	82.6
2009/10	77.0
2008/09	63.7
2007/08	57.3
2006/07	45.0

£82.6m
+7.3%

Strategy and performance

Viridor is committed to leading the way in maximising the opportunities generated by the Government's landfill diversion, recycling and renewable energy targets.

In this way it will grow and add value through:

- developing new, and expanding existing, recycling operations to meet ambitious EU/UK targets
- successfully exploiting the huge potential in waste-based renewable energy generation
- capitalising on its strong position in landfill waste disposal.

Strategy	Performance	KPI
Growth in recycling Growing organically and through acquisition of businesses with a strategic and geographic fit	Viridor is the UK's largest operator of Materials Recycling Facilities (MRFs). We made five further acquisitions of recycling businesses during the year. The second full year of our joint venture recycling-led PFI contract at Greater Manchester contributed £4.9 million to profits, reflecting the major investment made	Recyclates traded m tonnes 2010/11: 1.7 2009/10: 1.4
Increasing power generation Capitalising on waste-based energy generation (often via PPP and PFI) opportunities with profit potential throughout the UK	The first full year of operation of the Lakeside EfW plant near Heathrow delivered approaching £9 million in profits (including Viridor sub-contract profits). Construction of the combined heat and power EfW plant at Runcorn is underway. Viridor received planning permission to build four further EfW plants (two subject to challenge)	Renewable energy generation capacity MW as at 31 March 2011: 136 2010: 128 2009: 101 2008: 84 2007: 75

Another year of growth and investment

Viridor has transformed itself over the last decade from a traditional waste management company with significant landfill operations into a progressive resource management business with a growing focus on recovering the value in waste through recycling and by using waste as a source of renewable energy.

In 20010/11 some 46% of our profits came through recovering the value in waste, compared with 16% ten years ago. Over the same period we have seen our profits grow at an average rate of 20% per annum and our workforce from under 500 to over 3,200. This is a clear indication of the way in which embracing the environmental agenda has been an effective driver of growth; put simply, being green is good for business. We are confident that this focus on recycling and renewable energy will continue to drive long-term growth and value for Viridor and its stakeholders.

This highly significant shift in emphasis has involved a major cultural change for our business. For their essential contribution to this change, we congratulate our management and employees who have continued to deliver organisational and profit growth every year throughout this period of significant evolution.

During the financial year we continued, and further emphasised, these twin themes of profit growth and cultural change. It saw our company continue to grow through a number of strategic, in-fill acquisitions in the recycling industry and through the returns from two highly significant recent investment projects, the 25-year Greater Manchester Waste PFI contract and the Lakeside Energy from Waste (EfW) plant.

In addition it was a year in which we continued to make major long-term investments in the future capabilities and strength of our business which will, on completion, deliver significant additional growth in profits from 2014 onwards. Since last summer we have achieved planning permissions for four major EfW facilities at Cardiff, Dunbar, Ardley and Avonmouth (the Secretary of State's decision is subject to challenge on the latter two). These planning permissions underpin our strategic momentum.

During the year Viridor's reputation as a progressive force in our sector was recognised, and further boosted, when we were named the 'Recycling and Waste Management Business of the Year' at the National Recycling Awards.

We consider this to be recognition for the hard work, professionalism and commitment of all our employees. Viridor's Chief Executive had the opportunity to experience first-hand the creativity and energy of our workforce when he took part in Channel 4's 'Undercover Boss' primetime TV programme, which was broadcast in August 2010. Our employees' commitment to the company was apparent in the programme and showed the extent to which their ideas help develop our business and how they contributed to what was another successful year for Viridor.

Strong financial performance

The last financial year has shown another robust financial performance as we delivered revenues of £712.0 million and an operating profit (including joint ventures) of £82.6 million to continue Viridor's record of increasing its profit by an average 20% year-on-year since 2001. This was despite the fact that, as we had flagged to shareholders at the beginning of the year, our profits from landfill gas power generation were lower than in the previous year due to the ending of a contract in which prices had been fixed at a historic market peak.

The strength of our financial performance during 2010/11 was driven by our recycling businesses and the impact of our two major recent investments, the Greater Manchester Waste PFI and the Lakeside EfW plant.

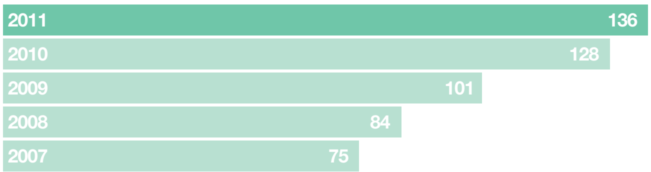
Recycling

Recycling continued to grow well, both in volume (reflecting both healthy organic and acquisition-driven growth) and through continued strong prices for recycled materials. The prices we achieved for recyclates were the direct result of our investment in ensuring the highest possible quality of output. This strength is leading to beneficial long-term relationships with customers via a global trading platform which also allows us to respond quickly to changes in market conditions.

During the year, we saw the volumes of recyclate traded increase to over 1.7 million tonnes, representing growth of 22% over the previous year's total of 1.4 million tonnes.

Recycling collections vehicle, Bargeddie Materials Recycling Facility (MRF)

KPI **Renewable energy generation capacity MW**
as at 31 March



136MW

Runcorn Energy from Waste Combined Heat and Power Facility
(artist's impression) – currently under construction

Of this growth the existing business contributed around 200,000 tonnes, an increase of 13%.

Growth was also driven by the acquisition of five privately-owned high-quality recycling businesses for a combined consideration of nearly £50 million, comprising seven Materials Recycling Facilities (MRFs) in East Anglia, the Midlands, the North West and the South West of England. These acquisitions reinforce our position as the UK's leading operator of MRFs, placing us at the forefront of a fast-growing business segment that continues to receive encouragement from government at both UK and European levels.

The businesses were acquired for the significant operational synergies that their geographic locations and services offer the company and for the additional capability to produce high quality recyclate for sale through our international distribution network. The noticeably better value of high-quality recyclate, when compared to virgin materials, is increasingly making it the first choice for manufacturers across the world. During the year these acquired businesses contributed a little over 100,000 tonnes of recyclate.

Strategically the shift to recycling is important to us due to the significantly higher profit we realise per tonne, compared with our landfill returns, which are reducing. This gap will increasingly widen as the UK Government seeks to discourage further landfill through the application of an £8 year-on-year increase in tax on each tonne of waste sent to landfill. This will raise landfill tax from its current level of £56 per tonne (from 1 April 2011) to £80 per tonne by 1 April 2014. This stance adopted by the Government strongly reinforces the long-term logic of our focus on recycling and energy recovery as the best methods for waste management which will also result in delivering enhanced value to investors.

Greater Manchester
2010/11 was the second year of operation of the 25-year Greater Manchester Waste PFI contract, a joint venture which is the UK's largest-ever combined waste and renewable energy project. We have now completed 31 of the 42 collection, recycling and renewable energy facilities that comprise the PFI contract. By the time the programme is complete, it will divert 75% of Greater Manchester's waste from landfill and recycle or compost over 50%.

A second major aspect of the Greater Manchester PFI contract is the construction of a Combined Heat and Power (CHP) EfW plant, Runcorn Phase I, which is on schedule to open towards the end of 2012/13. During the year we also commenced construction of Phase II of the Runcorn plant, a Viridor project, which is targeted at the North West market more generally. When this comes on stream in 2014/15 the combined plant will have a total waste capacity of 750,000 tonnes per annum and a CHP capacity of 120MW making it one of the largest and most efficient plants in Europe. The plant will operate alongside the existing EfW facility at Bolton

Waste landfilled m tonnes

3.5m tonnes

KPI **Total waste handled m tonnes**

8.3m tonnes

Another year of growth and investment continued

KPI **Profit before interest and tax (PBIT) plus joint ventures, profit before tax (PBT) and Return on equity**

	2001* £m	2002* £m	2003* £m	2004* £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	CAGR[1] 2010-11
PBIT plus joint ventures	13.1	14.9	17.6	20.2	28.6	34.3	45.0	57.3	63.7	77.0	82.6	20%
PBT	11.7	13.5	14.2	14.7	20.1	21.9	27.6	34.2	39.9	55.1	62.9	18%
Return on equity investment[2]	6.1%	7.0%	7.4%	7.5%	10.3%	10.6%	13.3%	16.5%	19.3%	18.7%	21.4%	–

* UK GAAP
[1] Compound Annual Growth Rate, being the rate of growth between 2001 and 2011 expressed as a single annual average figure over the period
[2] Return on equity investment is calculated as PBT expressed as a percentage of Pennon Group's equity investment in Viridor (£294 million)

which has a generating capacity of 9MW of electricity through the use of 120,000 tonnes of waste as fuel.

In Greater Manchester we have also received planning permission to build four Anaerobic Digestion (AD) plants with a capacity of up to 8MW of electrical power. The first plant was fully commissioned just after the year-end and the others are under construction.

Lakeside
This year saw us also make significant early returns on one of our largest recent investment projects, the Lakeside EfW plant near Heathrow airport, which delivered its first full year of operation in 2010/11. This important joint venture with Grundon Waste Management has the capacity to treat 410,000 tonnes of waste each year, with an electricity generation capacity of up to 37MW.

EfW prospects
We also have a very strong pipeline of further opportunities in the EfW sector including a new PPP contract signed in March 2011 with Oxfordshire County Council to build a new CHP-enabled plant at our site at Ardley, Oxfordshire. This major project is expected to result in the capacity to treat 300,000 tonnes of waste each year with an electricity generation capacity of 25MW. (As noted previously, the Secretary of State's decision to grant planning permission has been appealed against by a local group.)

Alongside a number of other potential sites for EfW and AD plants we already have planning permission in place for four further EfW sites at Exeter, Cardiff, Dunbar and Avonmouth (the latter also subject to challenge) that between them will be capable of annually treating over one million tonnes of waste with a generation capacity of 103MW of electricity and heat.

Landfill gas power generation
In another aspect of our renewable energy operations, we also saw continued volume growth in our landfill gas and power generation business which expanded its total operational capacity by 8% to reach 108MW during the year. As already mentioned the prices we received in 2010/11 were lower than in the previous year by some 9%. This was due to the ending in March 2010 of a highly profitable electricity forward sale contract at prices that reflected values achieved at the peak of the market in May 2008. We are confident that prices will firm up again in the years to come.

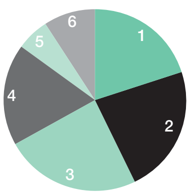
Renewable energy summary
We believe that future growth in our power generation volumes will be driven by our EfW and AD activities. We currently have a total renewable electricity production capacity (including landfill gas plants) of 136MW. With our current investment projects underway and our healthy pipeline of further PPP opportunities we are confident of growing our capacity to over 300MW in five years' time. We estimate that this will be around 0.5% of the UK's total electricity generation or between 3% and 4% of the country's total renewable energy capacity at that time.

We have called upon the Government to set a target for 6% of the UK's total electricity production to be generated from waste, by whatever technology, by 2015. We regard this target as being achievable, albeit challenging. We believe it is common sense, not just because of the need to divert waste from landfill and the positive implications for the UK of utilising its residual waste to generate energy, but also as a practical solution to increase the diversity of supply sources in a period of increasing uncertainty regarding future energy supplies.

Other business sectors
Our landfill business has seen volumes decline in recent years as recycling has increased in the UK and the move to generating energy from waste has gathered momentum, which are positive offsetting trends for Viridor. By the end of the last financial year, our total landfill capacity was 69 million cubic metres, which is 8 million m³ less than we operated at the end of 2009/10 and is in line with Viridor's strategy to focus its activities on recycling instead of landfill.

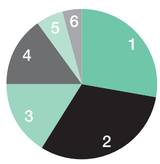
Our collection services remain strong as we have targeted controlled growth in industrial and commercial collection

Profit contribution† by segment 2010/11



1. Power generation	20%	4. Contracts and other	18%
2. Landfill	23%	5. Collection	6%
3. Recycling	24%	6. JVs	9%

Profit contribution† by segment 2009/10

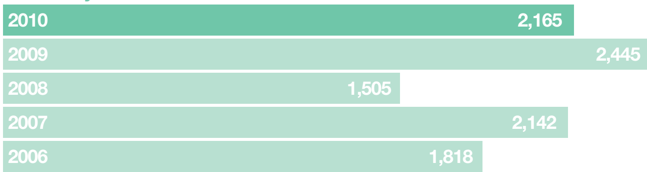


1. Power generation	28%	4. Contracts and other	15%
2. Landfill	31%	5. Collection	6%
3. Recycling	16%	6. JVs	4%

† Before central overhead costs, including pensions.

KPI **RIDDOR accident and incident rate per 100,000 employees**

Calendar year



2,165

Greater Manchester PFI contract Anaerobic Digestion Facility

within areas which provide the right service and geographic synergies with other areas of our business, such as providing materials for our recycling and EfW operations.

Key relationships

All waste and recycling facilities in England and Wales require environmental permits, or waste management licences or PPC permits in Scotland. These are issued and monitored by the Environment Agency and the Scottish Environment Protection Agency respectively. Viridor maintains a positive working relationship with the regulators via proactive liaison and issues management, at both a site specific and strategic level.

Local authorities are the largest single customer group accounting in total for 34% of the company's revenue. No individual authority accounts for more than 11%. Viridor's ROC contracts account for 6% of revenue primarily with one customer. No supplier accounts for more than 3% of Viridor's revenue. The company sources from competitive markets.

Our employees

The success of Viridor's continued expansion and development is as a direct result of its professional and motivated workforce; these attributes are embedded in our Mission Statement. We ensure that every support and protection is afforded to our employees through robust health and safety systems; and timely and focused training and personal development opportunities through our highly trained staff who provide support, guidance and advice to all our employees. New employees joining us via acquisitions receive particular attention to ensure that they are quickly and effectively assimilated into Viridor to ensure their health, safety and welfare and to allow them to contribute to the company's continued success. We are justifiably proud of our employees' achievements.

Looking ahead

We await with interest the Government's forthcoming waste policy review and believe strongly that the current market-friendly approach to recycling and generating energy from waste should be actively encouraged.

We believe that Viridor is well placed to build further on the successes that the approach of the Government's policy regime for waste has enabled over the last 20 years, which has been highly encouraging and progressive. These successes include a 58% reduction in the amount of CO_2 produced by the waste industry since 1990 (the best of any sector in the UK), a six-fold growth in energy produced from waste over the same period, and growth in municipal recycling from under 10% a decade ago to over 40% today.

These are outstanding achievements, driven by a regulatory environment in which Viridor has been able to take an action-orientated, entrepreneurial approach to environmental issues (proving that being green is good for business). As we target further growth, particularly in our recycling and EfW businesses, we believe it is important that the current light-touch, market-friendly approach is maintained to give us the operational freedoms we need for the benefit of our clients, for the environment at large and for our investors.

Looking ahead we intend to continue our current strategy of working hard to deliver what local and national government are seeking to achieve from recycling and waste management. Our profit profile in the next couple of years is likely to be driven by our recycling operations. Our healthy list of EfW and PPP prospects underpins our medium-term profit momentum.

In the long-term we are confident of continuing to deliver strong growth in shareholder value through continuing to lead the way in exploiting opportunities arising from the Government's landfill diversion, recycling and renewable energy targets.

Far left: Bredbury resource recovery centre, Stockport

Left: Household Waste Recycling Centre (HWRC), Salford

Pennon Group continued to deliver revenue and profit growth in 2010/11

Pennon Group performed well with both South West Water and Viridor making a strong contribution.

The year's financial highlights

Pennon Group performed well with a good set of results from both operating companies, South West Water and Viridor.

It was a considerable achievement for South West Water to deliver stable profits during the first year of the new five-year cycle, which included the reduction of the rate of return allowed by Ofwat, the economic regulator, from 5.1% to 4.5% (post-tax, real). Viridor has delivered strong profit growth, driven by its recycling activities and the success of its PFI and Energy from Waste (EfW) joint ventures.

During the year we secured further funding to finance continuing growth. By the year-end we had around £825 million in cash and facilities in place to fund South West Water's K5 (2010–2015) capital programme and future major growth in Viridor.

We have secured funding at a cost that is low in absolute terms. In addition South West Water's average interest rate of 4.0% (pre-tax, nominal) is substantially lower than the 6.2% assumed by Ofwat for the 2010–2015 period. This is a significant advantage compared with a number of our competitors which will help drive value for the Group and our shareholders for years to come.

The principal key measures we use to assess the Group's financial performance are profit before tax (PBT), earnings per share and the interest rate on average net debt.

Revenue

Group revenue increased by 8.4% to £1,159.2 million.

South West Water's revenue rose by 1.0% to £448.8 million as a result of tariff increases, higher demand and new connections, partially offset by a further reduction in revenue from customers switching from unmeasured to metered charges.

Viridor's revenue rose by 13.6% to £712.0 million, substantially driven by acquisitions and increased recycling activities.

Operating profit

Group operating profit fell by 2.0% to £260.9 million with South West Water down by 1.9% to £189.8 million and Viridor down by 1.6% to £71.6 million. Pages 10 and 16 give a detailed description of the financial performance of each company.

Finance costs

We continued our effective management of interest rates in 2010/11 with net interest payable on average net debt equating to 4.0% (2009/10 4.1%). During the year net finance costs (excluding pensions net interest, discount unwind on provisions and IFRIC 12 contract interest receivable) were £77.2 million, covered 3.4 times (2009/10 3.4 times) by Group operating profit.

Profit before tax

Profit before tax was £188.5 million, an increase of 1.5%.

Taxation

The Group's UK corporation tax charge for the year was £38.6 million (2009/10 £43.0 million). Deferred tax for the year was a credit of £21.7 million (2009/10 charge £1.3 million), which included a credit of £25.1 million from the impact of the reduction in the rate of corporation tax from April 2011.

Earnings per share

Underlying earnings per share increased by 3.7% to 42.3p. The weighted average number of shares in issue during the year was 354.6 million (2009/10 350.0 million). Net assets per share at book value at 31 March 2011 were 218p.

Dividends and retained earnings

The statutory net profit of £171.6 million has been transferred to reserves.

The Directors recommend the payment of a final dividend of 17.15p per share for the year ended 31 March 2011. With the interim dividend of 7.5p per share paid on 1 April 2011, this gives a total dividend for the year of 24.65p, an increase of 9.3% over 2009/10 (reflecting 4% real growth plus RPI of 5.3% at March 2011).

Reconciliation of underlying and statutory earnings per share	2010/11 p	2009/10† p	Growth %
Earnings per share – pence			
Statutory earnings per share	48.4	40.4	19.8
Deferred tax per share	(6.1)	0.4	
Underlying earnings per share	42.3	40.8	3.7

† Restated for IFRIC 18

Note

Earnings per share figures in this Business review exclude deferred tax. The Directors believe that this underlying measure provides a more useful comparison on business trends and performance. The term 'underlying' is not defined under International Financial Reporting Standards (IFRS) and may not be comparable with similarly titled measures used by other companies

KPI Profit before tax £m

£188.5m

KPI Underlying earnings per share pence

42.3p

† Restated for IFRIC 18

Proposed dividends totalling £88.2 million are covered 1.7 times by net profit (excluding deferred tax) (2009/10 1.8 times). Dividends are charged against retained earnings in the year in which they are paid.

Dividend policy

In last year's report we announced the Board's intention to increase the dividend each year by 4% above inflation from 2010/11 until at least 2014/15. The Group is well positioned to meet future challenges and to continue delivering shareholder value. We remain committed to this increase, which is not matched by any of our peers.

Operating costs

Operating costs for the year totalled £898 million. The biggest areas of expenditure were:

Expenditure	£m
Manpower	148
Landfill tax	146
Depreciation	141
Raw materials and consumables[1]	90
Transport	58
Property	30
Power	24
Abstraction and discharge consents	8
Statutory operating licences and royalties	8
Lease rentals (plant and machinery)	7

[1] Excludes elements of transport costs

Raw materials and consumable costs have increased during the year primarily due to higher levels of waste recycling activities.

Asset value opinion

In the opinion of the Directors, the current market value of the Group's land and buildings is not significantly different from the holding cost shown in the financial statements.

Group investment

During the year the Group's capital expenditure on property, plant and equipment was £199.0 million (2009/10 £192.2 million). The major categories of expenditure for both main businesses are shown below.

Cash flow

In 2010/11 the Group once again had a strong operating cash flow. Net borrowings increased by £39 million primarily due to acquisitions and investments in joint ventures.

Liquidity and debt profile

At 31 March 2011 the Group held cash and deposits of £555 million (including £123 million of restricted funds) and had undrawn facilities of £270 million. These totals include £400 million in new or renewed debt facilities arranged during the year, being:

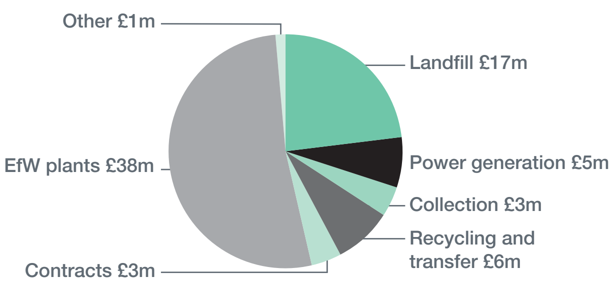
- replacement of £100 million Put Bond with £150 million 2040 5 ⅞% Bond
- renewal of £75 million term loans
- £115 million of new term loans and Revolving Credit Facilities
- US$100 million longer-term facility.

The Group's financing structure gives us the scope and flexibility we need to implement our strategic objectives and maximise value for our shareholders.

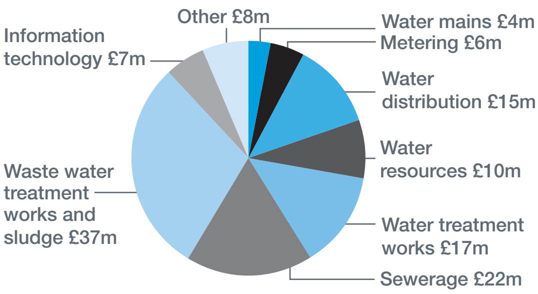
At 31 March 2011 the Group's loans and finance lease obligations totalled £2,489 million. After the £555 million held in cash this gives a net debt figure of £1,934 million, up by £39 million during the year.

Debt incurred for the construction in progress of Viridor's Runcorn Phase II EfW plant amounted to £46 million at 31 March 2011.

Viridor capital expenditure

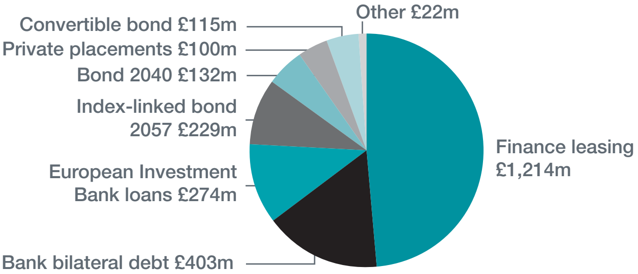


South West Water capital expenditure



Pennon Group continued to deliver revenue and profit growth in 2010/11 continued

Major components of debt



The major components of the Group's debt finance at 31 March 2011 are illustrated overleaf.

The Group's debt has a maturity of up to 46 years, with an average maturity of 23 years.

The Group has successfully fixed or put swaps in place to fix the interest rate on at least 50% of South West Water's debt for the entire K5 period up to 2015, at an average interest rate of 3.8%. A further 24% of South West Water's debt is index-linked to 2041-2057, at an overall real rate of 1.66%. As a result of these initiatives, South West Water's cost of finance is amongst the lowest in the industry.

The Group's average interest rate is impacted by the cost of carry of pre-funding with interest rates on cash deposits currently at very low levels. South West Water's average rate for 2010/11 comprises debt interest of 3.5% and pre-funding costs of 0.5%. Pennon Group Plc incurred net interest costs of £3 million, reflecting funding raised to support future Viridor investment. South West Water's and Pennon Group Plc's interest rates on average net debt for the year to 31 March 2011 were both 4.0%.

More than half of the Group's gross debt is finance leasing, giving us the benefits of a long maturity profile. The interest payable on the Group's finance leases benefits from the fixed credit margins which were secured at the inception of the lease.

At 31 March 2011 the fair value of the Group's borrowings was £261 million less than its book value (2009/10 £296 million) as detailed in note 27 to the financial statements.

Capital structure – overall position
At the end of the financial year the Group's net debt of £1,934 million gave a ratio of net debt to (equity plus net debt) of 71.3% (2009/10 74.1%).

South West Water's debt to Regulatory Capital Value (RCV) was 57.1% at 31 March 2011 (2009/10 60.6%) which is within Ofwat's optimum range of 55% – 65%.

Viridor is funded by a combination of Pennon Group equity and debt (raised by Pennon Group) and direct borrowing by Viridor. At the year-end Viridor's net debt was £487 million (2009/10 £420 million) equivalent to 4.2 times EBITDA (2009/10 3.7 times).

Treasury policies
The role of the Group's treasury function is to ensure that we have the funding to meet foreseeable needs, to maintain reasonable headroom for future contingencies and to manage interest rate risk. It operates only within policies approved by the Board and undertakes no speculative trading activity.

The Board regularly monitors expected financing needs for at least the next 12 months which are expected to be met for the coming year from existing cash balances, loan facilities and operating cash flows.

The Group has considerable financial resources and a broad spread of business activities. The Directors therefore believe that it is well placed to manage its business risks despite the ongoing uncertainties of the current economic environment.

Internal borrowing
South West Water's funding is treated for regulatory purposes as effectively ring-fenced. This means that funds raised by, or for, the company are used only in the provision of water and sewerage services and are not available as long-term funding for other areas of the Group.

Going concern
The Directors have a reasonable expectation that the Group has adequate resources to continue its operational existence for the foreseeable future. They therefore have continued to adopt the going concern basis in preparing the financial statements.

Taxation objectives and policies
Our tax strategy, as approved by the Board, is to enhance shareholder value by legally minimising the taxes we pay while having regard to our long-term relationship with the tax authorities. We will consider bona fide arrangements

KPI Interest rate on average net debt %

KPI Dividend per share pence

Summarised cash flow

	2010/11 £m	2009/10* £m
Cash inflow from operations	412	382
Pension contributions	(36)	(16)
Net cash inflow from operations	376	366
Net interest paid	(64)	(70)
Dividends and tax paid	(100)	(68)
Capital expenditure payments	(186)	(194)
Acquisitions/investment in joint ventures	(38)	(40)
Net cash outflow	(12)	(6)
Shares issued	2	2
Equity component of convertible bond issued	–	10
Debt acquired with acquisitions	(22)	(5)
Debt indexation/interest accruals	(7)	(4)
Increase in net borrowings	(39)	(3)

* Restated for IFRIC 18

which are integral to our business and which qualify for tax exemption or relief.

The total tax charge for the year of £16.9 million was less than the charge which would have arisen from the accounting profit before tax of £188.5 million taxed at the statutory rate of 28%. A reconciliation is provided in note 9 to the financial statements.

The Group made a net payment of £43.2 million of UK corporation tax in the year (2009/10 £3.8 million). The previous year included refunds received from HM Revenue & Customs arising from the reassessment of payments in earlier years.

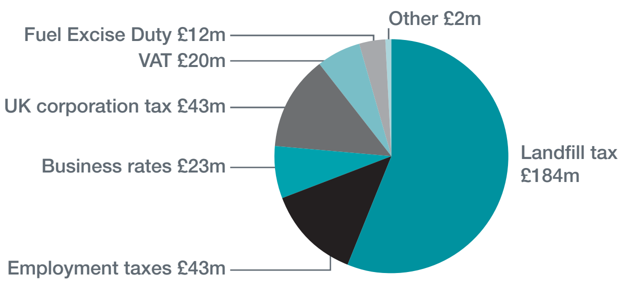
The Group's total tax contribution extends significantly beyond the UK corporation tax charge.

Total taxes amounted to £327 million of which £63 million was collected on behalf of the authorities for net VAT and employee payroll taxes.

The most significant taxes involved together with their profit impact were:

- landfill tax of £158 million was accounted for by the Group on behalf of HM Revenue & Customs. Landfill tax is an operating cost which is chargeable to customers and is contained within revenue. In addition the Group incurred landfill tax of £26 million on the disposal of waste to third parties. This is an operating cost for the Group and reduces profit before tax
- Value Added Tax (VAT) of £20 million (net) was collected by the Group and paid to the taxation authorities; VAT has no material impact on profit before tax. The increase of £13 million compared with the previous year is due to the increase in the rate of VAT and Viridor's increased revenue
- business rates of £23 million were paid to local authorities. This is a direct cost to the Group and reduces profit before tax

Tax contribution 2010/11



- employment taxes of £43 million include employees' Pay As You Earn (PAYE) and total National Insurance Contributions (NICs). Employer NICs of £11 million were expensed approximately 94% to operating costs with 6% capitalised to property, plant and equipment
- Fuel Excise Duty of £12 million related to transport costs. This reduced profit before tax.

The corporation tax rate for 2010/11 used to calculate the current year's tax is 28%. The forecast tax rate, as enacted into law on 29 March 2011, has been reduced to 26% for 2011/12 and is proposed to fall by a further 1% per annum until the financial year 2014/15 when the rate will be 23%.

In November 2010, as part of the PwC Building Public Trust Awards, Pennon Group Plc won the Tax Reporting in the FTSE 250 Award. The awards reward commitment of the largest listed companies in the UK to communicating their sustainable performance. The tax award recognises the most transparent disclosure of tax strategy, tax performance and the wider impact of tax.

Pensions

The Group operates defined pension schemes for certain existing employees of Pennon Group, South West Water and Viridor. The main schemes were closed to new entrants on or before 1 April 2008.

At 31 March 2011 the Group's pension schemes showed a deficit (before deferred tax) of £86 million (2009/10 £108 million). Net liabilities of £64 million (after deferred tax) represented less than 3% of the Group's total market capitalisation at 31 March 2011.

An actuarial valuation of the main scheme as at 31 March 2010 has now been completed. South West Water's cash contributions to the scheme are within Ofwat's Final Determination for the K5 period.

Insurance

Pennon Group manages its property and third party risks through insurance policies that mainly cover property, business interruption, public liability, environmental pollution and employer's liability.

The Group uses three tiers of insurance to cover operating risks:

- self-insurance – Group companies pay a moderate deductible on most claims
- cover by the Group's subsidiary (Peninsula Insurance Limited) of the layer of risk between the self-insurance and the cover provided by external insurers
- cover provided by the external insurance market, arranged by our brokers with insurance companies which have good credit ratings.

Principal risks and uncertainties

The following risks and uncertainties have been identified from Pennon Group's risk management process as potentially having a material adverse effect on its business, financial condition, results of operations and reputation. They are managed as described below but are not wholly within Pennon Group's total control and may still result in a material adverse impact on the Group. Factors besides those listed could also have a material adverse effect on the Group.

Risk and impact	Commentary and mitigation	Change
Law and regulatory		
Changes in law, regulation or decisions by governmental bodies or regulators could have a material adverse effect on our financial results or operations	There is a wide range of laws and regulations and policy decisions of government and regulators which could have a materially adverse effect on the results of operations of both South West Water and Viridor. Examples include:	
	• in compliance with EU legislation, the UK has landfill diversion, recycling and recovery targets. These, together with the impact of waste recycling regulations, higher producer responsibility obligations and pre-treatment requirements, coupled with rising landfill tax, will continue further to reduce landfill volumes, profits and possibly (over time) landfill asset values within Viridor (whilst at the same time being supportive of Viridor's recycling and renewable energy activities).	↑
	• the development of greater competition in the water industry could reduce South West Water's revenues. As part of its risk management and business strategic planning processes the company evaluates developments and proposals for competition which could also provide opportunities for business expansion. Legislation will be required for any further extension of competition in the water and sewerage services markets. The company evaluates proposals for regulatory reform and contributes fully to consultations and other forms of dialogue with regulators and stakeholders in order to effectively communicate its views.	↑
	• higher standards of environmental protection and quality standards could increase costs for both South West Water and Viridor. Specifically for South West Water such costs are met through the five-year regulatory price review mechanism but not all changes may be funded immediately or at all. Within Viridor, higher costs are sometimes, but not always, recovered through contractual arrangements with waste authorities.	↔
	• changes in the Renewable Obligation Certificate (ROC) pricing mechanism could significantly reduce revenues for Viridor. The Government has however made a strong commitment to renewables which is key to meeting the UK's long-term carbon reduction strategy and in particular to the grandfathering of existing Non Fossil Fuel Obligation (NFFO) contracts.	↓

How we manage risk internally

The manner in which we manage risk is set out on page 43.

Key

↔ Unchanged during year

↑ Increased during year

↓ Reduced during year

Risk and impact	Commentary and mitigation	Change
Law and regulatory continued	• the planning regime may have the effect of restricting the development of future waste treatment facilities by Viridor. Whilst Viridor has plans for further new treatment facilities it has been successful in obtaining planning permission for EfW plants at some key sites over the past year. Nevertheless this is an ongoing material risk to the future growth of Viridor and realisation of its strategy.	↔
	• in 2008 the Government announced its intention to transfer an element of sewers and pumping stations currently owned by private individuals and businesses to sewerage undertakers. Whilst legislation has not yet been quite finalised, it is anticipated that the transfer will occur in the autumn of 2011 and there will be additional costs for South West Water which should be recoverable through the regulatory price review mechanism.	↑
	• climate change and resulting increased regulatory standards required could increase costs for South West Water. The company has plans ready and will adapt the way it conducts its business to respond effectively to the hotter, drier summers and wetter winters which are anticipated.	↔
	• the five-year regulatory price review for South West Water assumes operating cost savings. The company has a track record, and remains confident, of delivering the assumed operating cost savings in the current regulatory period. A major restructuring programme is currently being implemented to contribute towards the additional efficiencies required.	↔
Economic conditions		
Economic conditions could materially affect the Group's revenues and profitability	Whilst the Group does have some exposure to reduced economic activity and inflation/deflation, South West Water's revenues are economically regulated through the price review mechanism and Viridor has a diversified revenue stream which includes exports to fast-growing developing economies. Examples of areas of impact are:	
	• in Viridor overall volumes of waste and other materials supplied have reduced due to less activity in municipal and commercial markets in current economic conditions. These may be expected to recover somewhat as the economy recovers.	↑
	• the Government's recent Spending Review has put pressure on local authority services, including household waste recycling sites' operations, which is expected to have a short-term impact. Viridor is working with local authority clients to deliver essential recycling and waste management services in an economic manner.	↑
	• recyclate prices are, like any commodity, volatile and are directly impacted by world economic conditions. The effect is most significant on recycling volumes of internationally traded commodities such as paper, card, plastics and metals. However recyclate is typically cheaper than virgin materials which limits the impact on prices for good quality recyclate and in 2010/11 recyclate revenues per tonne increased back up to the peak levels experienced before the global financial crisis.	↔
	• 'Brown energy prices' continue to be determined by the world and UK energy market and may go down as well as up. Prices in 2010/11 were around £30 per MWh lower than achieved in 2009/10 which affected the company's power generation comparative performance in 2010/11.	↔
	• South West Water's revenues can be reduced by higher bad debts and customer affordability. In addition to existing debt reduction strategies, which are kept under review, the company continues to implement new initiatives to improve and secure cash collection, including the use of property charging orders. The accounts of major customers are kept under close review. Provision was made in the last regulatory price review for companies to make an application for an Interim Determination (a price increase) in the event of household bad debts being significantly above the amount allowed by the economic regulator due to worsening economic circumstances in the company's operating area. South West Water has worked with the Government on the findings of the Walker Report and has promoted fairness for its bill payers and actively sought to introduce and promote practical measures to help customers struggling to pay their water bills.	↔

Principal risks and uncertainties continued

Risk and impact	Commentary and mitigation	Change
Finance and funding		
Access to finance and funding costs may be adversely affected by perceived credit rating and by prolonged periods of market volatility or liquidity and we are subject to limitations and restrictive obligations in respect of our borrowing and debt arrangements	The Group may be unable to raise sufficient funds to finance its activities or such funds may be only available at higher cost. The Group has robust treasury policies in place which include always having pre-funded surplus cash and/or committed facilities to cover at least one year's estimated cash flow and arranging for no more than 20% of net borrowing to mature in any one year. In addition in respect of South West Water the economic regulator has a statutory duty to ensure that it is able to finance its functions in the normal course of business. The Group has to date obtained funding at lower effective average interest rates compared with many other companies in its sector of activity. In addition the Group's debt has a long average maturity profile of 23 years.	↓
Operating performance		
Poor operating performance or a failure of, or interruption to, our operating systems or the inability to carry out network operations or damage to infrastructure may have a material adverse impact on both our financial position and reputation	Poor operating performance for both South West Water or Viridor could result in enforcement action, prosecutions, loss of permits and civil action which could all result in negative publicity, loss of customer confidence due to poor performance and, eventually, reduced demand for services and increased fixed costs. Within South West Water a major network failure or interruption may be suffered or the company may not be able to carry out critical network operations. Operational performance could be materially adversely affected by a failure to maintain the health of the system or network which could cause South West Water to fail agreed standards of service or specified quality standards. Specific measures taken by South West Water include: • a Water Resources Plan prepared every five years which is reviewed annually for a range of climate change and demand scenarios. The current Water Resources Plan indicates that no new reservoirs are required before the planning horizon of 2035. However investment is needed to develop the overall trunk main infrastructure, to expand treatment capacity and to enhance certain pumped storage facilities. • established procedures and controls as well as contingency plans and incident management procedures against the risk of contamination to water supplies and against failures of sewers and at waste water treatment works. Insurance policies are also maintained in relation to these risks, although there can be no assurance that all or any of the costs associated with these risks would be covered or that coverage will continue to be available in the future. Viridor operates in a competitive marketplace where price and service are key precursors to success. Sound policies and accredited procedures are in place with internal and external inspections, to maintain operations and achieve performance standards set.	↔
Capital investment		
The failure or increased costs of capital projects or acquisitions or joint ventures not achieving predicted revenues or performance could have a material adverse effect on both our financial position and reputation	South West Water may not carry out its capital programme within the price limits and with the efficiencies determined by Ofwat. However South West Water does have a track record of delivering its capital programme in accordance with regulatory requirements and progress is regularly monitored and reviewed.	↔
	Within Viridor there is a risk of project or contract failure or overpaying for an acquisition. However the Group has experienced and dedicated project/contract teams; detailed due diligence on all projects and acquisitions is carried out by experienced and qualified staff; and wherever possible back-to-back agreements with and guarantees from suppliers are entered into.	↔

Risk and impact	Commentary and mitigation	Change
Customer demand		
A reduced customer base, increased competition affecting prices or reduced demand for services could have a material adverse impact on our financial position	Viridor is experiencing increased competitive pressures in a number of areas of its business including in particular for recyclate volume, landfill gate fees and bidding for Public Private Partnership contracts (PPPs). However Viridor provides recycling and waste management services which are locally delivered services from locally managed facilities and a substantial amount of its turnover is contracted over the medium or long-term. With regard to major competitive projects being pursued there are barriers to entry due to planning permissions being difficult to obtain and significant investment requirements. Competitive pressures in respect of South West Water are referred to in the first risk set out at the beginning of this section.	↑
Business systems		
Information technology and business continuity systems and processes may fail which may cause material disruption to the Group's businesses and could have a material adverse impact on both our financial position and reputation	Some of Viridor's IT systems require replacement, development or upgrading to meet the growing requirements of the business and in some areas new technology being introduced may not operate or perform according to stated specification requirements. Viridor has a comprehensive development programme and plans in place to address the deficiencies identified and seek to ensure business continuity in the event of failure.	↔
	Whilst there always remains the risk of interruption, failure or third party intervention which could have a material adverse impact on the operation of South West Water's business, the company does have well developed IT systems and business continuity systems in place.	↔

Forward-looking statements

This Business review contains forward-looking statements regarding the financial position; results of operations; cash flows; dividends; financing plans; business strategies; operating efficiencies; capital and other expenditures; competitive positions; growth opportunities; plans and objectives of management; and other matters. These forward-looking statements, including, without limitation, those relating to the future business prospects, revenues, working capital, liquidity, capital needs, interest costs and income in relation to Pennon Group and its subsidiaries, wherever they occur in this Business review, are necessarily based on assumptions reflecting the views of Pennon Group and its subsidiary companies, as appropriate. They involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. Such forward-looking statements should, therefore, be considered in the light of relevant factors, including those set out in this 'Group risk review' section.

Our commitment to corporate responsibility

At Pennon Group the nature of our two operating businesses places corporate responsibility at the heart of our activities. Both South West Water and Viridor have a significant role to play in ensuring the environmental, social and economic wellbeing of the communities in which they operate.

Delivering operational excellence in the form of industry-leading drinking and bathing water quality; and low leakage figures, are key environmental and social achievements for South West Water. Viridor's growing recycling and energy recovery operations, alongside its focus on proactive environmental management systems and responsible land stewardship, clearly demonstrate how embracing the green agenda has been good for business.

At Group level the Board has established a range of corporate responsibility objectives that drive the targets of both companies. These are to:

Manage Pennon Group as a sustainable and successful business for the benefit of shareholders and other stakeholders.

Aim to ensure that all our business activities have a positive economic, social and environmental impact on the communities in which we operate.

Engage with all our stakeholders and to foster good relationships with them.

Strive for the highest standards of health and safety in the workplace so as to minimise accidents, incidents and lost time.

Develop and motivate our employees, treat them fairly and ensure that they are fully engaged in all aspects of Pennon Group's objectives.

Aspire to leadership in minimising emissions that contribute to climate change and develop climate change adaptation strategies.

Aspire to leadership in all aspects of waste prevention and resource efficiency.

South West Water and Viridor are responsible for including corporate responsibility objectives and targets within their own business plans which are aligned to these Group objectives. The Corporate Responsibility Committee has a wide-ranging responsibility for reviewing the two main operating businesses' strategies, policies, targets and performance against these objectives and targets.

Pennon Group's corporate responsibility KPIs for 2010/11 covered:

- renewable energy generation
- greenhouse gas emissions data
- recycling volumes
- community support, sponsorship and donations
- RIDDOR accident statistics
- capital investment.

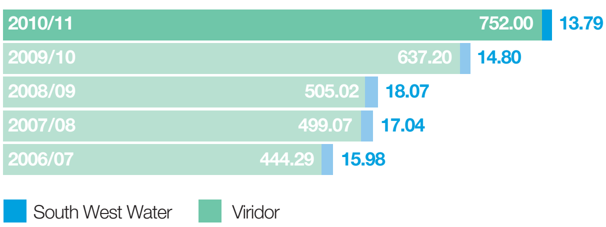
The Group's performance against these KPIs is detailed on page 29.

These are the key issues that drive our approach to sustainability. Full details of our Social and Environmental Policy and our Ethical Business Policy that underpin them may be found at pennon-group.co.uk where the full 2011 Corporate Responsibility Reports for South West Water and Viridor will also be published, in July and August respectively.

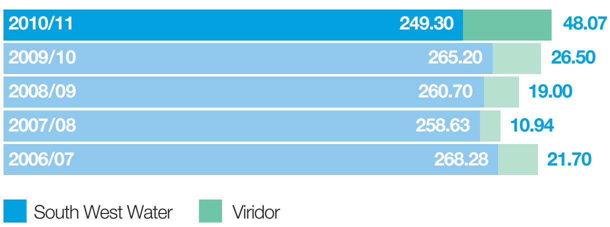
This summary report on corporate responsibility covers our main activities in the areas of environmental, social and economic sustainability.

1. Environmental sustainability
We strive to make a positive contribution to environmental sustainability by focusing on the interlinked concerns of improving the environment, minimising the Group's carbon footprint and increasing resource efficiency through focusing on:

Green energy generated Gigawatt hours (GWh)



On-site electricity use in Pennon Group Gigawatt hours (GWh)



Corporate responsibility KPIs	South West Water	Viridor
Renewable energy generation	13.79GWh	752GWh
Greenhouse gas emissions data	152,416tCO_2e	1,735,889tCO_2e
Recycling volumes	52,400 tonnes of dry solids	1,717,512 tonnes
Community support, sponsorship and donations:	–	£0.2m
• Viridor Credits	–	£9.9m
• South West Water Community Sponsorship Fund	£79,671	–
RIDDOR accident statistics	actual number 24 (2,008 per 100,000 employees)	actual number 62 (2,049 per 100,000 employees)
Capital investment	£125.1m	£73.7m

	Pennon
Community support, sponsorship and donations:	
• Pennon Environmental Fund[1]	£72,043
• Pennon Charitable Donations Committee	£78,678

[1] Pennon Environmental Fund is a subset of Viridor Credits

a. Environmental improvement

Instances of significant and successful environmental improvement projects during the year by South West Water include a record 90.3% of designated bathing waters in its region meeting the EU Guideline (or excellent) standard, up from 84% in 2009, while 96.5% passed the mandatory minimum standard.

The company has increased the breadth of its 'Upstream Thinking' strategy following the successful completion of the Exmoor 'Mires' Restoration pilot project, which was reported on in last year's report. It has enlarged its work on Exmoor, launched the 'Mires' project for Dartmoor and extended its work with farmers and other landowners to promote good catchment management. All these initiatives aim to provide long-term improvements in water quality and control water treatment costs. The Exmoor 'Mires' restoration project has received a national Golden Green Apple Award.

Under its Business Management System Viridor sets clear annual targets for continual improvement in its environmental performance, including targets to enhance biodiversity and habitat creation on its landholdings. The work of previous years came to fruition with the awarding of the Wildlife Trust's Biodiversity Benchmark at three of the company's closed landfill sites. Land management plans have been developed at these sites to ensure that the biodiversity action plan targets are met by protecting and enhancing the habitats and species found there. This scheme recognises that the company's landholdings, particularly closed landfill sites, can have significant benefits to plants and wildlife. More sites have been identified to achieve the standard.

Viridor continued to invest in mitigating the potential adverse impacts of landfill-generated leachate and gas, with an additional £2.2 million invested in leachate control systems and £7.7 million in landfill gas control and power generation. Landfill operations and associated impacts continue to decline as Viridor focuses on realising the value of waste through its recycling and energy recovery activities.

b. Climate change/greenhouse gases

During 2010/11 South West Water achieved a 0.7% reduction in emissions from energy use compared with the previous year.

It also generated 13.8GWh through capturing and processing methane gas from Anaerobic Digestion (AD) plants at waste water treatment works and from hydro-electric power plants.

South West Water made good progress in the development of renewable energy systems with major overhaul and control system replacements for its larger sewage gas combined heat and power plants to give improved reliability and increased outputs.

During 2010/11 it received the Certified Emissions and Measurement and Reduction Standard (CEMARS), recognising the rigour of its emission reductions over the last three years and its plans for the future.

Viridor's dedicated internal carbon management function oversees compliance with the Carbon Reduction Commitment Energy Efficiency Scheme (CRCEES), pursues energy efficiency and carbon reduction initiatives and ensures continual improvements in external carbon disclosure.

Carbon management training has been provided to senior management throughout the company. Further training and active involvement opportunities are being made available to all employees over the coming year.

A number of energy efficiency projects at some of the company's most energy-intensive sites continue. Significant energy savings, with associated carbon reductions, are expected to be realised throughout 2011/12.

Towards the end of 2010 the nationwide installation of Automated Meter Reading 'smart meters' commenced, with completion expected during the first half of 2011. Data from these will drive energy awareness and energy efficiency measures.

Our commitment to corporate responsibility continued

For the first time, the Carbon Saver Gold Standard was achieved by two of Viridor's departments (and the company is awaiting confirmation of a third). This was most notable as one is at its polymers recycling facility in Skelmersdale which is Viridor's most significant energy-intensive operation.

Viridor is a major player in the renewable energy sector which is helping the UK to meet its landfill diversion and renewable energy targets. During 2010/11 the company increased its electricity generation capacity from landfill gas to 108MW (up from 100MW the previous year and from 27MW in 2002).

In doing so it also prevented 86% of the methane produced by its landfill operations, which is 21 times as damaging as CO_2, from entering the atmosphere. By recycling an ever-growing proportion of the materials and waste it manages, or by using it in its energy recovery operations, the company prevents further landfill gases from being generated and also releases the value in waste for the benefit of our investors.

c. Resource productivity

South West Water's quality and environmental management systems help ensure that wastes are minimised and segregated for recycling. The company works with partners and contractors to minimise the quantities of waste produced and its sites have effective waste management procedures in place.

Alongside a range of other resource efficiency programmes the company delivered a further 3.1GWh energy-saving through initiatives across the business such as its 'PowerDown' challenge.

Viridor has fully embraced the green agenda as a key driver for its business activities, particularly its twin focus on recycling and energy recovery. Today 46% of its profits come through recovering the value in waste and these activities are continuing to grow rapidly as a proportion of its business. This is because the best uses of waste produced by society (after waste prevention and reuse) are recycling followed by the generation of renewable energy, either through AD or by controlled combustion.

The company's recycling activities saw it achieve 1.7 million traded tonnes of high-quality recyclate in 2010/11, up from just 100,000 tonnes in 2001. This was an increase from the 1.4 million tonnes traded in 2009/10, driven by acquisitions, new and existing recycling-led contracts and the second full year of operation for the waste management joint venture 25-year PFI contract in Greater Manchester. Viridor's Energy from Waste (EfW) output was also boosted by the first operational year of its joint venture, its Lakeside EfW plant near Heathrow. With current investment projects set to go live in the near future, and others now consented, the company has a target of 300MW of renewable energy capacity by 2015.

2. Social sustainability

Pennon Group and both our two main businesses strive to be good neighbours and consult fully with all stakeholders, including employees, customers, shareholders and the communities in which we operate.

South West Water's focus is on achieving the appropriate balance between its customers, investors and other stakeholders. It is therefore particularly important that it promotes practical ways of helping those of its customers who are struggling to pay their water bills. During 2010/11 it successfully extended its range of initiatives to help them do so – see page 11 of the Business review.

For historical and geographical reasons the South West Water region contains 30% of the country's bathing waters but just 3% of the population. Consequently the company's customers have faced the highest charges for water and sewerage. The company has continued to lobby the Government for this unfairness to be addressed and is encouraged by the proposals being consulted on by Defra in response to the Walker Review. It has also made significant progress during the year in reducing the number of complaints it received and in reducing the number of times customers needed to make contact.

South West Water values its employees and acknowledges the importance of the contribution that they make to its business. The company ran a number of initiatives during the year aimed at supporting their career progress and assuring their safety at work. While it was disappointing to see a rise in health and safety incidents during the year, the company has launched a high profile new behavioural health and safety campaign to ensure a safe working environment for its employees.

Viridor saw a reduction during the year in its employee RIDDOR accident rates which remain below waste industry averages. Even so, along with the rest of the Group, Viridor is targeting further improvements with a goal of achieving zero accidents and is working on several industry-wide initiatives partnered by the Health and Safety Executive to help with this.

During the year Viridor again strengthened its training function helping to focus on training delivery and individual professional development. Viridor employees achieved more than double the targeted number of National Vocational Qualifications. The company's training strategy will help to extend its Investor in People accreditation throughout the company.

Both businesses get involved with, and support, local communities in the areas in which they provide services. This support is provided via staff involvement, direct assistance or sponsorship of community events and projects.

Viridor provided £9.9 million of funding during the year for community and environmental projects through the Landfill Communities Fund via Viridor Credits.

3. Economic sustainability
Pennon Group plans and invests to deliver long-term value for investors while minimising environmental impact. Prudent financial control means we are also benefiting from the waste and water industries' lowest costs of finance, enabling the greatest possible proportion of revenues to be reinvested or realised as value for our investors and other stakeholders.

Such an approach enabled South West Water to deliver in 2010/11 the industry's leading leakage performance, near perfect drinking water quality and a consistent 'stable serviceability' rating.

It has also given Viridor the opportunity to accelerate its growth, both organically and through acquisition, to achieve increased future profitability through further realising the latent value of waste.

Economic investment is key to the economic sustainability of the Group.

The Group's tax objectives and policies are focused on long-term economic sustainability. See page 22 for details.

4. Verification
Pennon's corporate responsibility performance for 2010/11 has been audited by Acona Partners LLP, an independent management consultancy that specialises in the areas of sustainability and corporate responsibility.

Principal activities and business review

The principal activities of the Company and its subsidiaries ('the Group') are the provision of water and sewerage services, recycling, waste management and renewable energy. Information regarding the Group, including events and its progress during the year, events since the year-end and likely future developments is contained in the Business review set out on pages 1 to 31 of this Directors' report.

In addition the Business review contains a fair and balanced review of the business of the Group, including its position and prospects, Key Performance Indicators and a description of the principal risks and uncertainties facing the Group in accordance with the requirements of the Combined Code and Section 417 of the Companies Act 2006. In addition in accordance with the ABI Corporate Social Responsibility Guidelines, statements are included on any significant environmental, social and governance (ESG) risks and the actions taken in mitigating these risks within the Business review on page 24. Further information on ESG aspects of the Group's business are included in the Group Corporate responsibility report on pages 28 to 31. The principal subsidiaries of the Company are listed in note 39 to the financial statements on page 109.

Corporate governance and Directors' responsibilities statements

The Directors' responsibilities statements and the disclosures required by Part 6 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts & Reports) Regulations 2008 and Rule DTR 7.2 are set out in the Company's Corporate governance and internal control report on pages 34, 35 and 38 to 44 of this Annual Report which are hereby included within this Directors' report by reference.

Financial results and dividend

Group profit on ordinary activities after taxation was £171.6 million. The Directors recommend a final dividend of 17.15p per ordinary share to be paid on 7 October 2011 to shareholders on the register on 12 August 2011, making a total dividend for the year of 24.65p, the cost of which will be £88.2 million, leaving a credit to reserves of £83.4 million. The Business review on pages 20 to 23 analyses the Group's financial results in more detail and sets out other financial information, including the Directors' opinion on asset values on page 21.

Directors

Following the inclusion in the UK Corporate Governance Code (the Code) of a provision that all directors of FTSE companies should be subject to annual election by shareholders, all Directors are offering themselves up for re-election at this year's Annual General Meeting. The Board continues to believe that each Director makes an effective and valuable contribution to the Board, demonstrating continued commitment to his or her role. The Non-executive Directors, Gerard Connell, Dinah Nichols and Martin Angle, are all considered to be independent in accordance with the provisions of the Code. They do not have service contracts. The Chairman, Ken Harvey, does have a contract for services which is terminable upon 12 months' notice. All of the Executive Directors, Colin Drummond, David Dupont and Chris Loughlin, have service contracts which are due to expire when they reach age 60 (unexpired term for David Dupont and Chris Loughlin is until 10 June 2014 and 20 August 2012 respectively) with the exception of that of Colin Drummond who has reached age 60. His contract now continues subject to 12 months' notice and the other Executive Directors' contracts may also continue after they reach age 60. Formal resolutions for the above Directors' re-election will be proposed at the Annual General Meeting. The Directors' biographies are set out on pages 36 and 37.

No Director has, or has had, a material interest, directly or indirectly, at any time during the year under review in any contract significant to the Company's business. A list of all the Directors during the year is set out in the emoluments table on page 52. Further details relating to the Directors and their service agreements or contracts for services are set out on pages 49 and 51 and details of the Directors' interests in shares of the Company are given on pages 53 to 56.

Directors' insurance and indemnities

The Directors have the benefit of the indemnity provisions contained in the Company's Articles and the Company has maintained throughout the year Directors' and Officers' liability insurance for the benefit of the Company, the Directors and its Officers. The Company has entered into qualifying third party indemnity arrangements for the benefit of all its Directors in a form and scope which comply with the requirements of the Companies Act 2006 and which were in force throughout the year and remains in force.

Statement as to disclosure of information to auditors

a) so far as each of the Directors in office at the date of the signing of the report is aware, there is no relevant audit information of which the Company's auditors are unaware; and

b) each of the Directors has taken all the steps each Director ought to have taken individually as a director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

2011 Annual General Meeting business

In addition to routine business, resolutions will be proposed at the Annual General Meeting to:

- renew the existing authorities to issue a limited number of shares and to purchase up to 10% of the issued share capital of the Company
- seek authority to make political donations under the Political Parties, Elections and Referendums Act 2000, as amended. (It is not the Group's policy to make political donations. This is a precautionary measure which is followed by many companies to ensure that there is no inadvertent breach of the law)
- re-elect Mr K G Harvey, Mr M D Angle, Mr G D Connell, Mr C I J H Drummond, Mr D J Dupont, Mr C Loughlin and Ms D A Nichols as Directors of the Company
- renew the Pennon Group All-Employee Share Ownership Plan
- renew the Pennon Group Executive Share Ownership Scheme
- seek authority to continue to call general meetings other than an annual general meeting on not less than 14 clear days' notice (pursuant to the EU Shareholder Rights Directive shareholder authority is required to continue to call meetings on at least 14 clear days' notice).

Financial instruments

Details of the financial risk management objectives and policies of the Group and the exposure of the Group to price, credit, liquidity and cash flow risks are set out in the Business review on pages 22 and 26.

Employment policies and employee involvement

The Group has a culture of continuous improvement through investment in people at all levels within the Group. The Group is committed to pursuing equality and diversity in all its employment activities including recruitment, training, career development and promotion and ensuring there is no bias or discrimination in the treatment of people. In particular, applications for employment are welcomed from persons with disabilities and special arrangements and adjustments as necessary are made to ensure that applicants are treated fairly when attending for interview or for pre-employment aptitude tests. Wherever possible the opportunity is taken to retrain people who become disabled during their employment in order to maintain their employment within the Group.

Employees are consulted regularly about changes which may affect them either through their trade union appointed representatives or by means of the elected Staff Council which operates in South West Water for staff employees.

These forums, together with regular meetings with particular groups of employees, are used to ensure that employees are kept up to date with the operating and financial performance of their employer.

The Group also uses a monthly information cascade process to provide employees with important and up to date information about key events and to receive feedback from employees.

Further information about employment matters relating to the Group are set out on pages 13, 19, 30 and 31 of the Business review.

The Group encourages share ownership amongst its employees by operating an HM Revenue & Customs (HMRC) approved Sharesave Scheme and Share Incentive Plan. At 31 March 2011 around 35% of the Group's employees participated in these plans.

Research and development

Research and development activities within the Group involving water and waste treatment processes amounted to £0.2 million during the year (2009/10 £0.2 million).

Pennon Group donations

During the year donations amounting to £78,678 (2009/10 £63,609) were made. Further details are included on page 29 of the Group Corporate responsibility report. No political donations were made (2009/10 Nil).

Tax status

The Company is not a close company within the meaning of the Income and Corporation Taxes Act 1988.

Payments to suppliers

It is the Group's payment policy for the year ending 31 March 2012 to follow the Code of The Better Payment Practice Group on supplier payments. Information about the Code can be obtained from the website payontime.co.uk The Company will agree payment terms with individual suppliers in advance and abide by such terms. The ratio, expressed in days, between the amount invoiced to the Company by its suppliers during 2010/11 and the amount owed to its trade creditors at 31 March 2011, was 14 days.

Purchase of own ordinary shares

The Company has authority from shareholders to purchase up to 10% of its own ordinary shares (as renewed at the Annual General Meeting in 2010) which was valid as at 31 March 2011 and remains currently valid. Of the 5,092,574 shares held in Treasury at 31 March 2010, 783,007 were subsequently re-issued under the Company's employee share schemes for proceeds of £1.6 million.

Independent auditors

PricewaterhouseCoopers LLP were appointed auditors until the conclusion of the twenty-second Annual General Meeting. A resolution for their re-appointment upon the recommendation of the Audit Committee of the Board will be proposed at the Annual General Meeting.

Appointed business

South West Water Limited is required to publish additional financial information relating to the 'appointed business' as water and sewerage undertaker in accordance with the Instrument of Appointment from the Secretary of State for the Environment. A copy of this information is available on the website southwestwater.co.uk or upon application to the Group Company Secretary at Peninsula House, Rydon Lane, Exeter EX2 7HR.

Annual General Meeting

The twenty-second Annual General Meeting of the Company will be held at the Sandy Park Conference Centre, Sandy Park Way, Exeter, Devon EX2 7NN on 28 July 2011 at 11.00am. Details of the resolutions are summarised above and set out in the separate Notice of Annual General Meeting which is circulated to shareholders with this Annual Report or provided by electronic communication via the Company's website pennon-group.co.uk

Information required by Section 311A of the Companies Act 2006 is also on the Company's website.

By Order of the Board

Ken Woodier
Group General Counsel & Company Secretary
22 June 2011

Chairman's introduction to governance

The Board remains committed to the highest standards of corporate governance with the aim of continuing to enhance its effectiveness.

Dear shareholder I am pleased to introduce the Corporate Governance Report for 2011 on behalf of the Board.

Ken Harvey
Chairman,
Pennon Group Plc

The Annual Report is the principal means of reporting to our shareholders on the Board's governance policies. This Report sets out how the main and supporting principles of good corporate governance contained in Section 1 of the Combined Code (June 2008 version), have been applied in practice. The Code is publicly available on the Financial Reporting Council (FRC) website frcpublications.com

Following the publication of the updated Combined Code (now the UK Corporate Governance Code) by the FRC in June 2010 and the issuance of the FRC's Guidance on Board Effectiveness in March 2011 we took the opportunity to review our governance practices and procedures. Whilst we will be reporting formally on the updated Code in next year's Annual Report (as required by the updated Code), I am pleased to say that our review has indicated that we are well placed to comply fully with its provisions.

Role of the Board and its effectiveness

My primary role as Chairman is to provide leadership to the Board and to provide the right environment to enable the Directors and the Board as a whole to perform effectively to promote the success of the Company for the benefit of its shareholders. In doing so we take account of the interests of our customers, employees, suppliers, communities in which we operate and other interested stakeholders.

Although I firmly believe we do have good governance in place and operate effectively as a Board, there is always room for improvement. Each year we carry out a detailed performance evaluation of the Board and each of the Committees as well as of the Directors and the Group General Counsel & Company Secretary. Further details of the review are set out later in this report. One particular aspect I am always mindful of is the need to ensure that the Non-executive Directors continue to have appropriate up to date knowledge and understanding of both South West Water and Viridor as they develop and pursue new initiatives. It is with that in mind that during the year the Board has had a number of visits to key sites within both South West Water and Viridor and has met and discussed current issues with key managers and employees across the Group. Our visits have been to a broad range of waste plants in Scotland, Greater Manchester and near London (Lakeside), Household Waste Recycling Sites and traditional and modern sewage treatment facilities. The Board has also received a number of presentations on key developments in the businesses including remote monitoring, sustainable energy saving and environmental protection initiatives.

As reported last year, the Board has been considering the options available for an externally facilitated performance evaluation in accordance with the updated Code's provisions. During

2011/12 the Board will be undertaking an evaluation supported by an independent external consultancy, with the aim of achieving real added value for the Directors and the Board as a whole.

Shareholder engagement
The Directors and I recognise the importance and value of regular communications with our shareholders. This ensures that we understand their needs and wishes and hopefully that we provide them with confidence that we have the right governance structures, processes and systems in place to assist us in achieving our stated objectives.

A regular dialogue with the Company's institutional shareholders is maintained through a comprehensive investor relations programme. During the year some 60 meetings with institutional shareholders (including with prospective shareholders) were held and attended by the Group Director of Finance and the Company's Investor Relations Manager. The Chief Executive of South West Water, the Chief Executive of Viridor and I also attended when appropriate. The Group Director of Finance reports to the Board regularly on major shareholders' views about the Group and every six months a presentation is received by the Board from the Company's Brokers on equity market developments and shareholder perceptions.

I also actively encourage the participation of shareholders at our Annual General Meeting (AGM) and as usual at our 2011 AGM on 28 July all our Directors aim to be present together with a number of directors and executives of South West Water and Viridor to meet with shareholders to discuss the business of the Group.

Annual re-election of directors
It is Pennon Group's view, along with many other companies and interested parties, that the decision of the FRC in updating the Combined Code to include a provision for the annual re-election of all directors was not in the interests of companies generally and could be detrimental to good governance. Our concerns are that it can encourage short-termism by shareholders and removes the protection provided in most company's Articles of Association to ensure that there is a continuing number of directors on the Board who have in-depth experience and understanding of their business. It could also make it more difficult to recruit new board members. Even though we regard this change as not being in the interests of companies or their shareholders, we nevertheless do wish to ensure full compliance with the updated Code wherever possible and therefore the Board has agreed that each Director will stand for re-election at the 2011 AGM. Along with many other companies we will monitor the effect of this provision over time.

Compliance with Combined Code and other requirements
I am pleased to report that throughout the year the Company complied with the provisions and applied the main principles of Section 1 of the Combined Code with no exceptions to report.

My introduction to this Corporate Governance Report and the following sections are made in compliance with the Combined Code, FSA Listing Rule 9.8.6 and FSA Disclosure and Transparency Rules 7.1 and 7.2 and cover the work of our Board and its Committees; our internal control systems and procedures including risk management; our corporate governance statements relating to share capital and control; and our Going Concern and Directors' Responsibilities Statements.

Ken Harvey
Chairman
22 June 2011

Board of Directors

Chairman

Kenneth George Harvey CBE, BSc
Chairman

Committees
Nomination (Chairman)

Appointed on 1 March 1997. Ken was formerly chairman and chief executive of Norweb Plc. He was chairman of National Grid Holdings in 1995 and was previously deputy chairman of London Electricity and earlier its engineering director. He has also been chairman of a number of limited and private equity funded companies. Currently he is the senior independent non-executive director of National Grid Plc.

Executive Directors

Colin Irwin John Hamilton Drummond MA, MBA, LTCL, CCMI
Chief Executive, Viridor

Committees
Corporate Responsibility
Executive

Appointed on 1 April 1992. Prior to joining the Company Colin was a divisional chief executive of Coats Viyella, having previously been corporate development director of Renold plc, a strategy consultant with the Boston Consulting Group and an official of the Bank of England. He is chairman of the Government's Living with Environmental Change Business Advisory Board; of UKTI's Environmental Sector Advisory Group; and of the Environmental Sustainability Knowledge Transfer Network. He is a senior visiting research fellow in Earth Sciences at Oxford University; and a Past Master of the Worshipful Company of Water Conservators.

David Jeremy Dupont MA, MBA
Group Director of Finance

Committees
Executive

Appointed on 2 March 2002. David was formerly regulatory and finance director of South West Water Limited, having joined Pennon Group Plc (then South West Water Plc) in 1992 as strategic planning manager. Previously he held business planning and development roles with Gateway Corporation. He is a member of the CBI Environmental Affairs Committee and the CBI South West Regional Council.

Christopher Loughlin BSc Hons, MICE, CEng, MBA
Chief Executive, South West Water

Committees
Corporate Responsibility
Executive

Appointed on 1 August 2006. Chris was previously chief operating officer with Lloyd's Register and earlier in his career was an executive director of British Nuclear Fuels Plc and executive chairman of Magnox Electric Plc. He was also a senior diplomat in the British Embassy, Tokyo, working in both the consulting and contracting sectors. Chris started his career as a chartered engineer and subsequently held a number of senior positions with British Nuclear Fuels. He has been chairman of Water UK since 1 April 2008 and since the year-end has been appointed a non-executive director of the Cornwall Local Enterprise Partnership.

Independent Non-executive Directors

Martin David Angle BSc Hons, FCA
Non-executive Director

Committees
Audit
Corporate Responsibility
Nomination
Remuneration (Chairman)

Appointed on 1 December 2008. Martin currently holds non-executive directorships with Savills plc, OAO Severstal, Shuaa Capital PSC and The National Exhibition Centre where he is Chairman. In addition he sits on the Advisory Board of the Warwick Business School and the Board of the FIA Foundation. Formerly he held senior positions with Terra Firma Capital Partners and various of its portfolio companies, including the executive chairmanship of Waste Recycling Group Limited. Before that he was the group finance director of TI Group plc and held a number of senior investment banking positions with SG Warburg & Co Ltd, Morgan Stanley and Dresdner Kleinwort Benson.

Gerard Dominic Connell MA
Senior Independent Non-executive Director

Committees
Audit (Chairman)
Corporate Responsibility
Nomination
Remuneration

Appointed on 1 October 2003. Until last year Gerard was group finance director of Wincanton Plc. Previously he was a director of Hill Samuel and a managing director of Bankers Trust having trained originally at Price Waterhouse. He has held other corporate finance and business development positions in the City and in industry. He is also a governor of King's College School, Wimbledon.

Dinah Alison Nichols CB, BA Hons
Non-executive Director

Committees
Audit
Corporate Responsibility (Chairman)
Nomination
Remuneration

Appointed on 12 June 2003. Dinah was formerly Director General Environment at the Department for Environment, Food and Rural Affairs and previously held various senior appointments within Government, including being head of the water directorate during the period of water privatisation. She is also a Crown Estate Counsellor, a non-executive director of Shires Smaller Companies Plc and a director of several charitable trusts.

Company Secretary

Kenneth David Woodier, Solicitor, CMA, DMS, CPE Law
Group General Counsel & Company Secretary

Committees
Executive

Appointed company secretary to the Board in March 1998. Ken was formerly the head of group legal services at Pennon Group Plc (then South West Water Plc) from February 1990. Previously he held senior legal positions with H.P. Bulmer (Holdings) Plc, Investors in Industry Plc (3i) and Severn Trent Water.

Corporate governance and internal control

The Board and its Committees

The Board

The Directors, independence and responsibilities

The Board of Directors at the end of the year comprised the Chairman, three Executive Directors and three Non-executive Directors. All three Non-executive Directors are considered to be independent as none of the relationships or circumstances set out in paragraph A.3.1 of the Combined Code apply to them. They are also considered to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations. Their biographies on pages 36 and 37 demonstrate a broad range of business and financial experience. Gerard Connell is the Senior Independent Non-executive Director. His duties include the annual evaluation of the performance of the Chairman, deputising for the Chairman when necessary and being available as an additional point of contact on the Board for shareholders. Gerard is also chairman of the Audit Committee and in accordance with the Combined Code's principles relating to audit committee membership he has recent and relevant financial experience (as recently he was group finance director of Wincanton Plc). Martin Angle is also a member of the Audit Committee and he has relevant financial experience as set out in his biography on page 37. There is a clear division of responsibilities between the roles of Chairman and the Chief Executives of South West Water and Viridor as recorded in the descriptions of the roles approved by the Board. All Directors are subject to re-election when they have held office for three years but at the 2011 Annual General Meeting, regardless of whether the Director has held office for three years, each Director will stand for re-election reflecting the new provision in the updated Code.

The Directors on the Board and their attendance at the 11 scheduled meetings of the Board during 2010/11 are shown below.

All Directors are equally accountable for the proper stewardship of the Group's affairs with the Non-executive Directors having a particular responsibility for ensuring that strategies proposed for the development of the business are critically reviewed. The Non-executive Directors also critically examine the operational and financial performance of the Group and fulfil a key role in corporate accountability through their membership of the Committees of the Board. In addition the Chairman holds meetings with the Non-executive Directors without the Executive Directors present, to discuss performance and strategic issues.

How the Board operates

In accordance with Group policies the Board has a schedule of matters reserved for its decision and delegates more detailed consideration of certain matters to Board Committees; to the subsidiary boards of South West Water and Viridor; to the Executive Directors; and to the Group General Counsel & Company Secretary, as appropriate. The matters reserved to the Board include the approval of financial statements; acquisitions and disposals; major items of capital expenditure; authority levels for other expenditure; risk management; and approval of the strategic plan and annual operating budgets.

The Board operates by receiving written reports circulated in advance of its meetings from the Executive Directors and the Group General Counsel & Company Secretary on matters within their respective business areas in the Group. Under the guidance of the Chairman, all matters before the Board are discussed openly and presentations and advice are received frequently from other senior executives within the Group or from external advisers.

Directors have access to the advice and services of the Group General Counsel & Company Secretary and the Board has established a procedure whereby Directors, in order to fulfil their duties, may seek independent professional advice at the Company's expense. The training needs of Directors are reviewed as part of the performance evaluation process.

Performance evaluation

The Board has internal procedures to evaluate the performance of the whole Board, each Committee, the Chairman, each individual Director and the Group General Counsel & Company Secretary. The evaluation procedure relating to the Board and its Committees was administered for the year by the Group General Counsel & Company Secretary. All participants' views were sought on a range of questions which were specifically designed to ensure objective evaluation of performance. Responses were then summarised and evaluated by the Group General Counsel & Company Secretary for the Board and each Committee to consider and determine whether any changes should be made

Board

Members	Appointment date	Attendance
Kenneth Harvey (Chairman)	March 1997	11/11
Non-executive Directors:		
Martin Angle	December 2008	10/11
Gerard Connell	October 2003	11/11
Dinah Nichols	June 2003	11/11
Executive Directors:		11/11
Colin Drummond	April 1992	11/11
David Dupont	March 2002	11/11
Christopher Loughlin	August 2006	10/11

Gerard Connell
Audit Committee Chairman

to be more effective. Overall performance was considered to be satisfactory but a number of views expressed by Directors on the operation of the Board and certain Committees were considered with a view to further improving performance and governance.

The Chairman's performance was evaluated separately by the Non-executive Directors, led by the Senior Independent Non-executive Director. The Chairman's other significant commitments outside the Group have not changed during the year and the Board is satisfied that such commitments do not prejudice the Chairman's performance in relation to his Group role.

Dealing with conflicts of interest
The Board has in place a procedure for the consideration and authorisation of conflicts or possible conflicts with the Company's interests. This is in accordance with the Directors' interests provisions of the Companies Act 2006 and the Company's Articles of Association which grants to Directors authority to approve such conflicts subject to appropriate conditions.

Board committees
Group policies allocate the tasks of giving detailed consideration to specified matters, to monitoring executive actions and to assessing reward, to the Board Committees as set out in the remaining sections of this governance report and the Directors' Remuneration Report on pages 45 and 46.

The Audit Committee

Members	Appointment date	Attendance
Gerard Connell (Chairman)	October 2003	6/6
Martin Angle	December 2008	6/6
Dinah Nichols	June 2003	6/6

With the significant growth of Viridor over the last few years a particular focus this year has been seeking to ensure that the business has the policies, systems and controls in place to manage a more complex and regionalised business across the UK, whilst maintaining performance and profit growth. The Committee was pleased to note that an additional non-executive director was appointed to the Viridor board together with two additional executive directors (responsible respectively for corporate responsibility and regulatory matters; and for operations), that there are plans in place for IT systems to be enhanced and upgraded; and that detailed independent reviews had been carried out into the systems and controls in place, including site self-assessment questionnaires to assist in reinforcing the consistent application of company policy at the local level.

In South West Water the emphasis has been on continuing to systematically review and challenge both its risks and the controls mitigating those risks as recorded in a corporate risk register which was further enhanced in the year. The Committee was also pleased to note that the South West Water board had appointed a further non-executive director and therefore now has two independent non-executive directors in addition to the non-executive chairman.

We have also recognised the need to continue to ensure that our approach to risk is appropriate, particularly in the current challenging economic climate and having regard to the pressures faced by the Group. We have therefore refreshed our risk review process this year and in the coming months will be carrying out a full review of the process with external assistance, bearing in mind that it is over 10 years since the Group introduced detailed risk management policies and procedures in accordance with the Turnbull Recommendations.

As part of the Group's risk review process we have assessed the key areas of sensitivity to the Group and these are set out on pages 24 to 27. This year we have concentrated on the high level key risks to the Group and have provided an indication of how the level of risk has changed over the past year.

As reported in previous Annual Reports we continue to monitor carefully the effectiveness of our external auditors as well as their independence, bearing in mind that it is recognised there is a need to use our auditors' firm for non-audit services from time to time. We have full regard to the Auditing Practices Board's Ethical Standards and note that the revisions to these standards (announced in December 2010) required no change to our existing procedures and safeguards as many of the recommendations had already been adopted as best practice.

Periodically a detailed review of the provision of external auditors is undertaken in accordance with best practice. The last such review was undertaken in 2006 when the current auditors were appointed following a comprehensive competitive tender process. In addition the auditors' appointment is reviewed annually by the Committee. As part of this annual

The Audit Committee continued

review the Committee considers the tenure, quality and fees of the auditors.

Our policy for the engagement of the auditors' firm for non-audit work involves the Group Director of Finance setting out in a report to the Committee reasons for appointing the auditors' firm for any material work and obtaining the approval of the Committee. We carefully review whether it is necessary for the auditors' firm to carry out such work and we will only grant approval for their appointment if we are satisfied that the auditors' independence and objectivity are fully safeguarded.

The Company's auditors assist in this process by ensuring that the senior partner responsible for the external audit of the Group remains responsible for such audit for no more than five years and that there is a Quality Review Partner who is involved in planning the audit and in the reviewing of the final accounts of the Company including assessing any critical matters which may be identified in the audit. The auditors have also confirmed to the Committee that they have complied with all relevant guidance issued by the Auditing Practices Board and have implemented appropriate safeguards including:

- all non-audit related services, where necessary, being performed by personnel independent of the audit engagement team
- no work being undertaken that would require the auditors to act in a capacity as an advocate
- no aspect of the auditing engagement partner's performance being assessed on the level of non-audit fees charged to the Company
- the Committee Chairman meeting with the auditors' Quality Review Partner periodically to discuss the scope and performance of their work.

Set out on page 77 is the level of fees paid to the Company's auditors' firm for audit services, or audit-related services and non-audit services following the guidance proposed by the Auditing Practices Board's Ethical Standards Guidance for Auditors. It is recognised that the level of non-audit fees payable to the Company's auditors' firm in the past year was in excess of the audit fee paid. This was primarily due to fees paid to the corporate finance arm of the auditors' firm in relation to the major new PPP/PFI contract gains by Viridor. We scrutinised carefully the reasons for the engagement of the auditors' firm in accordance with the process described above. Of paramount importance was the continuing independence of the auditors which the Committee was satisfied was maintained due to the safeguards followed by the auditors' firm as described above. We were also satisfied that it was appropriate to appoint the auditors' firm to undertake such work because of the auditors' firm's specialist knowledge and the limited number of consultants with the expertise to undertake such engagements.

The Committee also acknowledged that the absolute level of non-audit fees payable to the Company's auditors is similar to the level of non-audit fees incurred by a number of other comparable companies within the FTSE 350.

Another area of particular importance to the Committee is the internal audit activities of the Group. The Group has a long standing and effective centralised internal audit function together with separate reviews undertaken within both South West Water and Viridor. A Group Internal Audit Plan is approved in September each year. It takes account of the activities to be undertaken by the external auditor and also the Group's annual and regular interim risk management reviews. This approach seeks to ensure that there is an ongoing programme of internal and external audit reviews focused on key risk areas throughout the Group. The Group Audit Manager reports quarterly to the Committee on audit reviews undertaken and their findings.

The areas of the business of the Group which received audit attention over the past year included for example – Group taxation, treasury and pensions processes and administration; South West Water payment processes, credit management and debt collection, payroll and related HR procedures, leakage management and IT security and network administration; and Viridor PFI approval processes, resource management including recyclate trading and foreign exchange management, WEEE recycling, power generation sales, landfill site practices and procedures and IS security and network administration.

We have considered a range of matters during the year in accordance with our established calendar of business and Terms of Reference including in particular:

- reviewing the accounting policies and reporting judgements adopted by the Group in preparing its financial statements. We were satisfied that they were appropriate to provide a fair assessment of the financial performance of the Group
- agreeing the external auditors' strategy for carrying out the audit during the past financial year
- carrying out a review of the Half Year Report with the external auditors
- considering a report from the external auditors on the review of the financial year-end and meeting them in the absence of management to discuss their remit and any issues arising from the audit, including management's treatment of significant judgements which the auditors had confirmed (following discussion with management) were considered to be satisfactory.

Ken Harvey
Nomination Committee Chairman

- considering an internal control report from the external auditors which reviewed the co-ordination of activities with the Group's internal audit function
- keeping under review the effectiveness of the Group's internal controls, including all material financial, operational and compliance controls and risk management systems
- monitoring and reviewing the effectiveness of the Group's internal audit function and approving the annual internal audit plan
- reviewing the findings of the internal audit function and reviewing and monitoring management's responsiveness to such findings
- overseeing the relationship with the external auditors including their appointment, remuneration, re-appointment and the monitoring of their independence and objectivity particularly having regard to the supply of any non-audit services by the auditors' firm
- reviewing the level of audit and non-audit fees paid.

After consideration of the reports provided by the external auditors, and our assessment of the performance and independence of the auditors during the year in conjunction with the Group Director of Finance, we consider that it is appropriate that the external auditors be re-appointed and will make an appropriate recommendation to shareholders at the Annual General Meeting.

It is our practice as an additional assurance, at the end of each meeting of the Committee, to hold separate meetings with the external auditors and the internal Group Audit Manager without management present to discuss their respective areas of activity during the previous period and any issues arising from their audits.

The Nomination Committee

Members	Appointment date	Attendance
Kenneth Harvey (Chairman)	March 1997	2/2
Gerard Connell	October 2003	2/2
Martin Angle	December 2008	2/2
Dinah Nichols	June 2003	2/2

The Nomination Committee meets as and when required to select and recommend to the Board suitable candidates for appointment as executive and non-executive directors to the Board and as executive directors to the Viridor and South West Water boards, determine the nomination process and review succession plans. It is the practice of the Committee, led by the Chairman, to appoint an external search consultancy to assist in any Board appointments.

During the year the Committee considered the annual performance evaluation results for the Committee, reviewed succession planning for the Group and considered and approved the appointment of two new executive directors to the Viridor board.

The Remuneration Committee

Details of the Remuneration Committee and the Directors' remuneration report can be found on pages 45 to 56.

Dinah Nichols
Corporate Responsibility Committee Chairman

The Corporate Responsibility Committee

Members	Appointment date	Attendance
Dinah Nichols (Chairman)	June 2003	5/5
Gerard Connell	October 2003	5/5
Martin Angle	December 2008	4/5
Colin Drummond	April 1992	5/5
Christopher Loughlin	August 2006	4/5

The Corporate Responsibility Committee's duties, in the context of the requirement for companies to conduct their business in a responsible manner (including in relation to environmental, social and governance (ESG) matters), are to review the strategies, policies, management, initiatives, targets and performance of the Pennon Group of companies in the areas of occupational health and safety and security; environment; workplace policies; non-financial regulatory compliance and the role of the Group in society.

During the year the Committee considered a wide range of matters in accordance with its Terms of Reference including:

- the 2010/11 Corporate Responsibility Report and the associated Verifier's Report
- the South West Water and Viridor Corporate Responsibility Reports
- health and safety and security plans and performance
- the Verifier's recommendations for the next Corporate Responsibility Report
- progress against the corporate responsibility targets for 2010/11
- the corporate responsibility targets for 2011/12
- the annual review of Group policies
- a Group plan for community support.

In reporting on corporate responsibility, the Company has sought to comply with the Association of British Insurers' Guidelines on Responsible Investment Disclosure. The Business review on pages 28 to 31 contains the Group's 2011 Annual Corporate Responsibility Report.

Board committees' terms of reference
The Terms of Reference of the Audit, Remuneration, Nomination and Corporate Responsibility Committees are available upon request to the Group General Counsel & Company Secretary and are also set out on the Company's website pennon-group.co.uk

Internal control
Wider aspects of internal control
The Board is responsible for maintaining the Group's system of internal control to safeguard shareholders' investment and the Group's assets and for reviewing its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group that has been in place throughout the financial year 2010/11 and up to the date of the approval of this Annual Report and Accounts.

The Board confirms that it continues to apply procedures in accordance with the Combined Code and the 'Guidance on Internal Control' (The Turnbull Guidance) which suggests means of applying the internal control part of the Code. As part of these procedures the Board has a Group Risk Management Policy (GRMP) which provides for the identification of key risks in relation to the achievement of the business objectives of the Group, monitoring of such risks and annual evaluation of the overall process, as described in more detail below. The GRMP is applied by all business units within the Group in accordance with an annual timetable.

Risk identification
A full risk and control assessment is undertaken annually by the management of each business to identify financial and non-financial risks which are then regularly updated. Each business compiles (as part of regular management reports) an enhanced

and focused assessment of key risks against corporate objectives. The Board at each meeting receives from the Executive Directors details of any new high-level risks identified and how they are to be managed, together with details of any changes to existing risks and their management. The subsidiary boards of South West Water and Viridor also receive at each meeting similar reports in respect of their own areas of responsibility. All Executive Directors and senior managers are required to certify on an annual basis that they have effective controls in place to manage risks and to operate in compliance with legislation and Group procedures. All of these processes serve to ensure that a culture of effective control and risk management is embedded within the organisation and that the Group is in a position to react appropriately to new risks as they arise. Details of key risks affecting the Group are set out in the Business review on pages 24 to 27.

Internal control framework

The Group also has a well established internal control framework which is operated and which applies in relation to the process for preparing the Group's consolidated accounts. This framework comprises:

- a clearly defined structure which delegates an appropriate level of authority, responsibility and accountability, including responsibility for internal financial control, to management of operating units
- a comprehensive budgeting and reporting function with an annual budget approved by the Board of Directors, which also monitors the financial reporting process, monthly results and updated forecasts for the year against budget
- documented financial control procedures. Managers of operating units are required to confirm annually that they have adequate financial controls in operation and to report all material areas of financial risk. Compliance with procedures is reviewed and tested by the Company's internal audit function
- an investment appraisal process for evaluating proposals for all major capital expenditure and acquisitions, with defined levels of approval and a system for monitoring the progress of capital projects
- a post-investment evaluation process for major capital expenditure and acquisitions to assess the success of the project and learn any lessons to be applied to future projects.

Internal control review

An evaluation of the effectiveness of overall internal control compliance by the Group is undertaken in respect of each financial year (and subsequently up to the date of this report) to assist the Audit Committee in considering the Group internal audit plan for the forthcoming financial year and also the Business review for the Annual Report. The Group General Counsel & Company Secretary initially carries out the evaluation with Directors and Senior Management for consideration by the Audit Committee and subsequently for final evaluation by the Board.

In addition the Audit Committee regularly reviews the operation and effectiveness of the internal control framework and annually reviews the scope of work, authority and resources of the Company's internal audit function. The Committee reports and makes recommendations to the Board on such reviews. For 2010/11 and up to the date of the approval of the Annual Report and Accounts, both the Audit Committee and the Board were satisfied with the effectiveness of the GRMP and the internal control framework and their operation within the Group.

Further information on the internal control review is set out on page 39 in relation to the Audit Committee.

Going concern

The Directors consider, after making appropriate enquiries, that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Directors' responsibilities statements

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for the year.

In preparing these financial statements the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and accounting estimates which are reasonable and prudent
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the financial statements and the Directors'

Corporate governance and internal control continued

Remuneration Report comply with the Companies Act 2006 and, as regards the Group financial statements, article 4 of the International Accounting Standards (IAS) Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the Directors, whose names and functions are listed on pages 36 and 37, confirms that, to the best of their knowledge:

a) the financial statements, which have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and of the Company and

b) the Directors' report contained on pages 1 to 33 includes a fair review of the development and performance of the business and position of the Company and the Group, together with a description of the principal risks and uncertainties they face.

The Directors are responsible for the maintenance and integrity of the Company's website pennon-group.co.uk Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Corporate governance statements

The following disclosures are made pursuant to Part 6 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts & Reports) Regulations 2008 and Rule 7.2.3.R of the UK Listing Authority's Disclosure and Transparency Rules (DTR).

As at 31 March 2011:

a) details of the Company's issued share capital, which consists of ordinary shares of nominal value 40.7 pence each, are set out in note 32 to the financial statements on pages 99 to 101. All of the Company's issued shares are fully paid up, rank equally in all respects and are listed on the Official List and traded on the London Stock Exchange. The rights and obligations attaching to the Company's shares, in addition to those conferred on their holders by law, are set out in the Company's Articles of Association ("Articles"), copies of which can be obtained from Companies House in the UK or by writing to the Group Company Secretary at the Company's registered office.

   The holders of the Company's shares are entitled to receive the Company's reports and accounts and in relation to general meetings of the Company they have the right to attend and speak, exercise voting rights and appoint proxies;

b) there are no restrictions on the transfer of issued shares of the Company or on the exercise of voting rights attached to them, except where the Company has exercised its right to suspend their voting rights or to prohibit their transfer following the omission of their holder or any person interested in them to provide the Company with information requested by it in accordance with Part 22 of the Companies Act 2006 or where their holder is precluded from exercising voting rights by the Financial Services Authority's Listing Rules or the City Code on Takeovers and Mergers;

c) details of significant direct or indirect holdings of securities of the Company are set out in the shareholder analysis on page 115;

d) the Company's rules about the appointment and replacement of Directors are contained in the Articles and accord with usual English company law provisions. The powers of directors are determined by UK legislation and the Articles in force from time to time. Changes to the Articles must be approved by the Company's shareholders by passing a special resolution;

e) the Directors have the power to make purchases of the Company's own shares in issue as set out in the Directors' report on page 33 'Purchase of Own Ordinary Shares'. No such purchases have been made during the year. The Directors also have the authority to allot shares up to an aggregate nominal value of (i) £47,958,483 (such amount to be reduced by any shares under (ii) following allotted or rights granted in excess of £47,958,483) or (ii) £95,916,966 by way of rights issue (such amount to be reduced by any shares allotted or rights granted from (i)) which were approved by shareholders at the 2010 Annual General Meeting (AGM). In addition, shareholders approved a resolution giving the Directors a limited authority to allot shares for cash other than pro rata to existing shareholders. These resolutions remain valid until the conclusion of this year's AGM. Similar resolutions will be proposed at this year's AGM. The Directors have no present intention to issue ordinary shares other than pursuant to the Company's employee share schemes and Scrip Dividend Alternative; and

f) there are a number of agreements which take effect, alter or terminate upon a change of control of the Company following a takeover bid, such as bank loan agreements, Eurobond documentation, private placement debt and employees' share plans. None of these is considered to be significant in terms of their potential impact on the business of the Group as a whole.

By Order of the Board

Ken Woodier
Group General Counsel & Company Secretary
22 June 2011

Directors' remuneration report

Martin Angle
Remuneration Committee Chairman

Dear shareholder

I am pleased to present the remuneration report for 2011 on behalf of the Board. In accordance with our usual practice and as required by the Companies Act 2006 we will be presenting this report for your approval at our Annual General Meeting in July.

This report is designed to provide you with details of:

- the Remuneration Committee
- the Group's Remuneration Policy
- Directors' remuneration
- specific remuneration disclosures required by the Directors' Remuneration Report Regulations which are audited.

We appreciate that there is ongoing investor concern relating to executive director remuneration generally and, whilst focus has been on the financial sector primarily, it is fully recognised that there is a continuing need for other sectors to reflect this concern in their remuneration policies and overall remuneration practice. This is why in 2009/10 the Committee decided that salaries for Executive Directors should not be increased despite the Group's businesses being well positioned in the economic slowdown and that last year the increase was circa 4.5% which was consistent with the aggregate average salary increases generally in the Group over the two-year period 2009/10 and 2010/11.

The Remuneration Committee

Members	Appointment date	Attendance
Martin Angle (Chairman)	December 2008	7/7
Gerard Connell	October 2003	7/7
Dinah Nichols	June 2003	7/7

The Committee's Terms of Reference include:

- advising the Board on the framework of executive remuneration for the Group
- determining the remuneration and terms of engagement of the Chairman, the Executive Directors and Senior Management of the Group.

No Director or any other attendee participates in any discussion on, or determination of, his or her own remuneration.

During the year the Committee received advice or services which materially assisted the Committee in the consideration of remuneration matters from Ken Harvey, Chairman of the Company, and from the following advisors who were appointed directly by the Committee:

- Ken Woodier, Group General Counsel & Company Secretary, on remuneration and share scheme matters. He also provides legal advice and company secretarial services to the Company
- Deloitte LLP, auditing and remuneration consultants, on calculating the Company's total shareholder return compared with two comparator groups for the Company's Performance & Co-investment Plan. Deloitte also provide financial and tax advice to the Company
- Aon Hewitt Limited (formerly Hewitt Associates Limited), pensions and remuneration consultants, on providing advice on pension benefits. Aon Hewitt also provide actuarial and investment advice to the Company and to the Trustees of the Group's pension schemes.

Remuneration policy

In 2009 the Committee undertook a review of the Company's remuneration policy and with advice from Towers Watson Limited the Committee concluded that the current policy remained appropriate. This policy which will be applied in 2011/12, and is also currently intended to be applied in each subsequent year, is to provide a remuneration package for Executive Directors which is adequate to attract, retain and motivate good quality executives and which is commensurate with the remuneration packages provided by companies of similar size and complexity. The key guiding principles of this policy are to:

- design an overall package to be competitive and to take account of the markets in which the Group's businesses operate
- support the overarching business strategy for the Group
- adopt incentive arrangements designed to reward performance and align the interests of the Executive Directors with those of shareholders
- reinforce the incentive element of the package by maintaining base salaries for Executive Directors at the relevant market median
- have a remuneration package which is fair and consistent with other companies in the sector and which provides incentives for outperformance.

The policy in respect of Non-executive Directors' fees is set out on page 51 in the Non-executive Directors remuneration section.

In setting executive remuneration the Committee not only takes account of employment market conditions, but seeks to ensure that there are coherent pay and benefit structures across the Group which are consistent with the remuneration packages of the Executive Directors and Senior Management. From summary reports on workforce remuneration and terms and conditions of employment by the Executive Directors with regard to their respective business areas, the Committee has regard to the general levels of responsibility, qualifications and experience required throughout the Group in setting salary and other benefits of the Executive Directors and Senior Management. The Committee also ensures that the incentive structures do not raise environmental, social or governance risks by inadvertently motivating irresponsible behaviour. A number of individual performance objectives specifically relate to achieving non-financial targets (as outlined on page 47).

The balance between maximum performance-related remuneration receivable and direct remuneration (i.e. excluding pensions, car benefit and health cover) is the same as last year with one-third direct and two-thirds performance-related. This is expected to continue for the foreseeable future. The Company also has a Shareholding Guideline which applies to Executive Directors and Senior Management. It is structured to demonstrate their commitment to the future success of the Group. Executive Directors are expected to build up their shareholding over a five-year period to a value which is at least equivalent to their basic annual salary.

Elements of remuneration

Fixed	Variable (Performance-related)	
Base Salary	Short-term – Annual:	Long-term – three years:
Pension – Final Salary (Defined Benefit) or cash alternative	Annual Incentive Bonus Plan – Maximum 100% of basic salary with 50% paid in cash and 50% in shares deferred for three years	Performance and Co-investment Plan (PCP) – future performance over three years
Other – car benefit and health cover	Assessed against corporate financial performance and individual personal achievements relating to a range of operational and compliance targets.	total shareholder return performance criteria – 50% linked to water and waste comparator group and 50% linked to relative FTSE 250 with an underpin relating to operational and economic performance

The following is a detailed summary of the elements of remuneration set out above:

(i) **Basic salary and benefits** – these are set out on page 52 for each Executive Director and are not related to performance. The Committee reviews salaries annually taking account of market data available from independent remuneration consultants. A pay freeze was applied in 2009/10 and last year the general increase was circa 4.5%. When reviewing base salaries the Committee takes account of the performance of the individual Executive Directors which the Committee assesses with the advice of Ken Harvey, Chairman of the Company. Other benefits, not mentioned below, include four times salary life assurance cover; a fully expensed car or a cash alternative; and health cover.

(ii) **Performance-related bonus** – annual performance related bonuses are awarded in accordance with the Group's Annual Incentive Bonus Plan (the Bonus Plan) and are based on the achievement by the Executive Directors of overall corporate and individual objectives set by the Committee. The maximum bonus achievable under the Bonus Plan for Executive Directors for 2010/11 was 100% of basic salary. To achieve the maximum percentage bonus allocated in respect of the corporate targets of earnings per share and profit before tax it is necessary for the Company to achieve a specified level of superior outperformance. Half of any bonus awarded is in the form of Ordinary shares in the Company which must usually be held for a period of three years before release (Deferred Bonus Shares). During this period the Directors, in respect of the Deferred Bonus Shares, are entitled to receive any dividends declared by the Company. No additional performance conditions applicable to the release of the Deferred Bonus Shares, apart from maintaining continuous service with the Company, are considered appropriate by the Committee in view of the stretching performance conditions applicable to achieve the initial award of the Deferred Bonus Shares. The Committee, in setting the performance objectives for Executive Directors, takes account of corporate performance on environmental, social and governance (ESG) matters. Objectives set embrace appropriate ESG parameters which are important to the success of the Group and which seek to ensure that the Group meets a number of its ESG targets as set out in the Group corporate responsibility report on pages 28 to 31 of the Business review. The Committee in setting such objectives and in determining its remuneration policy overall ensures that the relevant incentives to Directors and Senior Management aligns their interests with shareholders and raise no ESG risks by inadvertently motivating irresponsible behaviour.

As reported last year the Bonus Plan is now operated in conjunction with the Company's Executive Share Option Scheme (ESOS) on the basis that the aggregate pre-tax value of the awards made under both the Bonus Plan and the ESOS would be the same as they would have been if the Bonus Plan had been operated alone, as in earlier years. This is achieved by providing for Deferred Bonus Shares awarded to be forfeited by the Directors up to the same value as that of any gain made in respect of options exercised by the Directors pursuant to the ESOS at the end of the three-year restricted period. Only the HMRC approved part of the ESOS was operated in 2009/10 which enabled options over Ordinary shares in the Company to be granted to Directors to the value of £30,000 at the then prevailing price. No further options will be granted to the Executive Directors pursuant to the Bonus Plan until the existing options either are exercised or lapse at the end of the three-year restricted period. Details of the options are set out in the table in paragraph (d) on page 56.

Set out below is a summary of the performance targets determined by the Committee for each Executive Director for 2011/12. These are similar to the targets applied for 2010/11.

Colin Drummond – A bonus of up to 40% for outperformance of Group earnings per share against budget; up to 40% calculated by reference to outperformance of the profit before tax and net debt budgets of Viridor; and up to 20% for personal objectives relating to key business targets for Viridor.

David Dupont – A bonus of up to 40% for outperformance of Group earnings per share against budget; up to 40% for outperformance against budget relating to net debt and net interest of the Group and profit before tax of South West Water and Viridor; and up to 20% for personal objectives relating to Group financing and other Group initiatives.

Chris Loughlin – A bonus of up to 40% for outperformance of Group earnings per share against budget; up to 20% for personal objectives relating to implementing South West Water's new strategies and projects and meeting compliance targets; and up to 40% calculated by reference to the average bonus earned by the other Executive Directors of South West Water (which relate to outperformance against the operating costs, profit before tax, capital expenditure and net debt budgets of the company; the position the company achieves in the 'Service Incentive Mechanism' of water and sewerage companies established by Ofwat; the achievement of a range of service standards set for the company by Ofwat; and personal objectives relating to key initiatives, projects and compliance targets for South West Water).

Directors' remuneration report continued

The achievements of the Executive Directors against their individual performance objectives are assessed by the Committee following the financial year-end when the audited results of the Company and performance against the parameters set are known. This enables the Committee to apply largely objective criteria in determining the level of bonus (if any) which should be awarded, with the advice of the Chairman of the Company, Ken Harvey.

(iii) Long-term incentive plan – A Performance and Co-investment Plan (PCP) was operated by the Company during the year for Executive Directors and Senior Management.

The purpose of the PCP is to award shares to participants subject to the achievement of stretching performance conditions measured over three years. Awards under the PCP, in the form of a conditional right over Ordinary shares in the Company, were made by the Committee in July 2010 and, for Executive Directors, the award was over shares worth 100% of basic salary. In accordance with its discretion pursuant to the rules of the PCP, the Committee made the vesting of the awards also subject to the fulfilment of a co-investment condition whereby Executive Directors were required to invest and hold shares in the Company equal to 20% of the value of their award over the Restricted Period (being a period of three years from the date of the award). The percentage requirement for Senior Management was suitably scaled back. The number of shares subject to each award in the event of vesting will be increased by such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on those shares prior to vesting or exercise.

The PCP awards made in July 2010 will vest based on the Company's total shareholder return (TSR) performance over a three-year performance period against two different comparator groups as set out below. This is the same performance criteria that was applied to the PCP awards made in July 2009 and July 2008. TSR measures the value created for shareholders through increases in share price and the payment of dividends and was applied by the Committee because, based upon advice received from remuneration consultants, Deloitte LLP, it believes that this is an appropriate measure to align the interests of the Executive Directors with those of shareholders:

- up to 50% of an award will vest according to the Company's TSR performance measured against an index made up of the following six listed water and waste comparator companies:

  Northumbrian Water Group
  Séché Environnement
  Severn Trent
  Shanks Group
  Suez Environnement
  United Utilities

  These are the Company's key listed sector comparators.

Water/Waste index	Vesting
Above the index + 15%	50%
Equal to the index	15%
Straight-line vesting in between above positions	
Below the index	0%

- up to 50% of an award will vest according to the Company's ranked TSR performance against the constituents of the FTSE 250 index (excluding investment trusts). This is the FTSE index to which the Company belonged at the time of the award.

FTSE 250 index	Vesting
At or above the 75th percentile	50%
Above 50th percentile	15%
Straight-line vesting in between the above positions	
At or below the 50th percentile	0%

In addition to the above TSR conditions, before any award is capable of vesting, there is an 'Underpin' condition whereby the Committee needs to be satisfied that the underlying operational and economic performance of the Company is at a satisfactory level. This evaluation includes consideration of ESG factors and safety performance, as well as financial performance. Whilst the Committee intends currently to apply similar performance conditions including the 'Underpin' to any future PCP awards, they are reviewed on an annual basis to ensure that the conditions continue to be appropriate and suitably stretching for future awards.

For the first PCP awards made in August 2007 (following shareholder approval at the Annual General Meeting in July 2007) the same performance measures were used as set out above save that the sector comparator group included Biffa and Kelda Group (instead of Séché and Suez). As these companies subsequently de-listed, the Committee in respect of the 2007 award at the end of the three-year Restricted Period in August 2010 had discretion to include them in the calculation of the index up to the date of de-listing (or other earlier date at its discretion) and exclude them from that date onwards or adopt an alternative approach. The Committee's view was that there was no particular reason to exercise its discretion to make any change to the comparator group constituents and therefore the TSR performance was considered with the two de-listed companies being excluded in their entirety.

The calculation of TSR performance over the three-year performance period (being 1 April 2007 to 1 April 2010) for the PCP awards made in August 2007 was undertaken by Deloitte LLP for the Committee. The table below summarises the calculation:

Comparator group	Portion of award	Rank	Percentile rank	Final Vesting level
Waste/Water Index	50%	7.2% outperformance against index	–	31.9%
FTSE 250 (excluding investment trusts)	50%	69th out of 194	64.8%	35.4%
Total vesting				67.3%

The Committee was satisfied that the 'Underpin' condition referred to above had been met and therefore approved the vesting of 67.3% of the award as calculated by Deloitte (together with shares equivalent to the value of dividends declared during the Restricted Period on such shares) with the remaining 32.7% lapsing.

(iv) Other share schemes – Executive Directors are entitled to participate in the Company's Sharesave Scheme and Share Incentive Plan. Both are all-employee plans to which performance conditions do not apply.

(v) Service contracts – In accordance with Company policy, all Executive Directors have service contracts subject to one year's notice. They are due to expire when Executive Directors reach their normal retirement age of 60 unless extended by agreement between the Director and the Company. No provision is made for termination payments under the service contracts. In the event of termination by the Company of any Executive Director's service contract, the Board would determine what payments (if any) should be made to the Director depending on the circumstances of the termination. The dates of the contracts are:

Colin Drummond	5 March 1992
David Dupont	2 January 2003
Chris Loughlin	16 May 2006

Colin Drummond reached his normal retirement date on 22 February 2011 but has continued in employment with the Company in the same position as Chief Executive, Viridor, and as a Director of the Pennon Group Board. His service contract with the Company continues subject to one year's notice.

(vi) Provision for pensions – During the year Colin Drummond and David Dupont participated in the Pennon Group Pension Scheme and the Pennon Group Executive Pension Scheme. These are funded defined benefit schemes which, dependent on length of service at normal retirement date, could amount to two-thirds of final pensionable pay, with the exception of service to 5 April 2006 where an Earnings Cap applied in these Schemes to these two Directors.

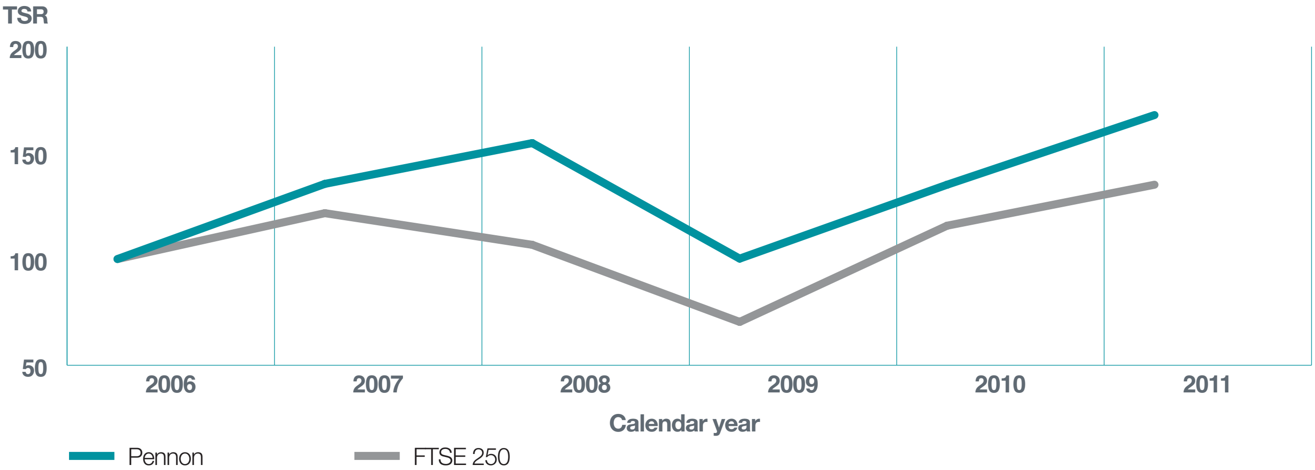
Both were provided with additional pension benefits under an unapproved funded Supplementary Pension Scheme of the Company in order to bring their pension benefits up to a level which would have been provided under the other schemes as if the Earnings Cap had not applied. With effect from 6 April 2006 the Earnings Cap no longer applied to pension schemes as part of the simplification of taxation of pensions legislation. The Committee accordingly decided to provide all of the Directors' future service pension benefits above the Earnings Cap level from the Pennon Group Executive Pension Scheme. The Supplementary Pension Scheme was therefore closed and the accrued benefits were paid out to its members in April 2006.

The pensionable pay for Executive Directors consists of the highest basic salary in any consecutive 12-month period of service within five years of retirement. Bonuses are not included in pensionable pay.

Colin Drummond (from 22 February 2011) and Chris Loughlin receive an annual payment (payable by monthly instalments) equivalent to 30% of each of their annual basic salaries in lieu of the provision of pension benefits.

In determining remuneration arrangements for Executive Directors, the Committee gives full consideration to their impact on the pension schemes' funds and costs of providing individual pension arrangements or payments in lieu of pension provision.

Total shareholder return (TSR)



The graph above shows the value, over the five-year period ending on 31 March 2011, of £100 invested in Pennon Group on 31 March 2006 compared with the value of £100 invested in the FTSE 250 Index. The other points plotted are the values at intervening financial year-ends. This Index is considered appropriate as it is a broad equity market index of which the Company has been a constituent over most of the period covered.

The graph above has been produced in accordance with regulations made pursuant to Section 421 of the Companies Act 2006.

Non-executive Directors and the Chairman

Non-executive Directors' remuneration (excluding that of the Chairman, Ken Harvey) consisting of fees only as set out below, is determined by the Board of Directors, including the Chairman, but in the absence of the other Non-executive Directors. It is usually reviewed each year to take account of market changes in Non-executive Directors' fees. In reviewing the fees, the Board takes into account market information on Non-executive Directors' fees. Following no increase in 2009/10 the fees were reviewed last year and increased by circa 4.5%. The base Non-executive Director fee in the year was £37,500 per annum. The Audit, Remuneration and Corporate Responsibility Committee chairs were paid fees of £10,000, £7,000 and £7,000 per annum respectively and Committee members received £4,000 each. For this and subsequent years the policy expected to be applied in respect of Non-executive Director fees will be to set fees around the median level compared with the market, which the Board believes is appropriate to attract and retain suitably experienced Non-executive Directors.

The Chairman's remuneration is set by the Remuneration Committee. Following no increase in 2009/10 the Chairman's fee was reviewed last year and increased by 4.5% by the Committee.

The policy of the Committee to be applied to the Chairman's fee for this and in subsequent years is the same as that for the Non-executive Directors as set out above. In addition to a fee the Chairman receives a fully-expensed car benefit and health cover. No other benefits or remuneration are received by the Chairman.

The Non-executive Directors (excluding the Chairman) have contracts for services setting out their terms and conditions of appointment which are subject to the Articles of Association of the Company and which may be extended by agreement between the Company and the Non-executive Directors. No provision is made for any termination payment under these contracts.

The Chairman has a contract for services dated 1 April 2005 which is subject to 12 months' notice to provide the Company with reasonable security with regard to his ongoing service. No provision is made for any termination payments under this contract.

The contracts for services of the Chairman and the Non-executive Directors reflect corporate governance best practice and, together with the Executive Directors' service contracts, are available for inspection at the Company's registered office during normal business hours.

The dates of the Non-executive Directors' contracts are:

Director	Date of contract	Expiry date of contract
Martin Angle	28 November 2008	30 November 2011
Gerard Connell	30 September 2003	30 September 2012
Dinah Nichols	10 June 2003	11 June 2012

The above contracts do not contain any notice periods.

The information set out below and on the remaining pages of this Remuneration Report (pages 52 to 56) has been audited by the Group's independent auditors, PricewaterhouseCoopers LLP.

Directors' remuneration report continued

Emoluments of Directors

The emoluments of individual Directors holding office during 2010/11 were:

Director	Salary/fees £000	Performance related bonus payable[2] £000	Other emoluments[1] £000	Payment in lieu of pension[3] £000	Total 2011 – Year to 31 March £000	Total 2010 – Year to 31 March £000
Chairman:						
Ken Harvey	230	–	23	–	253	246
Executive Directors:						
Colin Drummond	345	167	23	11	546	507
David Dupont	345	162	24	–	531	503
Chris Loughlin	345	161	23	103	632	583
Non-executive Directors:						
Martin Angle	52	–	–	–	52	50
Gerard Connell	55	–	–	–	55	53
Dinah Nichols	52	–	–	–	52	50
Total	1,424	490	93	114	2,121	1,992

1 Other emoluments are car benefit and health cover.

2 In addition to the performance-related cash bonus, Executive Directors are due to receive a conditional award of shares as referred to in a note to (c) 'Annual Incentive Bonus Plan – Deferred Bonus Shares (long-term incentive element)' on page 55.

3 In lieu of any pension provision by the Company, Colin Drummond (from 22 February 2011) and Chris Loughlin received cash payments equivalent to 30% of each of their annual basic salaries.

No expense allowances chargeable to tax or termination or compensation payments were made during the year.

Executive Directors’ pensions

Defined benefit pensions accrued and payable on retirement for Executive Directors holding office during 2010/11 were:

Director	Increase/ (decrease) in accrued pension during 2010/11 (net of inflation) £000 a	Increase/ (decrease) in accrued pension during 2010/11 £000 b	Accrued pension at 31 March 2011 £000 c	Transfer value at 31 March 2011 £000 d	Transfer value at 31 March 2010 £000 e	Increase/ (decrease) in transfer value (net of Directors’ contributions) £000 f	Increase/ (decrease) in transfer value of Column a (net of Directors’ contributions) £000 g
Colin Drummond	(32)	(25)	121	2,710	3,424	(743)	(597)
David Dupont	8	15	145	3,150	2,798	320	153

The headings a) to g) above are as follows:

a) increase/decrease in accrued pension during 2010/11 (net of inflation)

b) increase/decrease in accrued pension during 2010/11

c) accrued pension at 31 March 2011 payable at normal retirement age

d) transfer value of the accrued pension in c) as at 31 March 2011

e) transfer value of the accrued pension at the end of the previous financial year on 31 March 2010

f) increase/decrease in transfer value during the year (net of Directors’ contributions)

g) increase/decrease in transfer value of column a) (net of Directors’ contributions)

The pension figure quoted above for Colin Drummond (column c) is lower than the pension figure quoted in last year’s remuneration report due to Colin having retired from the Company’s pension scheme on 22 February 2011 and beginning to draw his pension. Colin elected to take a Pension Commencement Lump Sum of £386,057 with a tax payment of £420,990 being made from the pension scheme which was deducted from his accrued pension benefit. The figure shown in column c) for Colin is the residual pension in payment as at 31 March 2011.

Directors’ share interests

(a) Shareholdings

The number of ordinary shares of the Company in which Directors held beneficial interests at 31 March 2011 and 31 March 2010 were:

Director	2011 Ordinary shares (40.7p each)	2010 Ordinary shares (40.7p each)	Director	2011 Ordinary shares (40.7p each)	2010 Ordinary shares (40.7p each)
Martin Angle	–	–	Ken Harvey	18,209	18,209
Gerard Connell	4,000	4,000	Chris Loughlin	58,534	38,876
Colin Drummond	263,225	239,218	Dinah Nichols	4,549	4,549
David Dupont	237,945	213,510			

Since 31 March 2011 1,526 additional Ordinary shares (40.7p each) in the Company have been acquired by Chris Loughlin as a result of participation in the Company’s Scrip Dividend Alternative and the Company’s Share Incentive Plan and 143 additional Ordinary shares (40.7p each) in the Company have been acquired by David Dupont as a result of dividend reinvestment in an ISA.

There have been no other changes in the beneficial interests or the non-beneficial interests of the Directors in the Ordinary shares of the Company between 1 April 2011 and 4 June 2011.

b) Performance and Co-investment Plan (Long-term incentive plan)

In addition to the above beneficial interests, the following Directors have or had a contingent interest in the number of Ordinary shares (40.7p each) of the Company shown below, representing the maximum number of shares to which they would become entitled under the Group's Long-Term Incentive Plan should the relevant criteria be met in full:

Director and date of award	Conditional awards held at 1 April 2010	Conditional awards made in year	Market price upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional Awards held at 31 March 2011	Date of end of period for qualifying conditions to be fulfilled
Colin Drummond							
29/8/07	53,859	–	557.00p	40,691*	232	–	28/8/10
10/7/08	51,764	–	637.50p	–	–	51,764	9/7/11
1/7/09	67,831	–	486.50p	–	–	67,831	30/6/12
2/7/10	–	63,186	546.00p	–	–	63,186	1/7/13
David Dupont							
29/8/07	53,859	–	557.00p	40,691*	232	–	28/8/10
10/7/08	51,764	–	637.50p	–	–	51,764	9/7/11
1/7/09	67,831	–	486.50p	–	–	67,831	30/6/12
2/7/10	–	63,186	546.00p	–	–	63,186	1/7/13
Chris Loughlin							
29/8/07	49,371	–	557.00p	37,300*	213	–	28/8/10
10/7/08	49,411	–	637.50p	–	–	49,411	9/7/11
1/7/09	64,748	–	486.50p	–	–	64,748	30/6/12
2/7/10	–	63,186	546.00p	–	–	63,186	1/7/13

* 67.3% of the 29 August 2007 award shares vested on 29 August 2010 as explained in the section (iii) 'Long Term Incentive Plan' on page 48 of this report at a market price of £5.70 per share. The total number of shares that vested included additional shares equivalent in value to such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on the vested shares during the Restricted Period of three years. The balance of the award lapsed.

(c) Annual Incentive Bonus Plan – Deferred Bonus Shares (long-term incentive element)

The following Directors have a contingent interest in the number of Ordinary shares (40.7p each) of the Company shown below, representing the total number of shares to which they would become entitled under the deferred bonus element of the Annual Incentive Bonus Plan (the Bonus Plan) at the end of the relevant qualifying period:

Director and date of award	Conditional awards held at 1 April 2010	Conditional awards made in year	Market price upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional Awards held at 31 March 2011	Date of end of period for qualifying condition to be fulfilled
Colin Drummond							
27/6/08	22,838	–	620.00p	–	–	22,838	26/6/11
29/9/09*	16,730	–	473.40p	–	–	16,730	28/9/12
27/7/10	–	27,091	572.50p	–	–	27,091	26/7/13
David Dupont							
27/6/08	21,145	–	620.00p	–	–	21,145	26/6/11
29/9/09*	17,880	–	473.40p	–	–	17,880	28/9/12
27/2/10	755	–	524.50p	–	–	755	26/2/13
27/7/10	–	25,938	572.50p	–	–	25,938	26/7/13
Chris Loughlin							
27/6/08	18,806	–	620.00p	–	–	18,806	26/6/11
29/9/09*	19,562	–	473.40p	–	–	19,562	28/9/12
27/2/10	1,261	–	524.50p	–	–	1,261	26/2/13
27/7/10	–	25,133	572.50p	–	–	25,133	26/7/13

* In addition to the awards made on 29 September 2009 the Directors also received options pursuant to the Company's Executive Share Option Scheme (the ESOS), details of which are set out in the table of paragraph (d) on page 56. These awards were made in conjunction with the operation of the Bonus Plan, the provisions of which have been varied by the Remuneration Committee to provide for forfeiture of equivalent shares from the Bonus Plan in the event that the ESOS options are exercised by the Directors. Further details of this variation to the Bonus Plan and to the operation of the ESOS are set out in paragraph (ii) 'Performance-related bonus' on page 47.

During the year the Directors received dividends on the above shares in accordance with the conditions of the Bonus Plan as follows:

Colin Drummond £15,398 ; David Dupont £15,181; Chris Loughlin £10,103.

Chris Loughlin also received Ordinary shares (40.7p each) in the Company as a result of participation in the Company's Scrip Dividend Alternative and these shares are included in the figure given for the additional Ordinary shares (40.7p each) in the Company that Chris acquired since 31 March 2011 given on page 53.

A further conditional award of shares will be made in 2011/12 to the value of the amount of the performance-related cash bonus shown in the Emoluments of Directors table on page 52. Paragraph (ii) 'Performance-related bonus' on page 47 sets out the provisions relating to the conditional award of shares pursuant to the Bonus Plan.

(d) Executive Share Option Scheme

The following Directors have a contingent interest in the number of options in the Ordinary shares (40.7p each) of the Company pursuant to the Company's Executive Share Option Scheme shown below. Further details relating to the operation of the Scheme are set out in paragraph (ii) 'Performance-related bonus' on page 47.

Director and date of grant	Options held at 1 April 2010	Granted in year	Exercised in year	Exercise price per share	Market price of each share on exercising	Market value of each share at 31 March 2011	Options held at 31 March 2011	Maturity date
Colin Drummond 29/9/09	6,337	–	–	473.40p	–	625.00p	6,337	28/9/12
David Dupont 29/9/09	6,337	–	–	473.40p	–	625.00p	6,337	28/9/12
Chris Loughlin 29/9/09	6,337	–	–	473.40p	–	625.00p	6,337	28/9/12

(e) Sharesave Scheme

Details of options to subscribe for Ordinary shares (40.7p each) of the Company under the all-employee Sharesave Scheme were:

Director and date of grant	Options held at 1 April 2010	Granted in year	Exercised in year	Exercise price per share	Market price of each share on exercising	Market value of each share at 31 March 2011	Options held at 31 March 2011	Exercise period/ maturity date
Colin Drummond 6/7/09	2,351	–	–	386.00p	–	625.00p	2,351	1/9/12 – 28/2/13
David Dupont 3/7/07	3,136	–	–	522.00p	–	625.00p	3,136	1/9/12 – 28/2/13
Chris Loughlin 3/7/07	3,136	–	–	522.00p	–	625.00p	3,136	1/9/12 – 28/2/13

(f) Share price

The market price of the Ordinary shares (40.7p each) of the Company at 31 March 2011 was 625p (2010 522.50p) and the range during the year was 482.9p to 650p (2009/10 404.00p to 549.50p).

Basis of preparation

The Remuneration Report has been prepared in accordance with the Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (the Regulations) and meets the relevant requirements of the FSA Listing Rules. In accordance with the Regulations, the following sections of the Remuneration Report are subject to audit: Emoluments of Directors; Executive Directors' Pensions; and Directors' Share Interests (including long-term incentive plan and bonus plan awards and their vesting criteria and share options and sharesave) for which the independent auditors' opinion thereon is expressed on page 57. The other sections are not subject to audit nor are the pages referred to from within the audited sections.

The remuneration report was approved by the Board of Directors and signed on its behalf by

Martin Angle
Chairman of the Remuneration Committee
22 June 2011

Independent auditors' report

to the members of Pennon Group Plc

We have audited the financial statements of Pennon Group Plc for the year ended 31 March 2011 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Group and Company Balance sheets, the Group and Company Statements of Changes in Equity, the Group and Company Cash Flow Statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on pages 43 and 44, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatement or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Company's affairs as at 31 March 2011 and of the Group's profit and Group's and Company's cash flows for the year then ended
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006 and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006
- the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements and
- the information given in the Corporate Governance Statement set out on pages 38 to 44 with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us or
- the Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns or
- certain disclosures of Directors' remuneration specified by law are not made or
- we have not received all the information and explanations we require for our audit or
- a corporate governance statement has not been prepared by the Company.

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 43, in relation to going concern
- the parts of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

David Charles
(Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol

22 June 2011

Consolidated income statement

For the year ended 31 March 2011

	Notes	2011 £m	2010 (Restated note 5) £m
Revenue	6	**1,159.2**	1,068.9
Operating costs			
Manpower costs	7	**(148.3)**	(137.3)
Raw materials and consumables used		**(121.6)**	(76.3)
Other operating expenses		**(486.7)**	(453.6)
Depreciation and amortisation		**(141.7)**	(135.4)
Operating profit	6	**260.9**	266.3
Finance income	8	**45.1**	34.4
Finance costs	8	**(121.8)**	(116.0)
Share of post-tax profit from joint ventures		**4.3**	1.1
Profit before tax	6	**188.5**	185.8
Taxation	9	**(16.9)**	(44.3)
Profit for the year		**171.6**	141.5
Profit attributable to equity shareholders		**171.6**	141.5
Earnings per share (pence per share)	11		
– Basic		**48.4**	40.4
– Diluted		**48.1**	40.3

The notes on pages 63 to 112 form part of these financial statements.

Consolidated statement of comprehensive income

For the year ended 31 March 2011

	Notes	2011 £m	2010 (Restated note 5) £m
Profit for the year		**171.6**	141.5
Other comprehensive loss			
Actuarial gains/(losses) on defined benefit pension schemes	29	**2.4**	(44.4)
Net fair value losses on cash flow hedges		**(0.1)**	–
Share of other comprehensive loss from joint ventures	20	**(3.0)**	(3.2)
Tax on items taken directly to or transferred from equity	9, 30	**(3.3)**	17.4
Other comprehensive loss for the year net of tax	35	**(4.0)**	(30.2)
Total comprehensive income for the year		**167.6**	111.3
Total comprehensive income attributable to equity shareholders		**167.6**	111.3

The notes on pages 63 to 112 form part of these financial statements.

Balance sheets

At 31 March 2011

	Notes	Group 2011 £m	Group 2010 (Restated note 5) £m	Company 2011 £m	Company 2010 £m
Assets					
Non-current assets					
Goodwill	15	**292.4**	257.4	**–**	–
Other intangible assets	16	**4.4**	5.1	**–**	–
Property, plant and equipment	17	**2,927.5**	2,825.7	**0.3**	0.2
Other non-current assets	19	**116.0**	101.0	**367.7**	338.5
Financial assets at fair value through profit		**2.6**	–	**–**	–
Deferred tax assets	30	**–**	–	**4.2**	5.0
Investments in subsidiary undertakings	20	**–**	–	**1,032.0**	1,032.0
Investments in joint ventures	20	**1.5**	0.2	**–**	–
		3,344.4	3,189.4	**1,404.2**	1,375.7
Current assets					
Inventories	21	**7.4**	6.4	**–**	–
Trade and other receivables	22	**220.6**	194.7	**92.7**	84.5
Financial assets at fair value through profit		**0.9**	–	**–**	–
Derivative financial instruments	23	**6.9**	3.4	**6.6**	3.4
Current tax recoverable	26	**–**	–	**1.7**	1.3
Cash and cash deposits	24	**555.5**	493.9	**236.6**	174.6
		791.3	698.4	**337.6**	263.8
Liabilities					
Current liabilities					
Borrowings	27	**(99.2)**	(229.0)	**(316.1)**	(351.2)
Derivative financial instruments	23	**(5.3)**	(3.6)	**–**	–
Trade and other payables	25	**(258.9)**	(196.0)	**(11.1)**	(17.3)
Current tax liabilities	26	**(79.4)**	(83.8)	**–**	–
Provisions	31	**(16.3)**	(23.9)	**–**	–
		(459.1)	(536.3)	**(327.2)**	(368.5)
Net current assets/(liabilities)		**332.2**	162.1	**10.4**	(104.7)
Non-current liabilities					
Borrowings	27	**(2,390.1)**	(2,160.2)	**(572.9)**	(462.8)
Other non-current liabilities	28	**(30.4)**	(16.0)	**(8.7)**	(8.7)
Derivative financial instruments	23	**(16.3)**	(14.1)	**–**	–
Retirement benefit obligations	29	**(85.8)**	(107.9)	**(6.8)**	(11.7)
Deferred tax liabilities	30	**(293.8)**	(312.2)	**–**	–
Provisions	31	**(80.7)**	(78.2)	**–**	–
		(2,897.1)	(2,688.6)	**(588.4)**	(483.2)
Net assets		**779.5**	662.9	**826.2**	787.8
Shareholders' equity					
Share capital	32	**147.0**	145.3	**147.0**	145.3
Share premium account	33	**9.2**	10.9	**9.2**	10.9
Capital redemption reserve	34	**144.2**	144.2	**144.2**	144.2
Retained earnings and other reserves	35	**479.1**	362.5	**525.8**	487.4
Total shareholders' equity		**779.5**	662.9	**826.2**	787.8

The notes on pages 63 to 112 form part of these financial statements.

The financial statements on pages 58 to 112 were approved by the Board of Directors and authorised for issue on 22 June 2011 and were signed on its behalf by:

K G Harvey
Chairman
Pennon Group Plc
Registered Office: Peninsula House, Rydon Lane, Exeter, Devon, England EX2 7HR. Registered in England No. 2366640

Statements of changes in equity

Group	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings and other reserves (Restated note 5) £m	Total equity (Restated note 5) £m
At 1 April 2009	144.5	11.7	144.2	300.2	600.6
Profit for the year	–	–	–	141.5	141.5
Other comprehensive loss for the year	–	–	–	(30.2)	(30.2)
Total comprehensive income for the year	–	–	–	111.3	111.3
Transactions with equity shareholders					
Dividends paid	–	–	–	(73.4)	(73.4)
Adjustment for shares issued under the scrip dividend alternative	0.8	(0.8)	–	9.6	9.6
Adjustment in respect of share-based payments	–	–	–	2.9	2.9
Proceeds from treasury shares re-issued	–	–	–	1.9	1.9
Equity component of convertible bond issued	–	–	–	10.0	10.0
Total transactions with equity shareholders	0.8	(0.8)	–	(49.0)	(49.0)
At 31 March 2010	145.3	10.9	144.2	362.5	662.9
Profit for the year	–	–	–	171.6	171.6
Other comprehensive loss for the year	–	–	–	(4.0)	(4.0)
Total comprehensive income for the year	–	–	–	167.6	167.6
Transactions with equity shareholders					
Dividends paid	–	–	–	(79.6)	(79.6)
Adjustment for shares issued under the scrip dividend alternative	1.7	(1.7)	–	22.8	22.8
Adjustment in respect of share-based payments	–	–	–	3.9	3.9
Transfer from hedging reserve to property, plant and equipment	–	–	–	0.3	0.3
Proceeds from treasury shares re-issued	–	–	–	1.6	1.6
Total transactions with equity shareholders	1.7	(1.7)	–	(51.0)	(51.0)
At 31 March 2011	**147.0**	**9.2**	**144.2**	**479.1**	**779.5**

Company	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings and other reserves £m	Total equity £m
At 1 April 2009	144.5	11.7	144.2	459.3	759.7
Profit for the year	–	–	–	81.6	81.6
Other comprehensive loss for the year	–	–	–	(2.3)	(2.3)
Total comprehensive income for the year	–	–	–	79.3	79.3
Transactions with equity shareholders					
Dividends paid	–	–	–	(73.4)	(73.4)
Adjustment for shares issued under the scrip dividend alternative	0.8	(0.8)	–	9.6	9.6
Adjustment in respect of share-based payments	–	–	–	0.7	0.7
Proceeds from treasury shares re-issued	–	–	–	1.9	1.9
Equity component of convertible bond issued	–	–	–	10.0	10.0
Total transactions with equity shareholders	0.8	(0.8)	–	(51.2)	(51.2)
At 31 March 2010	145.3	10.9	144.2	487.4	787.8
Profit for the year	–	–	–	90.1	90.1
Other comprehensive loss for the year	–	–	–	2.7	2.7
Total comprehensive income for the year	–	–	–	92.8	92.8
Transactions with equity shareholders					
Dividends paid	–	–	–	(79.6)	(79.6)
Adjustment for shares issued under the scrip dividend alternative	1.7	(1.7)	–	22.8	22.8
Adjustment in respect of share-based payments	–	–	–	0.8	0.8
Proceeds from treasury shares re-issued	–	–	–	1.6	1.6
Total transactions with equity shareholders	1.7	(1.7)	–	(54.4)	(54.4)
At 31 March 2011	**147.0**	**9.2**	**144.2**	**525.8**	**826.2**

The notes on pages 63 to 112 form part of these financial statements.

Cash flow statements

For the year ended 31 March 2011

	Notes	Group 2011 £m	Group 2010 (Restated note 5) £m	Company 2011 £m	Company 2010 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	36	**376.2**	365.4	**(44.2)**	(113.8)
Interest paid		**(78.2)**	(84.2)	**(22.0)**	(19.4)
Tax paid		**(43.2)**	(3.8)	**(0.3)**	(0.2)
Net cash generated/(outflow) from operating activities		**254.8**	277.4	**(66.5)**	(133.4)
Cash flows from investing activities					
Interest received		**14.4**	14.5	**20.9**	20.7
Dividends received		**–**	–	**93.1**	80.6
Acquisition of subsidiary undertakings (net of cash acquired)	38	**(25.1)**	(9.3)	**–**	–
Investments in subsidiary undertakings		**–**	(0.1)	**–**	(45.0)
Loans advanced to joint ventures		**(12.5)**	(30.7)	**–**	–
Loan repayments received from joint ventures		**3.5**	–	**–**	–
Purchase of property, plant and equipment		**(190.3)**	(197.2)	**(0.2)**	(0.1)
Proceeds from sale of property, plant and equipment		**4.7**	3.5	**–**	–
Net cash (used in)/received from investing activities		**(205.3)**	(219.3)	**113.8**	56.2
Cash flows from financing activities					
Proceeds from treasury shares re-issued	32	**1.6**	1.9	**1.6**	1.9
Convertible bond issued (net proceeds)		**–**	121.9	**–**	121.9
Deposit of restricted funds (net)		**(30.8)**	(73.3)	**–**	(0.5)
Proceeds from new borrowing		**187.0**	237.2	**139.9**	238.9
Repayment of borrowings		**(104.6)**	(234.9)	**(70.0)**	(215.8)
Finance lease sale and lease back		**–**	38.9	**–**	–
Finance lease principal repayments		**(20.5)**	(18.5)	**–**	–
Dividends paid		**(56.8)**	(63.8)	**(56.8)**	(63.8)
Net cash (used in)/received from financing activities		**(24.1)**	9.4	**14.7**	82.6
Net increase in cash and cash equivalents		**25.4**	67.5	**62.0**	5.4
Cash and cash equivalents at beginning of the year	24	**389.5**	322.0	**173.2**	167.8
Cash and cash equivalents at end of the year	24	**414.9**	389.5	**235.2**	173.2

The notes on pages 63 to 112 form part of these financial statements.

Notes to the financial statements

1. General information

Pennon Group Plc is a company registered in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 60. Pennon Group's business is operated through two main subsidiaries. South West Water Limited holds the water and sewerage services appointments for Devon, Cornwall and parts of Dorset and Somerset. Viridor Limited's business is recycling, waste management and renewable energy.

2. Principal accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented.

(a) Basis of preparation

These financial statements have been prepared on the historical cost accounting basis (except for fair value items, principally acquisitions and derivatives as described in accounting policy note (b) and (n) respectively) and in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union, with those parts of the Companies Act 2006 applicable to companies reporting under IFRS and the requirements of the Financial Services Authority. A summary of the principal accounting policies is set out below, together with an explanation where changes have been made to previous policies on the adoption of new accounting standards and interpretations in the year.

The going concern basis has been adopted in preparing these financial statements as stated by the Directors on page 43.

The following revised standard and new interpretation, which are mandatory for the first time in the year beginning 1 April 2010, are relevant to the Group:

IFRS 3 'Business combinations' (revised)

The revised standard requires all payments to purchase a business to be recorded at fair value at the acquisition date, with some contingent payments subsequently re-measured at fair value through income. All transactions costs are to be expensed. The Group has accounted for the acquisitions made during the year in accordance with the revised standard. In the year £1.1 million of transaction costs have been expensed that previously would have been considered part of the cost of acquisition.

IFRIC 18 'Transfers of assets from customers'

From 1 July 2009 where an item of property, plant and equipment provided by a customer, or an equivalent payment to provide such property, plant and equipment, gives access to the supply of goods or services then the asset exchanged generates revenue. The effect of the restatement on the comparative figures is set out in note 5. In the year assets with a value of £17.4 million (2010 £2.0 million) were transferred to the Group, increasing deferred income (included in accruals and other payables) by £14.7 million (2010 nil) and profit by £2.7 million (2010 £2.0 million).

The following revised standards, amended standards and interpretations, which are mandatory for the first time in the financial year beginning 1 April 2010, are relevant to the Group but have had no material impact:

IFRS 1	'First-time adoption of IFRS' (revised)
IFRS 1	'First-time adoption of IFRS' (amendment)
IFRS 2	'Share-based payment' (amendment)
Improvements to IFRS 2009	
IAS 27	'Consolidated and separate financial statements' (revised)
IAS 32	'Financial instruments: presentation' (amendment)
IAS 39	'Financial instruments: recognition and measurement' (amendment)
IFRIC 15	'Agreement for the construction of real estate'
IFRIC 16	'Hedges of a net investment in a foreign operation'
IFRIC 17	'Distribution of non-cash assets to owners'

At the date of approval of these financial statements the following new standards, revised standards, amended standards and new interpretations, which have not been applied in these financial statements, were in issue, but not yet effective:

IFRS 1	'First-time adoption of IFRS' (amendment) (hyperinflation exemptions and fixed date for IFRS transition)*
IFRS 1	'First-time adoption of IFRS' (amendment) (limit exemption from IFRS 7 disclosures)
IFRS 7	'Financial instruments: disclosure on derecognition' (amendment) *
IFRS 9	'Financial instruments'*
IFRS 10	'Consolidated financial statements'*
IFRS 11	'Joint arrangements'*
IFRS 12	'Disclosure of interests in other entities'*
IFRS 13	'Fair value measurement'*
Improvements to IFRS 2010	
IAS 12	'Income taxes' (amendment)*
IAS 24	'Related party disclosures' (revised)
IAS 27	'Separate financial statements' (revised)*
IAS 28	'Investments in associates and joint ventures' (revised)*
IFRIC 14	'Prepayments of a minimum funding requirement' (amendment)
IFRIC 19	'Extinguishing financial liabilities with equity instruments'

* Denotes not yet endorsed for use in the European Union

2. Principal accounting policies continued

(a) Basis of preparation continued

The presentational impact of these standards and interpretations is being assessed. The Directors expect that the adoption of these standards and interpretations will have no material impact on the financial statements of the Group.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions which affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best assessment of the amounts, actual events or actions and results may ultimately differ from those estimates.

(b) Basis of consolidation

The Group financial statements include the results of Pennon Group Plc and its subsidiary, joint venture and associate undertakings.

The results of subsidiary, joint venture and associate undertakings are included from the date of acquisition or incorporation, and excluded from the date of disposal. The results of subsidiaries are consolidated where the Group has the power to govern the financial and operating policies of a subsidiary. The results of joint ventures and associate undertakings are accounted for on an equity basis.

Intra-group trading and loan balances and transactions are eliminated on consolidation.

The acquisition method of accounting is used to account for the purchase of subsidiaries. The excess of the value transferred to the seller in return for control of the acquired business together with the fair value of any previously held equity interest in that business over the Group's share of the fair value of the identifiable net assets is recorded as goodwill.

(c) Revenue recognition

Revenue represents the fair value of consideration receivable, excluding value added tax, trade discounts and inter company sales, in the ordinary course of business for goods and services provided.

Revenue is recognised once the services or goods have been provided to the customer.

Income from main water and waste water charges includes billed amounts for estimated usage and also an estimation of the amount of unbilled charges at the year-end based upon a defined methodology reflecting historical consumption and current tariffs.

Income from electricity generated from waste management landfill gas production includes an estimation of the amount to be received under renewables obligation certificates.

Accrued income from waste management contracts at the balance sheet date is recognised using management's expectation of amounts to be subsequently billed for services rendered to the client in accordance with the terms of the contract.

Income from recycling activities within waste management includes amounts based upon market prices for recyclate products and industry schemes for waste electrical and electronic equipment ('WEEE' notes) and packaging volumes ('PRNs') processed.

Revenue from long-term service concession arrangements is recognised based on the fair value of work performed. Where an arrangement includes more than one service, such as construction and operation of waste management facilities, revenue and profit are recognised in proportion to a fair value assessment of the total contract value split across the service provided.

Interest income is recognised on a time-apportioned basis using the effective interest method.

(d) Landfill tax

Landfill tax is included within both revenue and operating costs.

(e) Segmental reporting

Each of the Group's business segments provides services which are subject to risks and returns which are different from those of the other business segments. The Group's internal organisation and management structure and its system of internal financial reporting is based primarily on business segments. The principal business segments comprise the regulated water and sewerage services undertaken by South West Water Limited and the waste management business of Viridor Limited. Segmental revenue and results include transactions between businesses. Inter-segmental transactions are eliminated on consolidation.

2. Principal accounting policies continued

(f) Goodwill

Goodwill arising on consolidation from the acquisition of subsidiary and joint venture undertakings represents the excess of the purchase consideration over the fair value of net assets acquired.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed. Further details are contained in accounting policy (j).

When a subsidiary or joint venture undertaking is sold, the profit or loss on disposal is determined after including the attributable amount of unamortised goodwill.

Goodwill arising on acquisitions before 1 April 2004 (the Group's date of transition to IFRS) has been retained at the previous UK GAAP amounts, subject to annual testing for impairment. Goodwill written-off to reserves under UK GAAP prior to 1998 was not reinstated on transition to IFRS and will not be included in determining any subsequent profit or loss on disposal.

(g) Other intangible assets

Other intangible assets acquired in a business combination are capitalised at fair value at the date of acquisition. Following initial recognition, finite life intangible assets are amortised on a straight-line basis over their estimated useful economic lives, with the expense taken to the income statement through operating costs.

(h) Property, plant and equipment

i) Infrastructure assets (being water mains and sewers, impounding and pumped raw water storage reservoirs, dams, pipelines and sea outfalls)

Infrastructure assets were included at fair value on transition to IFRS and subsequent additions are recorded at cost less accumulated depreciation. Expenditure to increase capacity or enhance infrastructure assets is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the Group. The cost of day-to-day servicing of infrastructure components is recognised in the income statement as it arises.

Infrastructure assets are depreciated over their useful economic lives, and are principally:

Dams and impounding reservoirs	200 years
Water mains	40 – 100 years
Sewers	40 – 100 years

Assets in the course of construction are not depreciated until commissioned.

ii) Landfill sites

Landfill sites are included within land and buildings at cost less accumulated depreciation. Cost includes acquisition and development expenses. The cost of a landfill site is depreciated to its residual value (which is linked to gas production at the site post-closure) over its estimated operational life taking account of the usage of void space.

iii) Landfill restoration

Where the obligation to restore a landfill site is an integral part of its future economic benefits, a non-current asset within property, plant and equipment is recognised. The asset recognised is depreciated based on the usage of void space.

iv) Other assets (including properties, overground plant and equipment)

Other assets are included at cost less accumulated depreciation.

Freehold land is not depreciated. Other assets are depreciated evenly to their residual value over their estimated economic lives, and are principally:

Land and buildings – Freehold buildings	30 – 60 years
Land and buildings – Leasehold buildings	Over their estimated economic lives or the finance lease period, whichever is the shorter
Operational properties	40 – 80 years
Fixed plant	20 – 40 years
Vehicles, mobile plant and computers	3 – 10 years

Assets in the course of construction are not depreciated until commissioned.

The cost of assets includes directly attributable labour and overhead costs which are incremental to the Group. Borrowing costs directly attributable to the construction of a qualifying asset (an asset necessarily taking a substantial period of time to be prepared for its intended use) are capitalised as part of the asset.

Asset lives and residual values are reviewed annually.

Gains and losses on disposal are determined by comparing sale proceeds with carrying amounts. These are included in the income statement.

2. Principal accounting policies continued

(i) Leased assets
Assets held under finance leases are included as property, plant and equipment at the lower of their fair value at commencement or the present value of the minimum lease payments, and are depreciated over their estimated economic lives or the finance lease period, whichever is the shorter. The corresponding liability is recorded as borrowings. The interest element of the rental costs is charged against profits using the actuarial method over the period of the lease.

Rental costs arising under operating leases are charged against profits in the year they are incurred.

(j) Impairment of non-financial assets
Assets with an indefinite useful life are not subject to amortisation and are tested annually for impairment, or whenever events or changes in circumstance indicate that the carrying amount may not be recoverable.

Assets subject to amortisation or depreciation are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which an asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value, less costs to sell, and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Value in use represents the present value of projected future cash flows expected to be derived from a cash-generating unit, discounted using a pre-tax discount rate which reflects an assessment of the market cost of capital of the cash-generating unit.

Impairments are charged to the income statement in the year in which they arise.

(k) Investment in subsidiary undertakings
Investments in subsidiary undertakings are initially recorded at cost, being the fair value of the consideration paid. Subsequently, investments are reviewed for impairment on an individual basis annually or if events or changes in circumstances indicate that the carrying value may not be fully recoverable.

(l) Investment in joint ventures
Joint ventures are entities over which the Group exercises joint control. Investments in joint ventures are accounted for using the equity method of accounting. Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable net assets of the joint venture at the date of acquisition is recognised as goodwill and is included in the carrying value of the investment in the joint venture.

The carrying value of the Group's investment is adjusted for the Group's share of post-acquisition profits or losses recognised in the income statement and statement of comprehensive income. Losses of a joint venture in excess of the Group's interest are not recognised unless the Group has a legal or constructive obligation to fund those losses.

(m) Cash and cash deposits
Cash and cash deposits comprise cash in hand and short-term deposits held at banks. Bank overdrafts are shown within current borrowings.

(n) Derivatives and other financial instruments
The Group classifies its financial instruments in the following categories:

i) Loans and receivables
All loans and borrowings are initially recognised at fair value, net of transaction costs incurred. Following initial recognition interest-bearing loans and borrowings are subsequently stated at amortised cost using the effective interest method.

Gains and losses are recognised in the income statement when the instruments are derecognised or impaired. Premia, discounts and other costs and fees are recognised in the income statement through the amortisation process.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

The fair value of the liability component of a convertible bond is determined using the market interest rate for an equivalent non-convertible bond. This amount is recorded as a liability on an amortised cost basis using the effective interest method until extinguished on conversion or maturity of the bonds. The remainder of the proceeds are allocated to the conversion option. This is recognised in shareholders' equity.

2. Principal accounting policies continued

(n) Derivatives and other financial instruments continued

ii) Derivative financial instruments and hedging activities

The Group uses derivative financial instruments, principally interest rate swaps and foreign exchange forward contracts, to hedge risks associated with interest rate and exchange rate fluctuations. Derivative instruments are initially recognised at fair value on the date the derivative contract is entered into and subsequently remeasured at fair value for the reported balance sheet.

The Group designates certain hedging derivatives as either:

– a hedge of a highly probable forecast transaction or change in the cash flows of a recognised asset or liability (a cash flow hedge) or

– a hedge of the exposure to change in the fair value of a recognised asset or liability (a fair value hedge).

The gain or loss on remeasurement is taken to the income statement except for cash flow hedges which meet the conditions for hedge accounting, when the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised directly in equity, and the ineffective portion in the income statement. The gains or losses deferred in equity in this way are subsequently recognised in the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

In order to qualify for hedge accounting the Group is required to document in advance the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed at the end of each reporting period to ensure that the hedge remains highly effective.

The full fair value of a hedging derivative is classified as a non-current asset or liability when the remaining maturity of the hedged item is more than one year, and as a current asset or liability when the remaining maturity of the hedged item is less than one year.

Derivative financial instruments which do not qualify for hedge accounting are classified as a current asset or liability with any change in fair value recognised immediately in the income statement.

iii) Financial assets at fair value through profit

Financial assets at fair value through profit reflect the fair value movement of the hedged risk on a hedged item which has been designated in a fair value hedging relationship. The fair values of these financial assets are initially recognised on the date the hedging relationship is entered into and subsequently remeasured at each subsequent balance sheet date. The gain or loss on remeasurement for the period is recognised in the income statement.

iv) Trade receivables

Trade receivables do not carry any interest receivable and are recognised initially at fair value and subsequently at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due in accordance with the original terms of the receivables.

v) Trade payables

Trade payables are not interest-bearing and are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

(o) Taxation including deferred tax

The tax charge for the year is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date.

Deferred tax is provided in full using the liability method on temporary differences between the tax basis of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future for it to be utilised.

(p) Provisions

Provisions are made where there is a present legal or constructive obligation as a result of a past event and it is probable that there will be an outflow of economic benefits to settle this obligation and a reliable estimate of this amount can be made. Where the effect of the time value of money is material the current amount of a provision is the present value of the expenditures expected to be required to settle obligations. The unwinding of the discount to present value is included as a financial item within finance costs.

The Group's policies on provisions for specific areas are:

i) Landfill restoration costs

Provisions for the cost of restoring landfill sites are made when the obligation arises. Where the obligation recognised as a provision gives access to future economic benefits, an asset in property, plant and equipment is recognised. Provisions are otherwise charged against profits based on the usage of void space.

ii) Environmental control and aftercare costs

Environmental control and aftercare costs are incurred during the operational life of each landfill site and for a considerable period thereafter. Provision for all such costs is made over the operational life of the site and charged to the income statement on the basis of the usage of void space at the site.

iii) Restructuring costs

Provisions for restructuring costs are recognised when a detailed formal plan for the restructuring has been communicated to affected parties.

2. Principal accounting policies continued

(q) Share capital and treasury shares

Ordinary shares are classified as equity.

Where the Company purchases the Company's equity share capital (treasury shares) the consideration paid, including any directly attributable costs, is deducted from equity until the shares are cancelled or re-issued. Where such shares are subsequently re-issued any consideration received, net of any directly attributable transaction costs, is included in equity.

The Group balance sheet includes the shares held by the Pennon Employee Share Trust which have not vested at the balance sheet date. These are shown as a deduction from shareholders' equity until such time as they vest.

(r) Dividend distributions

Dividend distributions are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders. Interim dividends are recognised when paid; final dividends when approved by shareholders at the Annual General Meeting.

(s) Employee benefits

i) Retirement benefit obligations

The Group operates defined benefit and defined contribution pension schemes.

Defined benefit pension schemes

Defined benefit pension scheme assets are measured using bid price. Defined benefit pension scheme liabilities are measured by independent actuaries who advise on the selection of Directors' best estimates. The projected unit credit method is employed and liabilities discounted at the current rate of return on high quality corporate bonds of equivalent term to the liabilities. The increase in liabilities of the Group's defined benefit pension schemes expected to arise from employee service in the year is charged against operating profit.

The expected return on scheme assets and the increase during the year in the present value of scheme liabilities are included in other finance income or costs.

Changes in benefits granted by the employer are recognised immediately in income, in past service cost.

Actuarial gains and losses arising from experience items and changes in actuarial assumptions are charged or credited to equity in the statement of comprehensive income.

Defined contribution scheme

Costs of the defined contribution pension scheme are charged to the income statement in the period in which they arise.

ii) Share-based payment

The Group operates a number of equity-settled share-based payment plans for employees. The fair value of the employee services required in exchange for the grant is recognised as an expense over the vesting period of the grant.

Fair values are calculated using an appropriate pricing model. Non market-based vesting conditions are adjusted for in assumptions as to the number of shares which are expected to vest.

(t) Pre-contract and development costs

Pre-contract and development costs are expensed as incurred, except where it is probable that the contract will be awarded or the development completed, in which case they are recognised as an asset which is amortised to the income statement over the life of the contract.

(u) Fair values

The fair value of the interest rate swaps is based on the market price of comparable instruments at the balance sheet date if they are publicly traded.

The fair values of short-term deposits, loans and overdrafts with a maturity of less than one year are assumed to approximate to their book values. In the case of non-current bank loans and other loans the fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

(v) Service concession arrangements

Where the provision of waste management services is performed through a contract with a public sector entity which controls a significant residual interest in asset infrastructure at the end of the contract, then consideration is treated as contract receivables, split between the construction of assets, operation of the service and the provision of finance, which is recognised as interest receivable.

(w) Transfers of assets from customers

Where an item of property, plant and equipment that must be used to connect customers to the network is received from a customer, or where cash is received from a customer for the acquisition or construction of such an item, that asset is recorded and measured on initial recognition at its fair value. The credit created by the recognition of the asset is recognised in the income statement. The period over which the credit is recognised depends upon the nature of the service provided, as determined by the agreement with the customer. Where the service provided is solely a connection to the network, the credit is recognised at the point of connection. If the agreement does not specify a period, revenue is recognised over a period no longer than the economic life of the transferred asset used to provide the ongoing service.

(x) Foreign exchange

Transactions denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in a foreign currency are translated at the closing balance sheet rate. The resulting gain or loss is recognised in the income statement.

3. Financial risk management

(a) Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (interest rate risk), liquidity risk, credit risk and foreign currency risk. The Group's treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs, maintains reasonable headroom for contingencies and manages inflation and interest rate risk.

The principal financial risks faced by the Group relate to interest rate and counterparty credit risk.

These risks and treasury operations are managed by the Group Director of Finance in accordance with policies established by the Board. Major transactions are individually approved by the Board. Treasury activities are reported to the Board and are subject to review by internal audit.

Financial instruments are used to raise finance, manage risk and optimise the use of surplus funds. The Group does not engage in speculative activity.

i) Market risk

The Group has a policy of maintaining at least 50% of interest bearing liabilities at fixed rates. The Group uses a combination of fixed rate and index-linked borrowings and fixed rate interest swaps as cash flow hedges of future variable interest payments to achieve this policy. At the year end 53% of Group net borrowings were at fixed rates (including 50% of South West Water's borrowings fixed for the period to March 2015) and 19% index-linked after the impact of financial derivatives. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not therefore an exposure for the Group. These instruments are analysed in note 27.

The interest rate for index-linked debt is based upon an RPI measure which is also used in determining the amount of income from customers in South West Water.

The Group has no significant interest-bearing assets upon which the net return fluctuates from market risk. Deposit interest receivable is expected to fluctuate in line with interest payable on floating rate borrowings. Consequently the Group's income and operating cash flows are largely independent of changes in market interest rates.

For 2011 if interest rates on net borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year would have decreased/increased by £0.6 million (2010 £1.1 million).

For 2011 if RPI on index-linked borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year would have decreased/increased by £1.3 million (2010 £1.2 million).

ii) Liquidity risk

The Group actively maintains a mixture of long-term and short-term committed facilities which are designed to ensure the Group has significant available funds for operations and planned expansions equivalent to at least one year's forecast requirements at all times. Details of undrawn committed facilities and short-term facilities are provided in note 27.

Refinancing risk is managed under a Group policy that permits no more than 20% of Group net borrowings to mature in any financial year.

The Group and South West Water have entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on South West Water Limited's Regulatory Capital Value and Viridor Limited's EBITDA) and interest cover.

3. Financial risk management continued

(a) Financial risk factors continued

ii) Liquidity risk continued

Contractual undiscounted cash flows were:

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Over 5 years £m	Total £m
Group					
31 March 2011					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	72.6	266.6	314.8	1,095.6	1,749.6
Interest payments on borrowings	35.4	35.2	65.4	569.3	705.3
Finance lease liabilities	47.4	57.0	217.3	2,243.1	2,564.8
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	8.1	4.9	(1.9)	7.9	19.0
31 March 2010					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	197.3	31.7	425.2	949.6	1,603.8
Interest payments on borrowings	27.1	22.9	43.0	348.2	441.2
Finance lease liabilities	46.9	47.0	193.7	2,322.9	2,610.5
Derivative financial liabilities					
Derivative contracts – net payments	14.3	8.3	12.9	–	35.5
Company					
31 March 2011					
Non-derivative financial liabilities					
Borrowings	33.4	245.1	230.0	231.8	740.3
Interest payments on borrowings	19.2	17.5	10.7	12.0	59.4
31 March 2010					
Non-derivative financial liabilities					
Borrowings	70.6	10.6	351.9	99.8	532.9
Interest payments on borrowings	19.3	14.5	13.9	–	47.7

iii) Credit risk

Credit and counterparty risk arises from cash and cash deposits, derivative financial instruments and deposits with bank and financial institutions, as well as exposure to customers, including outstanding receivables. Further information on the credit risk relating to trade receivables is given in note 22.

Counterparty risk arises from the investment of surplus funds and from the use of derivative financial instruments. The Board has agreed a policy for managing such risk which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures. The Group has no other significant concentration of credit risk. The Group's surplus funds are managed by the Group's treasury function and are usually placed in short-term fixed interest deposits or the overnight money markets. Deposit counterparties must meet a credit rating threshold set by the Board of P1 (Moody's) or A1 (Standard and Poor's).

3. Financial risk management continued

(a) Financial risk factors continued

iv) Foreign currency risk

Foreign currency risk occurs at transactional and translation level from borrowings and transactions in foreign currencies. These risks are managed through cross-currency interest rate swaps and forward contracts which provide certainty over foreign currency risk.

(b) Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to minimise the cost of capital.

In order to maintain or adjust the capital structure the Group seeks to maintain a balance of returns to shareholders through dividends and an appropriate capital structure of debt and equity for each business segment and the Group.

The Group monitors capital on the basis of the gearing ratio. This ratio is calculated as net borrowings divided by total capital. Net borrowings are analysed in note 37 and calculated as total borrowings less cash and cash deposits. Total capital is calculated as total shareholders' equity plus net borrowings.

The gearing ratios at the balance sheet date were:

	2011 £m	2010 (Restated note 5) £m
Net borrowings (note 37)	**1,933.8**	1,895.3
Total shareholders' equity	**779.5**	662.9
Total capital	**2,713.3**	2,558.2
Gearing ratio	**71.3%**	74.1%

South West Water Limited is also monitored on the basis of the ratio of its net borrowings to Regulatory Capital Value. Ofwat's optimum range for gearing is 55% – 65%.

	2011 £m	2010 £m
Regulatory Capital Value	**2,703.5**	2,555.0
Net borrowings	**1,542.8**	1,547.2
Net borrowings/Regulatory Capital Value	**57.1%**	60.6%

The Group has entered into covenants with lenders, whilst terms vary, these typically provide for limits on gearing and interest cover. The Group has been in compliance with its covenants during the year.

(c) Determination of fair values

The Group uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2)
- inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The Group's financial instruments are valued using level 2 measures as analysed in note 23.

The fair value of financial instruments not traded in an active market (for example over-the-counter derivatives) is determined by using valuation techniques. A variety of methods and assumptions are used based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows.

The carrying values less impairment provision of trade receivables and payables are assumed to approximate to their fair values. The fair value of financial liabilities is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

4. Critical accounting judgements and estimates

The Group's principal accounting policies are set out in note 2. Management is required to exercise significant judgement and make use of estimates and assumptions in the application of these policies.

Areas which management believes require the most critical accounting judgements are:

Underlying earnings per share

Underlying earnings per share is presented to provide a more useful comparison of business trends and performance. The term underlying is not a defined term under IFRS, and may not be comparable with similarly-titled profit measurements reported by other companies. A reconciliation between underlying and the statutory measure is included in the Directors' report on page 20 and the analysis of earnings per share (note 11).

Environmental and landfill restoration provisions

Restoration and aftercare provisions are recognised in the financial statements at the net present value of the estimated future expenditure required to settle the Group's restoration and aftercare obligations. A discount is applied to recognise the time value of money and is unwound over the life of the provision. This is included in the income statement as a financial item within finance costs. As at 31 March 2011 the Group's environmental and landfill restoration provisions were £94.1 million (note 31).

Where a provision gives access to future economic benefits, an asset is recognised and depreciated in accordance with the Group's depreciation policy.

Retirement benefit obligations

The Group operates defined benefit pension schemes for which actuarial valuations are carried out as determined by the trustees at intervals of not more than three years.

The pension cost under IAS 19 is assessed in accordance with Directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on information supplied to the actuary, supplemented by discussions between the actuary and management. The principal assumptions used to measure schemes' liabilities, sensitivities to changes in those assumptions and future funding obligations are set out in note 29 of the financial statements.

Cash-generating units

For the purposes of assessing impairment of goodwill, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The waste management segment is considered to be a single cash-generating unit as it is an integrated business. The principal assumptions used to assess impairment are set in note 15 of the financial statements.

Taxation

The Group corporation tax provision of £79.4 million reflects the management's judgement of the amount of tax payable for fiscal years with open tax computations where liabilities remain to be agreed with HM Revenue & Customs. Management periodically evaluates items detailed in tax returns where the tax treatment is subject to interpretation. The Group establishes provisions on a full basis for individual tax items where, in the judgement of management, the tax position is uncertain.

Areas which management believes require the most critical accounting estimations are:

Service concession arrangements

Consideration from public sector entities for the operation of waste management service concessions is treated as contract receivables, split between profit on the construction of assets, operation of the service and provision of finance recognised as interest receivable. Management's allocation between these three elements is assessed according to prevailing external market conditions according to the type of service provided.

Site development costs

The development of waste management facilities for additional landfill capacity and new projects (such as Energy from Waste plants) are subject to obtaining planning permissions. Development costs are capitalised using management's assessment of the likelihood of a successful outcome for each project. To the extent that planning permission is not received any capitalised development costs would be expensed.

Landfill costs

The estimation of landfill reserves is of particular importance in assessing landfill costs, since the cost of a landfill site is depreciated over its estimated operational life taking into account the usage of void space and gas production at the site post-closure. The estimates of landfill reserves are regularly reviewed and updated during the financial year for usage and other events (for example site extensions). Estimates are also subject to physical review by external advisors.

A number of factors impact on the depreciation of landfill reserves including the available landfill space, future capital expenditure and operating costs. The assumptions are revised as these factors change.

The estimate of gas production at landfill sites post-closure reduces the depreciation of landfill reserves. An assessment is undertaken for individual sites of the historic profile of gas production during landfilling activity and the projected generation post-closure according to the type of waste contained in the landfill and expected profile of gas production over time.

4. Critical accounting judgements and estimates continued

Carrying value of property, plant and equipment

The Group's accounting policy for property, plant and equipment assets is set out in note 2. The carrying value of property, plant and equipment as at 31 March 2011 was £2,927.5 million. In the year ended 31 March 2011 additions totalled £199.0 million and the depreciation charge was £142.3 million. Estimated useful economic lives of property, plant and equipment are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of capital investment to the Group, variations between actual and estimated useful lives could impact operating results both positively and negatively. Asset lives and residual values are reviewed annually and historically changes to remaining estimates of useful lives have not been material.

Defined benefit pension schemes

Directors' best estimates are based upon an assessment, with advice from the schemes' actuaries, of key financial and demographic assumptions.

The rate used to discount schemes' liabilities reflects the market rate for long-term corporate bonds, adjusted for the projected duration of liabilities. Inflation is based upon the market rate observed at 31 March by reference to long-term index-linked bonds.

Mortality assumptions are set upon actuarial advice in accordance with published statistics using a 'medium cohort' basis adjusted for scheme-specific experience, together with an allowance for future longevity improvements.

A schedule showing the impact upon the schemes' liabilities of changes in the assumptions made is included in note 29 to these financial statements.

Revenue recognition

The Group recognises revenue at the time of delivery of services. Payments received in advance of services delivered are recorded as a liability.

South West Water raises bills and recognises revenue in accordance with its entitlement to receive revenue in line with the limits established by the Periodic Review price-setting process. For water and waste water customers with water meters, revenue recognised is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the financial year-end. Estimated usage is based on historic data, judgement and assumptions; actual results could differ from these estimates which would result in operating revenue being adjusted in the period in which the revision of the estimates is determined.

Provision for doubtful debts

At each balance sheet date each subsidiary evaluates the collectability of trade receivables and records provisions for doubtful debts based on experience including comparisons of the relative age of accounts and consideration of actual write-off history.

The actual level of debt collected may differ from the estimated levels of recovery and could impact future operating results positively or negatively. As at 31 March 2011 the Group's current trade receivables were £195.1 million, against which £58.2 million was provided for impairment.

Impairment of intangible assets

The Group records all assets and liabilities acquired in business acquisitions, including goodwill, at fair value. Intangible assets which have an indefinite useful life, principally goodwill, are assessed at least annually for impairment.

The initial goodwill recorded and subsequent impairment analysis require management to make estimations of future cash flows, terminal values and an assessment of the long-term pre-tax discount rate to be applied to those cash flows which reflects an assessment of the cost of capital of the cash-generating unit.

5. Prior year adjustments

Accounting policy for transfers of assets from customers

The application of IFRIC 18 'Transfers of assets from customers', effective from 1 July 2009, has required a restatement of amounts for the prior year. Where an item of property, plant and equipment is received from a customer or where cash is received from a customer for the acquisition or construction of such an item the asset is recorded and measured on initial recognition at fair value. Transactions with customers in the Group's water and sewerage business fall within the scope of IFRIC 18.

As a result of the above change in accounting policy and restatements of the fair values associated with the finalisation of accounting for prior year acquisitions, comparative figures have been restated:

	Year ended 31 March 2010		
	Previously reported £m	Application of IFRIC 18 £m	Restated now reported £m
Income statement			
Other operating expenses	(455.6)	2.0	(453.6)
Profit for the year	139.5	2.0	141.5

	31 March 2010			
	Previously reported £m	Acquisitions £m	Application of IFRIC 18 £m	Restated now reported £m
Balance sheet				
Non-current assets				
Goodwill	254.4	3.0	–	257.4
Property, plant and equipment	2,822.7	1.0	2.0	2,825.7
Current assets				
Trade and other receivables	194.9	(0.2)	–	194.7
Current liabilities				
Trade and other payables	(195.8)	(0.2)	–	(196.0)
Current tax	(83.6)	(0.2)	–	(83.8)
Provisions	(21.5)	(2.4)	–	(23.9)
Non-current liabilities				
Deferred tax	(311.2)	(1.0)	–	(312.2)
Shareholders' equity				
Retained earnings:				
Brought forward	321.1	–	–	321.1
Profit for the year	139.5	–	2.0	141.5
Carried forward	375.6	–	2.0	377.6
Cash flow statement				
Cash generated from operations				
Profit for the year	139.5	–	2.0	141.5
Cash flow from investing activities				
Purchase of property, plant and equipment	(195.2)	–	(2.0)	(197.2)

Acquisition restatements are set out by individual acquisition in note 38.

6. Operating segments

Operating segments are reported in a manner consistent with internal reporting provided to the Chief Operating Decision-Maker, which has been identified as the Pennon Group Plc Board.

The water and sewerage business comprises the regulated water and sewerage services undertaken by South West Water Limited. The waste management business is the waste treatment, recycling and renewable energy services provided by Viridor Limited. Segment assets include goodwill and other intangible assets, property, plant and equipment, inventories, trade and other receivables and cash and cash deposits. Segment liabilities comprise operating liabilities and exclude taxation. The other segment liabilities include the Company's financing of business acquisitions and Group taxation liabilities. Capital expenditure comprises additions to property, plant and equipment, including additions resulting from acquisitions through business combinations.

	2011 £m	2010 (Restated note 5) £m
Revenue		
Water and sewerage	**448.8**	444.2
Waste management	**712.0**	626.5
Other	**9.5**	8.5
Less intra-segment trading*	**(11.1)**	(10.3)
	1,159.2	1,068.9
Segment result		
Operating profit before depreciation and amortisation (EBITDA)		
Water and sewerage	**286.8**	287.1
Waste management	**116.5**	114.8
Other	**(0.7)**	(0.2)
	402.6	401.7
Operating profit		
Water and sewerage	**189.8**	193.5
Waste management	**71.6**	72.8
Other	**(0.5)**	–
	260.9	266.3
Profit before tax		
Water and sewerage	**128.9**	129.5
Waste management	**62.9**	55.1
Other	**(3.3)**	1.2
	188.5	185.8

* Intra-segment trading between and to other segments by the water and sewerage and waste management segments is under normal commercial terms and conditions that would also be available to unrelated third parties. Intra-segment revenue of the other segment is at cost

6. Operating segments continued

	Water and sewerage (Restated note 5) £m	Waste management (Restated note 5) £m	Other £m	Eliminations £m	Group (Restated note 5) £m
Balance sheet					
31 March 2011					
Assets (excluding investments in joint ventures)	**2,845.5**	**1,075.2**	**1,002.8**	**(789.3)**	**4,134.2**
Investments in joint ventures	**–**	**1.5**	**–**	**–**	**1.5**
Total assets	**2,845.5**	**1,076.7**	**1,002.8**	**(789.3)**	**4,135.7**
Liabilities	**(2,036.1)**	**(810.0)**	**(1,299.4)**	**789.3**	**(3,356.2)**
Net assets/(liabilities)	**809.4**	**266.7**	**(296.6)**	**–**	**779.5**
31 March 2010					
Assets (excluding investments in joint ventures)	2,753.2	1,022.6	901.1	(789.3)	3,887.6
Investments in joint ventures	–	0.2	–	–	0.2
Total assets	2,753.2	1,022.8	901.1	(789.3)	3,887.8
Liabilities	(1,985.8)	(781.0)	(1,247.4)	789.3	(3,224.9)
Net assets/(liabilities)	767.4	241.8	(346.3)	–	662.9

Segment liabilities of the water and sewerage and waste management segments comprise operating liabilities. The other segment liabilities include the Company's financing of business acquisitions before 1999 and Group taxation liabilities.

	Notes	Water and sewerage (Restated note 5) £m	Waste management £m	Other £m	Group (Restated note 5) £m
Other information					
31 March 2011					
Amortisation of other intangible assets	16	**–**	**0.7**	**–**	**0.7**
Capital expenditure (including acquisitions)		**125.1**	**98.8**	**0.2**	**224.1**
Depreciation		**97.0**	**44.2**	**(0.2)**	**141.0**
Finance income	8	**22.6**	**21.4**	**1.1**	**45.1**
Finance costs	8	**83.5**	**34.3**	**4.0**	**121.8**
31 March 2010					
Amortisation of other intangible assets	16	–	0.3	–	0.3
Capital expenditure (including acquisitions)		145.3	55.9	0.3	201.5
Depreciation		93.6	41.7	(0.2)	135.1
Finance income	8	18.1	12.2	4.1	34.4
Finance costs	8	82.2	31.0	2.8	116.0

Geographical segments
Separate disclosure by geographical segment is not shown since the operations of the Group are substantially located in the United Kingdom.

7. Operating costs

	Notes	2011 £m	2010 £m
Manpower costs	13	**148.3**	137.3
Raw materials and consumables		**121.6**	76.3
Other operating expenses include:			
Profit on disposal of property, plant and equipment		**(2.3)**	(3.6)
Operating lease rentals payable:			
– Plant and machinery		**7.4**	7.7
– Property		**6.1**	6.3
Research and development expenditure		**0.2**	0.2
Trade receivables impairment	22	**8.4**	7.9
Depreciation of property, plant and equipment:			
– Owned assets		**106.4**	98.8
– Under finance leases		**34.6**	36.3
Amortisation of other intangible assets	16	**0.7**	0.3

Fees payable to the Group's auditors in the year were:

	2011 £000	2010 £000
Fees payable to the Company's auditors for the statutory audit of the Group	**400**	407
Other services pursuant to legislation:		
Regulatory reporting	**30**	27
Interim review	**30**	30
Other audit services	**47**	46
	107	103
Total fees for statutory audit and audit related services	**507**	510
Tax services	**150**	199
Corporate finance transactions	**988**	1,346
Other services	**170**	31
	1,308	1,576
Total fees	**1,815**	2,086
Fees payable to the Company's auditors in respect of Pennon Group pension schemes:		
Audit	**26**	24

Fees payable to the Company's auditor for the statutory audit of the Group include fees payable for the statutory audit of the Company of £47,000 (2010 £47,000) and fees payable for the audit of the Company subsidiaries of £353,000 (2010 £360,000).

Expenses reimbursed to the auditors in relation to the audit of the Group were £35,000 (2010 £38,000).

Corporate finance services in 2011 included fees of circa £0.5 million relating to corporate finance advice on the Runcorn Phase II EfW project which has now commenced construction.

Corporate finance services in 2010 included fees of circa £1.2 million relating to the conclusion of the Financial Close of the Greater Manchester PFI contract.

A description of the work of the Audit Committee is set out in its report on pages 39 to 41 which includes an explanation of how auditor objectivity and independence are safeguarded when non-audit services are provided by the auditors' firm.

8. Net finance costs

	Notes	2011 £m	2010 £m
Finance income			
Interest receivable		**6.1**	6.1
Interest receivable on shareholder loans to joint ventures		**6.7**	3.1
Interest receivable on service concession arrangements		**2.9**	2.7
Expected return on defined benefit pension schemes' assets	29	**29.4**	22.5
		45.1	34.4

	Notes	2011 £m	2010 £m
Finance costs			
Bank borrowings and overdrafts		**(55.5)**	(41.6)
Interest element of finance lease rentals		**(30.6)**	(45.7)
Other finance costs		**(3.9)**	(2.2)
Interest cost on retirement benefit obligations	29	**(27.8)**	(24.8)
Unwinding of discounts in provisions	31	**(4.0)**	(3.8)
		(121.8)	(118.1)
Net gains on derivative instruments:			
On derivatives deemed held for trading		**–**	2.1
		(121.8)	(116.0)
Net finance costs		**(76.7)**	(81.6)

9. Taxation

	Notes	2011 £m	2010 £m
Analysis of charge in year			
UK corporation tax		**38.6**	43.0
Deferred tax – other		**3.4**	1.3
Deferred tax arising on change of rate of corporation tax		**(25.1)**	–
Total deferred tax	30	**(21.7)**	1.3
Tax charge for year		**16.9**	44.3

UK corporation tax is calculated at 28% (2010 28%) of the estimated assessable profit for the year.

The deferred tax credit for the year ended 31 March 2011 is due to a non-recurring credit of £25.1 million arising from a 2% reduction in the rate of corporation tax that was substantively enacted in law by 29 March 2011.

The tax for the year differs from the theoretical amount which would arise using the standard rate of corporation tax in the UK (28%) from:

	2011 £m	2010 (Restated note 5) £m
Profit before tax	**188.5**	185.8
Profit before tax multiplied by the standard rate of UK corporation tax of 28% (2010 28%)	**52.8**	52.0
Effects of:		
Expenses not deductible for tax purposes	**1.7**	0.8
Other	**(1.1)**	(3.5)
Change in rate of corporation tax	**(25.1)**	–
Adjustments to tax charge in respect of prior years	**(11.4)**	(5.0)
Tax charge for year	**16.9**	44.3

Credit adjustments to tax charge in respect of prior years include amounts released from the prior year current tax liability where a reassessment of a number of tax items indicates that a tax deduction is now certain.

The average applicable tax rate for the year was 9% (2010 24%).

In addition to the amount debited to the income statement, a deferred tax charge relating to actuarial gains on defined benefit pension schemes of £2.9 million (2010 credit of £12.4 million) and a deferred tax charge relating to losses on cash flow hedges of £0.4 million (2010 credit of £5.0 million), have been charged directly to equity. A deferred tax credit relating to share-based payments of £0.5 million (2010 £0.2 million) has been taken directly to equity.

10. Profit of parent company

	2011 £m	2010 £m
Profit attributable to equity shareholders dealt with in the accounts of the parent company	**90.1**	81.6

As permitted by Section 408 of the Companies Act 2006 no income statement or statement of comprehensive income is presented for the Company.

11. Earnings per share

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year, excluding those held in the employee share trust (note 35), which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to include all dilutive potential ordinary shares. The Group has two types of dilutive potential ordinary shares – those share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the year; and the contingently issuable shares under the Group's Performance and Co-investment Plan and the deferred shares element of the Annual Incentive Bonus Plan, to the extent that the performance criteria for vesting of the awards are expected to be met. The convertible bonds issued in August 2009 did not have a dilutive effect on earnings per share during the year.

The weighted average number of shares and earnings used in the calculations were:

	2011	2010
Number of shares (millions)		
For basic earnings per share	**354.6**	350.0
Effect of dilutive potential ordinary shares from share options	**2.0**	1.5
For diluted earnings per share	**356.6**	351.5

Underlying basic and diluted earnings per share

Underlying earnings per share are presented to provide a more useful comparison on business trends and performance. The term underlying is not a defined term under IFRS and may not be comparable with a similarly titled profit measure reported by other companies. Underlying earnings have been calculated:

	2011			2010 (Restated note 5)		
	Profit after tax £m	Basic p	Earnings per share Diluted p	Profit after tax £m	Basic p	Earnings per share Diluted p
Statutory earnings per share	**171.6**	**48.4**	**48.1**	141.5	40.4	40.3
Deferred tax (credit)/charge	**(21.7)**	**(6.1)**	**(6.1)**	1.3	0.4	0.4
Underlying earnings per share	**149.9**	**42.3**	**(42.0)**	142.8	40.8	40.7

12. Dividends

	2011 £m	2010 £m
Amounts recognised as distributions to equity holders in the year:		
Interim dividend paid for the year ended 31 March 2010: 6.95p (2009 6.75p) per share	**24.5**	23.6
Final dividend paid for the year ended 31 March 2010: 15.60p (2009 14.25p) per share	**55.1**	49.8
	79.6	73.4
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2011: 7.50p (2010 6.95p) per share	**26.8**	24.5
Proposed final dividend for the year ended 31 March 2011: 17.15p (2010 15.60p) per share	**61.4**	55.1
	88.2	79.6

The proposed interim and final dividends have not been included as liabilities in these financial statements.

The proposed interim dividend for 2011 was paid on 1 April 2011 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting.

13. Employment costs

	2011 £m	2010 £m
Wages and salaries	**122.7**	117.4
Social security costs	**11.4**	10.6
Pension costs	**20.5**	15.9
Share-based payments	**3.4**	2.8
Total employment costs	**158.0**	146.7
Charged:		
Manpower costs	**148.3**	137.3
Capital schemes	**9.7**	9.4
Total employment costs	**158.0**	146.7

Details of Directors' emoluments are set out in note 14. There are no personnel, other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Group.

	2011	2010
Employees (average number)		
The average monthly number of employees (including Executive Directors) was:		
Water and sewerage	**1,196**	1,191
Waste management	**3,012**	2,853
Other	**44**	43
Group totals	**4,252**	4,087

The total number of employees at 31 March 2011 was 4,354 (2010 4,089).

14. Directors' emoluments

	2011 £m	2010 £m
Executive Directors:		
Salary	**1,035**	975
Performance-related bonus paid or payable	**490**	458
Share-based payments	**984**	847
Other emoluments	**70**	65
Payment in lieu of pension provision	**114**	95
Non-executive Directors	**412**	399
	3,105	2,839

The cost of share-based payment represents the amount charged to the income statement, as described in note 32.

The aggregate gains on vesting of Directors' share-based awards amounted to a total of £677,000 (2010 £378,000).

Total gains made by Directors on the exercise of share options were nil (2010 £3,000).

Total emoluments include £1,418,000 (2010 £1,301,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2011 retirement benefits were accruing to one Director under defined benefit pension schemes (2010 two). The accrued pension entitlement at 31 March 2011 under defined benefit schemes of the highest paid Director was nil (2010 £146,000).

No pension contributions were payable to defined contribution schemes but two Directors received payments in lieu of pension provision (2010 one).

More detailed information concerning Directors' emoluments (including pensions and the highest paid Director) and share interests is shown in the Directors' Remuneration Report on pages 45 to 56.

15. Goodwill

	(Restated note 5) £m
Cost:	
At 1 April 2009	236.5
Recognised on acquisition of subsidiaries	21.5
Disposals	(0.6)
At 31 March 2010	257.4
Recognised on acquisition of subsidiaries (note 38)	35.0
At 31 March 2011	292.4
Carrying amount:	
At 31 March 2010	257.4
At 31 March 2011	**292.4**

Goodwill acquired in a business combination is allocated at acquisition to the cash-generating unit (CGU) expected to benefit from that business combination. All of the carrying amount of goodwill is allocated to the waste management segment which is considered to be a single CGU, as it is an integrated business.

Goodwill is reviewed annually or when other events or changes in circumstance indicate that the carrying amount may not be fully recoverable.

The recoverable amount of the waste management segment is determined from value in use calculations. These estimates and assumptions are based on long-term market trends, market data, anticipated regulatory developments and management experience and expectations. Discount rates, cash flows and price increases are the key assumptions used in our plans. Cash flow projections are based on approved budgets and plans for the next five years based on growth rates and margins achieved historically and expectations for market development. Beyond this period long-term growth rates for the waste sector are based on UK Gross Domestic Product. The cash flows have been discounted using a pre-tax discount rate of 11.7% (2010 12.5%) which reflects the overall business risks associated with the waste management segment activities.

16. Other intangible assets

	Customer contracts £m	Patents £m	Total £m
Acquired intangible assets			
Cost:			
At 1 April 2009	12.5	0.2	12.7
At 31 March 2010	12.5	0.2	12.7
At 31 March 2011	12.5	0.2	12.7
Accumulated amortisation:			
At 1 April 2009	7.3	–	7.3
Charge for year	0.3	–	0.3
At 31 March 2010	7.6	–	7.6
Charge for year	0.7	–	0.7
At 31 March 2011	8.3	–	8.3
Carrying amount:			
At 31 March 2010	4.9	0.2	5.1
At 31 March 2011	**4.2**	**0.2**	**4.4**

Customer contracts are amortised over the useful economic life of each contract which at acquisition ranged between two and 15 years. The average remaining life is three years.

Patents are amortised over their estimated useful economic lives which at acquisition was 13 years. The average remaining life is seven years.

The carrying values of other intangible assets are reviewed annually or when events or changes in circumstance indicate that the carrying amounts may not be fully recoverable.

17. Property, plant and equipment

	Land and buildings (Restated note 5) £m	Infrastructure assets (Restated note 5) £m	Operational properties £m	Fixed and mobile plant, vehicles and computers (Restated note 5) £m	Landfill restoration £m	Construction in progress £m	Total (Restated note 5) £m
Group							
Cost:							
At 1 April 2009	386.1	1,345.9	597.7	1,197.7	46.1	147.6	3,721.1
Arising on acquisitions	9.5	–	–	13.7	–	–	23.2
Additions	20.7	38.0	0.8	33.3	–	99.4	192.2
Other (note 31)	–	–	–	–	2.6	–	2.6
Grants and contributions	–	(0.4)	–	–	–	–	(0.4)
Disposals	–	(0.7)	(0.2)	(19.8)	–	–	(20.7)
Transfers/reclassifications	1.9	36.3	8.1	97.5	–	(143.8)	–
At 31 March 2010	418.2	1,419.1	606.4	1,322.4	48.7	103.2	3,918.0
Arising on acquisitions	10.4	–	–	11.7	–	–	22.1
Additions	15.5	17.8	0.3	29.2	–	136.2	199.0
Assets adopted at fair value	–	12.4	0.6	1.7	–	–	14.7
Other (note 31)	–	–	–	–	4.7	–	4.7
Grants and contributions	–	(1.2)	–	–	–	–	(1.2)
Disposals	(1.2)	(1.8)	(4.4)	(59.3)	–	–	(66.7)
Transfers/reclassifications	0.9	21.6	11.3	66.3	–	(92.9)	7.2
At 31 March 2011	443.8	1,467.9	614.2	1,372.0	53.4	146.5	4,097.8
Accumulated depreciation:							
At 1 April 2009	156.7	73.4	153.1	579.5	12.6	–	975.3
Charge for year	15.8	20.5	10.9	86.9	2.4	–	136.5
Disposals	–	(0.7)	(0.2)	(18.6)	–	–	(19.5)
At 31 March 2010	172.5	93.2	163.8	647.8	15.0	–	1,092.3
Charge for year	16.3	21.5	10.8	90.9	2.8	–	142.3
Disposals	–	(1.8)	(4.4)	(58.1)	–	–	(64.3)
At 31 March 2011	188.8	112.9	170.2	680.6	17.8	–	1,170.3
Net book value:							
At 1 April 2009	229.4	1,272.5	444.6	618.2	33.5	147.6	2,745.8
At 31 March 2010	245.7	1,325.9	442.6	674.6	33.7	103.2	2,825.7
At 31 March 2011	**255.0**	**1,355.0**	**444.0**	**691.4**	**35.6**	**146.5**	**2,927.5**

Of the total depreciation charge of £142.3 million (2010 £136.5 million), £1.3 million (2010 £1.4 million) has been charged to capital projects and £141.0 million (2010 £135.1 million) against profits.

Asset lives and residual values are reviewed annually.

Asset transfers/reclassifications include assets transferred from other non-current assets of £7.2 million (2010 nil).

17. Property, plant and equipment continued

Assets held under finance leases included above were:

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Landfill restoration £m	Construction in progress £m	Total £m
Cost:							
At 31 March 2010	–	355.0	459.9	322.8	–	8.1	1,145.8
At 31 March 2011	–	357.0	465.0	312.3	–	0.5	1,134.8
Accumulated depreciation:							
At 31 March 2010	–	20.6	81.4	165.3	–	–	267.3
At 31 March 2011	–	26.0	89.2	175.9	–	–	291.1
Net book amount:							
At 31 March 2010	–	334.4	378.5	157.5	–	8.1	878.5
At 31 March 2011	**–**	**331.0**	**375.8**	**136.4**	**–**	**0.5**	**843.7**

	Fixed and mobile plant, vehicles and computers £m
Company	
Cost:	
At 1 April 2009	0.3
Additions	0.1
At 31 March 2010	0.4
Additions	0.2
Disposals	(0.2)
At 31 March 2011	0.4
Accumulated depreciation:	
At 1 April 2009	0.1
Charge for year	0.1
At 31 March 2010	0.2
Charge for year	0.1
Disposals	(0.2)
At 31 March 2011	0.1
Net book value:	
At 1 April 2009	0.2
At 31 March 2010	0.2
At 31 March 2011	**0.3**

Asset lives and residual values are reviewed annually.

18. Financial instruments by category

The accounting policies for financial instruments have been applied to the line items:

		Fair value			Amortised cost		
	Notes	Derivatives used for fair value hedging £m	Derivatives used for cash flow hedging £m	Derivatives deemed held for trading £m	Loans and receivables £m	Trade receivables and trade payables (Restated note 5) £m	Total £m
Group							
31 March 2011							
Financial assets							
Trade receivables	22	–	–	–	–	136.9	136.9
Derivative financial instruments	23	–	6.9	–	–	–	6.9
Cash and cash deposits	24	–	–	–	555.5	–	555.5
Total		–	6.9	–	555.5	136.9	699.3
Financial liabilities							
Borrowings	27	–	–	–	(2,489.3)	–	(2,489.3)
Derivative financial instruments	23	(3.5)	(18.1)	–	–	–	(21.6)
Trade payables	25	–	–	–	–	(92.7)	(92.7)
Total		(3.5)	(18.1)	–	(2,489.3)	(92.7)	(2,603.6)
31 March 2010							
Financial assets							
Trade receivables	22	–	–	–	–	123.7	123.7
Derivative financial instruments	23	–	3.4	–	–	–	3.4
Cash and cash deposits	24	–	–	–	493.9	–	493.9
Total		–	3.4	–	493.9	123.7	620.9
Financial liabilities							
Borrowings	27	–	–	–	(2,389.2)	–	(2,389.2)
Derivative financial instruments	23	–	(17.6)	(0.1)	–	–	(17.7)
Trade payables	25	–	–	–	–	(82.3)	(82.3)
Total		–	(17.6)	(0.1)	(2,389.2)	(82.3)	(2,489.2)
Company							
31 March 2011							
Financial assets							
Derivative financial instruments	23	–	6.6	–	–	–	6.6
Cash and cash deposits	24	–	–	–	236.6	–	236.6
Total		–	6.6		236.6		243.2
Financial liabilities							
Borrowings	27	–	–	–	(889.0)	–	(889.0)
Trade payables	25	–	–	–	–	(0.1)	(0.1)
Total		–	–	–	(889.0)	(0.1)	(889.1)
31 March 2010							
Financial assets							
Derivative financial instruments	23	–	3.4	–	–	–	3.4
Cash and cash deposits	24	–	–	–	174.6	–	174.6
Total		–	3.4	–	174.6	–	178.0
Financial liabilities							
Borrowings	27	–	–	–	(814.0)	–	(814.0)
Trade payables	25	–	–	–	–	(0.2)	(0.2)
Total		–	–	–	(814.0)	(0.2)	(814.2)

19. Other non-current assets

Non-current receivables

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Amounts owed by subsidiary undertakings	**–**	–	**366.8**	337.5
Amounts owed by related parties (note 43)	**56.6**	45.9	**–**	–
Other receivables	**59.4**	55.1	**0.9**	1.0
	116.0	101.0	**367.7**	338.5

Non-current receivables were due:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Between 1 and 2 years	**20.0**	16.6	**90.6**	83.8
Between 2 and 5 years	**5.9**	6.2	**277.1**	254.7
Over 5 years	**90.1**	78.2	**–**	–
	116.0	101.0	**367.7**	338.5

The fair values of non-current receivables were:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Amounts owed by subsidiary undertakings	**–**	–	**372.8**	336.9
Amounts owed by related parties	**126.7**	90.9	**–**	–
Other receivables	**59.4**	55.1	**1.0**	1.0
	186.1	146.0	**373.8**	337.9

The fair value of amounts owed by related parties is based on cash flows using a rate based on the borrowings rate of 2.5% (2010 2.5%).

The discount rate is equal to London Interbank Offered Rate plus an allowance to reflect an appropriate credit margin.

The effective interest rate on amounts owed by related parties was 14.0% (2010 11.3%).

Other receivables and prepayments include site development and pre-contract costs of £17.6 million (2010 £15.6 million).

20. Investments

Subsidiary undertakings

	£m
Company	
At 1 April 2009	944.8
Additions	87.2
At 31 March 2010	1,032.0
At 31 March 2011	**1,032.0**

Joint ventures

	Shares £m
Group	
At 1 April 2009	2.2
Additions	0.1
Share of profit	1.1
Share of other comprehensive loss	(3.2)
At 31 March 2010	0.2
Share of profit	4.3
Share of other comprehensive loss	(3.0)
At 31 March 2011	**1.5**

Details of the Group's principal subsidiary and joint venture undertakings are set out in note 39.

The Group's share of the results, assets and liabilities in its joint ventures, which are equity accounted in these financial statements, is:

	Assets		Liabilities		Income		
	Non–current £m	Current £m	Non-current £m	Current £m	Revenues £m	Profit £m	Other comprehensive income £m
2011							
Lakeside Energy from Waste Holdings Limited	**82.0**	**9.5**	**(87.8)**	**(2.2)**	**21.6**	**3.6**	**(2.3)**
Viridor Laing (Greater Manchester) Limited	**15.1**	**176.8**	**(146.1)**	**(45.8)**	**61.7**	**0.7**	**(0.7)**
2010							
Lakeside Energy from Waste Holdings Limited	84.2	2.6	(86.3)	(0.3)	14.4	1.0	(3.1)
Viridor Laing (Greater Manchester) Limited	16.0	81.0	(90.0)	(7.0)	44.0	0.1	(0.1)

21. Inventories

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Raw materials and consumables	**7.4**	6.4	**–**	–

22. Trade and other receivables – current

	Group		Company	
	2011 £m	2010 (Restated note 5) £m	**2011 £m**	2010 £m
Trade receivables	**195.1**	174.3	**–**	–
Less: provision for impairment of receivables	**(58.2)**	(50.6)	**–**	–
Net trade receivables	**136.9**	123.7	**–**	–
Amounts owed by related parties (note 43)	**8.8**	–	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**91.7**	84.2
Other receivables	**8.5**	8.1	**0.8**	0.3
Prepayments and accrued income	**66.4**	62.9	**0.2**	–
	220.6	194.7	**92.7**	84.5

The Directors consider that the carrying amounts of trade and other receivables approximate to their fair value.

There is no concentration of credit risk in trade receivables. The Group has a large number of customers who are dispersed and there is no significant loss on trade receivables expected that has not been provided for. The Group has created IAS 39 portfolio provisions, but cannot practicably identify which receivables specifically are the ones impaired. It is Group policy to consider a receivable in a portfolio to which an impairment has been allocated on a collective basis as not being impaired for the purposes of IFRS 7 disclosures until the loss can be specifically identified with the receivable.

The ageing of trade receivables which are past due but not specifically impaired was:

	2011 £m	2010 £m
Group		
Past due 1 – 30 days	**36.1**	27.4
Past due 31 – 120 days	**11.9**	10.3
More than 120 days	**84.5**	71.7

The Group's two principal operating businesses specifically review separate categories of debt to identify an appropriate provision for impairment. South West Water Limited has a duty under legislation to continue to provide domestic customers with services regardless of payment.

The movement in the allowance for impairment in respect of trade receivables was:

	2011 £m	2010 £m
At 1 April	**50.6**	43.1
Provision for receivables impairment	**8.4**	7.9
Receivables written-off during the year as uncollectible	**(8.3)**	(6.9)
Cumulative amounts previously excluded from debt	**7.3**	6.5
Arising on acquisitions	**0.2**	–
At 31 March	**58.2**	50.6

Other receivables and prepayments include site development and pre-contract costs of nil (2010 £4.0 million).

23. Derivative financial instruments

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Derivatives used for cash flow hedging				
Current assets	**6.9**	3.4	**6.6**	3.4
Current liabilities	**(4.4)**	(3.5)	**–**	–
Non-current liabilities	**(13.7)**	(14.1)	**–**	–
Derivatives used for fair value hedging				
Current liabilities	**(0.9)**	–	**–**	–
Non-current liabilities	**(2.6)**	–	**–**	–
Derivatives deemed held for trading				
Current liabilities	**–**	(0.1)	**–**	–

The fair value of hedging derivatives is split between current and non-current assets or liabilities based on the maturity of the cash flows.

The ineffective portion recognised in the income statement arising from cash flow hedges was nil (2010 nil).

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50% of Group net borrowings are at fixed rate. At 31 March 2011 53% of Group net borrowings were at fixed rate (2010 65%).

At 31 March 2011 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £605.0 million and a weighted average maturity of 4.0 years (2010 £775.0 million, with 4.4 years). The weighted average interest rate of the swaps for their nominal amount was 3.2% (2010 4.0%).

At 31 March 2011 the Company had cross-currency interest rate swaps to swap from floating to fixed rate and hedge financial liabilities, relating to a borrowing in the year of 70 million Australian Dollars, with a weighted average maturity of 2.0 years (2010 70 million Australian Dollars, with 3.0 years). The weighted average interest rate of the swaps was 3.7% (2010 3.7%).

Derivatives held for trading related to interest rate swaps at 31 March 2010 which no longer qualified for hedge accounting.

The amounts above are the fair value of swaps based on the market value of equivalent instruments at the balance sheet date.

Valuation hierarchy
The amounts of financial instruments carried at fair value by valuation method were:

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Assets				
Derivatives used for cash flow hedging	**6.9**	3.4	**6.6**	3.4
Total assets	**6.9**	3.4	**6.6**	3.4
Liabilities				
Derivatives used for cash flow hedging	**18.1**	17.6	**–**	–
Derivatives used for fair value hedging	**3.5**	–	**–**	–
Derivatives deemed held for trading	**–**	0.1	**–**	–
Total liabilities	**21.6**	17.7	**–**	–

The amounts above are the fair value of financial instruments using level 2 – Inputs that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

24. Cash and cash deposits

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Cash at bank and in hand	**15.9**	9.2	**39.3**	11.8
Short-term bank deposits	**121.8**	232.8	**95.8**	151.4
Other deposits	**417.8**	251.9	**101.5**	11.4
Total cash and cash deposits (note 37)	**555.5**	493.9	**236.6**	174.6

Group short-term deposits have an average maturity of one day.

Group other deposits have an average maturity of 68 days.

Group other deposits include restricted funds of £80.2 million (2010 £33.5 million) to settle long-term lease liabilities (note 27) and £40.0 million (2010 £56.3 million) relating to letters of credit.

For the purposes of the cash flow statement cash and cash equivalents comprise:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Cash and cash deposits as above	**555.5**	493.9	**236.6**	174.6
Bank overdrafts (note 27)	**(18.1)**	(12.7)	**–**	–
	537.4	481.2	**236.6**	174.6
Less: deposits with a maturity of three months or more (restricted funds)	**(122.5)**	(91.7)	**(1.4)**	(1.4)
	414.9	389.5	**235.2**	173.2

25. Trade and other payables – current

	Group		Company	
	2011 £m	2010 (Restated note 5) £m	**2011 £m**	2010 £m
Trade payables	**92.7**	82.3	**0.1**	0.2
Amounts owed to subsidiary undertakings	**–**	–	**6.4**	7.6
Amounts owed to joint venture (note 43)	**8.5**	5.0	**–**	5.0
Other tax and social security	**53.0**	49.3	**0.3**	0.2
Accruals and other payables	**104.7**	59.4	**4.3**	4.3
	258.9	196.0	**11.1**	17.3

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

Included in accruals and other payables are amounts provided by the Group in relation to claims received, which are considered by the Directors and the management of the Group to be the best estimate of the amounts that might be finally settled.

26. Current tax liabilities/(recoverable)

	Group		Company	
	2011 £m	2010 (Restated note 5) £m	**2011 £m**	2010 £m
UK corporation tax	**79.4**	83.8	**(1.7)**	(1.3)

27. Borrowings

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Current				
Bank overdrafts	**18.1**	12.7	**–**	–
Short-term loans	**35.3**	170.0	**34.9**	70.0
European Investment Bank	**21.1**	14.1	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**281.2**	281.2
	74.5	196.8	**316.1**	351.2
Obligations under finance leases	**24.7**	32.2	**–**	–
Total current borrowings (note 37)	**99.2**	229.0	**316.1**	351.2
Non-current				
Bank and other loans	**833.4**	568.9	**457.9**	350.2
Convertible bond	**115.0**	112.6	**115.0**	112.6
European Investment Bank	**252.5**	273.6	**–**	–
	1,200.9	955.1	**572.9**	462.8
Obligations under finance leases	**1,189.2**	1,205.1	**–**	–
Total non-current borrowings (note 37)	**2,390.1**	2,160.2	**572.9**	462.8
Total borrowings	**2,489.3**	2,389.2	**889.0**	814.0

Bank overdrafts at the balance sheet date arise from the timing of the payment of unpresented cheques.

The Company issued £125 million 4.625% convertible bonds in August 2009. The bonds mature five years from the issue date at their nominal value of £125 million or can be converted into shares, at the holders' option, at the maturity date at the conversion price of 597.81 pence per ordinary share.

The values of the liability component and the equity conversion component was determined at issuance of the bond. The value of the equity conversion component was determined to be £10 million, using the Black-Scholes valuation model, and has been recognised in shareholders' equity in retained earnings (note 35).

The fair values of non-current borrowings were:

	2011		2010	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Group				
Bank and other loans	**833.4**	**784.7**	568.9	533.3
Convertible bond	**115.0**	**161.8**	112.6	127.6
European Investment Bank	**252.5**	**219.5**	273.6	235.5
	1,200.9	**1,166.0**	955.1	896.4
Obligations under finance leases	**1,189.2**	**962.7**	1,205.1	967.7
	2,390.1	**2,128.7**	2,160.2	1,864.1
Company				
Bank and other loans	**457.9**	**440.7**	350.2	343.5
Convertible bond	**115.0**	**161.8**	112.6	127.6
	572.9	**602.5**	462.8	471.1

Where market values are not available, fair values of borrowings have been calculated by discounting expected future cash flows at prevailing interest rates.

27. Borrowings continued

The maturity of non-current borrowings was:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Between 1 and 2 years	**291.8**	55.0	**243.9**	10.0
Between 2 and 5 years	**418.7**	516.2	**229.1**	352.9
Over 5 years	**1,679.6**	1,589.0	**99.9**	99.9
	2,390.1	2,160.2	**572.9**	462.8

The weighted average maturity of non-current borrowings was 22 years (2010 22 years).

Finance lease liabilities – minimum lease payments:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Within one year	**47.9**	47.9	**–**	–
In the second to fifth years inclusive	**272.0**	242.6	**–**	–
After five years	**2,239.2**	2,323.2	**–**	–
	2,559.1	2,613.7	**–**	–
Less: future finance charges	**(1,345.2)**	(1,376.4)	**–**	–
	1,213.9	1,237.3	**–**	–

Finance lease liabilities – present value of minimum lease payments:	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Within one year	**47.9**	47.9	**–**	–
In the second to fifth years inclusive	**245.5**	218.4	**–**	–
After five years	**1,010.4**	1,038.4	**–**	–
	1,303.8	1,304.7	**–**	–

Included above are accrued finance charges arising on obligations under finance leases totalling £130.8 million (2010 £135.3 million), of which £6.4 million (2010 £11.9 million) is repayable within one year.

Within obligations under finance leases, South West Water Limited has utilised finance lease facilities of £180.0 million for certain water and sewerage business property, plant and equipment which are secured by bank letters of credit issued by United Kingdom financial institutions. These letters of credit, covering the full period of the finance leases, are renewable between the financial institutions and South West Water Limited at five-yearly intervals, the next being March 2016.

During 2007 the period for repayment of these leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £32.4 million at 31 March 2011 (2010 £24.1 million) are being held to settle the lease liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

During 2010 the period for repayment of certain existing leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £47.8 million at 31 March 2011 (2010 £9.4 million) are being held to settle the lease liability at the end of the lease term, subject to rights to release by negotiation with the lessor.

27. Borrowings continued

The effective interest rates at the balance sheet date and the exposure to interest rate changes and the repricing dates were:

	Effective rate %	6 months or less £m	6–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Group						
31 March 2011						
Bank overdrafts	1.5	18.1	–	–	–	18.1
European Investment Bank	1.2	273.6	–	–	–	273.6
Bank and other loans	3.9	469.2	228.7	153.6	132.2	983.7
Finance leases	1.9	558.5	447.5	116.9	91.0	1,213.9
		1,319.4	676.2	270.5	223.2	2,489.3
Effect of swaps	3.2	(793.8)	–	593.8	200.0	–
		525.6	676.2	864.3	423.2	2,489.3
31 March 2010						
Bank overdrafts	1.5	12.7	–	–	–	12.7
European Investment Bank	1.0	287.7	–	–	–	287.7
Bank and other loans	3.9	381.7	218.7	251.0	–	851.4
Finance leases	2.9	246.4	700.9	198.9	91.2	1,237.4
		928.5	919.6	449.9	91.2	2,389.2
Effect of swaps	4.0	(813.8)	255.0	508.8	50.0	–
		114.7	1,174.6	958.7	141.2	2,389.2
Company						
31 March 2011						
Bank and other loans	3.2	454.2	–	153.6	–	607.8
Effect of swaps	3.7	(38.8)	–	38.8	–	–
		415.4	–	192.4	–	607.8
31 March 2010						
Bank and other loans	2.3	281.7	–	251.0	–	532.7
Effect of swaps	3.7	(38.8)	–	38.8	–	–
		242.9	–	289.9	–	532.7

Undrawn committed borrowing facilities at the balance sheet date:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Floating rate:				
Expiring within one year	**50.0**	25.0	**–**	25.0
Expiring after one year	**160.0**	175.0	**90.0**	65.0
	210.0	200.0	**90.0**	90.0

In addition the Group has, at 31 March 2011, bank facilities of 100.0 million US Dollars (2010 nil) available to the Company and also has undrawn uncommitted short-term bank facilities of £60.0 million (2010 £60.0 million) available to the Company or South West Water Limited.

28. Other non-current liabilities

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Amounts owed to subsidiary undertakings	**–**	–	**8.7**	8.7
Other payables	**30.4**	16.0	**–**	–
	30.4	16.0	**8.7**	8.7

29. Retirement benefit obligations

The Group operates a number of defined benefit pension schemes and also a defined contribution section within the main scheme.

The assets of the Group's pension schemes are held in separate trustee administered funds. The trustees of the funds are required to act in the best interest of the funds' beneficiaries. The appointment of schemes' trustees is determined by the schemes' trust documentation. The Group has a policy for the main fund that one-half of all trustees, other than the Chairman, are nominated by members of the schemes, including pensioners.

Defined contribution schemes

Pension costs for defined contribution schemes were £2.8 million (2010 £2.4 million).

Defined benefit schemes

Assumptions

The principal actuarial assumptions at 31 March were:

	2011 %	2010 %
Expected return on scheme assets	7.3	7.3
Rate of increase in pensionable pay	3.9	4.1
Rate of increase for current and future pensions	3.4	3.6
Rate used to discount schemes' liabilities	5.5	5.5
Inflation	3.4	3.6

Mortality

Assumptions regarding future mortality experience are set based on actuarial advice in accordance with published statistics and experience. The mortality assumption uses a scheme-specific 'medium cohort' basis with an allowance for future longevity improvement.

The average life expectancy in years of a member having retired at age 62 on the balance sheet date is projected at:

	2011	2010
Male	24.9	22.0
Female	26.9	25.4

The average life expectancy in years of a future pensioner retiring at age 62, 20 years after the balance sheet date, is projected at:

	2011	2010
Male	25.7	23.4
Female	28.2	26.6

The sensitivities regarding the principal assumptions used to measure the schemes' liabilities are:

	Change in assumption	Impact on schemes' liabilities
Rate of increase in pensionable pay	+/– 0.5%	+/– 1.3%
Rate of increase in current and future pensions	+/– 0.5%	+/– 6.1%
Rate used to discount schemes' liabilities	+/– 0.5%	+/– 8.6%
Inflation	+/– 0.5%	+/– 7.8%
Life expectancy	+/– 1 year	+/– 3.1%

29. Retirement benefit obligations continued

The amounts recognised in the income statement were:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Current service cost	**(15.0)**	(10.5)	**(1.0)**	(0.8)
Past service cost	**(2.7)**	(1.1)	**–**	–
Total included in employment costs	**(17.7)**	(11.6)	**(1.0)**	(0.8)
Expected return on pension schemes' assets	**29.4**	22.5	**2.7**	2.2
Interest cost on retirement benefit obligations	**(27.8)**	(24.8)	**(2.7)**	(2.6)
Total included within net finance costs	**1.6**	(2.3)	**–**	(0.4)
Total charge	**(16.1)**	(13.9)	**(1.0)**	(1.2)

The actual return on schemes' assets was a profit of £34.7 million (2010 profit of £88.2 million).

The amounts recognised in the statement of comprehensive income were:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Actuarial gains/(losses) recognised in the year	**2.4**	(44.4)	**3.3**	(4.3)

The amounts recognised in the balance sheet were:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Fair value of schemes' assets	**454.2**	402.4	**30.7**	37.3
Present value of defined benefit obligations	**(540.0)**	(510.3)	**(37.5)**	(49.0)
Net liability recognised in the balance sheet	**(85.8)**	(107.9)	**(6.8)**	(11.7)

The schemes' assets and the expected long-term rates of return at the year-end were:

	2011			2010		
	Expected return %	**Value £m**	**Fund %**	Expected return %	Value £m	Fund %
Equities	**8.5**	**262.0**	**58**	8.5	244.5	61
Property	**8.2**	**18.6**	**4**	9.0	23.3	6
Bonds	**4.8**	**133.4**	**29**	5.0	125.8	31
Other	**4.4**	**40.2**	**9**	4.5	8.8	2
		454.2	**100**		402.4	100

Other assets principally represent cash contributions received from the Group towards the year-end which are invested during the subsequent financial year.

29. Retirement benefit obligations continued

The Company's share of the schemes' assets at the balance sheet date were:

	2011 £m	2010 £m
Equities	**17.6**	22.9
Property	**1.3**	2.3
Bonds	**9.0**	11.8
Other	**2.8**	0.3
	30.7	37.3

The expected return on schemes' assets is determined by considering the long-term returns and the balance between risk and reward on the various categories of investment assets held. Expected returns on equity and property investments reflect long-term rates of return experienced in the respective markets. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date.

In conjunction with its investment advisers, the trustees have structured the schemes' investments with the objective of balancing investment returns and levels of risk. The asset allocation for the main scheme has three principal elements:

- holding of bonds which is expected to be less volatile than most other asset classes and reflects the schemes' liabilities
- a proportion of equities, with fund managers having freedom in making investment decisions to maximise returns
- investment of a relatively small proportion of the schemes' assets (circa 10%) in alternative asset classes which give the potential for diversification (currently property).

The liabilities of the defined benefit schemes are measured by using the projected unit credit method which is an accrued benefits valuation method in which the scheme liabilities make allowance for projected earnings.

Movements in the net liability were:

	Group		Company	
	2011 £m	2010 £m	2011 £m	2010 £m
At 1 April	**(107.9)**	(66.0)	**(11.7)**	(7.3)
Income statement	**(16.1)**	(13.9)	**(1.0)**	(1.2)
Statement of comprehensive income	**2.4**	(44.4)	**3.3**	(4.3)
Employer contributions	**35.8**	16.4	**2.6**	1.1
At 31 March	**(85.8)**	(107.9)	**(6.8)**	(11.7)

Movements in the fair value of schemes' assets were:

	Group		Company	
	2011 £m	2010 £m	2011 £m	2010 £m
At 1 April	**402.4**	276.4	**37.3**	29.6
Expected return on schemes' assets	**29.4**	22.5	**2.7**	2.2
Actuarial gains/(losses)	**5.3**	65.7	**(10.4)**	6.3
Acquisition	**–**	38.2	**–**	–
Members' contributions	**1.0**	1.0	**–**	–
Benefits paid	**(19.7)**	(17.8)	**(1.5)**	(1.9)
Employer contributions	**35.8**	16.4	**2.6**	1.1
At 31 March	**454.2**	402.4	**30.7**	37.3

29. Retirement benefit obligations continued

Movements in the present value of schemes' defined benefit obligations were:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
At 1 April	**(510.3)**	(342.4)	**(49.0)**	(36.9)
Service cost	**(17.7)**	(11.6)	**(1.0)**	(0.8)
Interest cost	**(27.8)**	(24.8)	**(2.7)**	(2.6)
Actuarial (losses)/gains	**(2.9)**	(110.1)	**13.7**	(10.6)
Acquisition	**–**	(38.2)	**–**	–
Members' contributions	**(1.0)**	(1.0)	**–**	–
Benefits paid	**19.7**	17.8	**1.5**	1.9
At 31 March	**(540.0)**	(510.3)	**(37.5)**	(49.0)

The future cash flows arising from the payment of the defined benefits are expected to be settled primarily in the period between 15 and 40 years from the balance sheet date.

The five-year history of experience adjustments is:

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Group					
Fair value of schemes' assets	**454.2**	402.4	276.4	331.5	347.6
Present value of defined benefit obligations	**(540.0)**	(510.3)	(342.4)	(357.8)	(388.8)
Net liability recognised	**(85.8)**	(107.9)	(66.0)	(26.3)	(41.2)
Experience gains/(losses) on schemes' assets					
Amount (£m)	**5.3**	65.7	(101.6)	(44.7)	1.5
Percentage of schemes' assets	**1.2%**	16.3%	(36.7)%	(13.5)%	0.4%
Experience gains/(losses) on defined benefit obligations					
Amount (£m)	**0.8**	2.3	34.8	49.8	(2.7)
Percentage of defined benefit obligations	**0.1%**	0.4%	10.2%	13.9%	(0.7)%

The cumulative actuarial losses recognised in the Group statement of comprehensive income at 31 March 2011 were £105.8 million (2010 losses of £108.2 million).

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Company					
Fair value of schemes' assets	**30.7**	37.3	29.6	33.9	27.0
Present value of defined benefit obligations	**(37.5)**	(49.0)	(36.9)	(36.8)	(30.4)
Net liability recognised	**(6.8)**	(11.7)	(7.3)	(2.9)	(3.4)
Experience (losses)/gains on schemes' assets					
Amount (£m)	**(10.4)**	6.3	(9.6)	4.0	0.1
Percentage of schemes' assets	**(33.9)%**	16.9%	(32.4)%	11.8%	–
Experience gains/(losses) on defined benefit obligations					
Amount (£m)	**14.0**	0.4	1.6	(5.3)	(0.4)
Percentage of defined benefit obligations	**37.3%**	0.8%	4.3%	(14.4)%	(1.3)%

The cumulative actuarial losses recognised in the Company statement of comprehensive income at 31 March 2011 were £7.2 million (2010 losses of £10.5 million).

In 2011 the Group has completed the triennial actuarial valuation of its defined benefit schemes as at 1 April 2011 which resulted in similar future service and reduced deficit recovery contributions. The Group has made deficit recovery contributions of £21 million during the year (2010 £13 million). The Group monitors funding levels on an annual basis and expects to pay total contributions of £24 million during the year ended 31 March 2012.

30. Deferred tax

Deferred tax is provided in full on temporary differences under the liability method using a tax rate of 26% (2010 28%).

Movements on deferred tax were:

	Group		Company	
	2011 £m	2010 (Restated note 5) £m	**2011 £m**	2010 £m
Liabilities/(assets) at 1 April	**312.2**	328.4	**(5.0)**	(2.6)
(Credited)/charged to the income statement	**(21.7)**	1.3	**(0.2)**	(1.5)
Charged/(credited) to equity	**2.8**	(17.6)	**1.0**	(0.9)
Arising on acquisitions	**0.5**	0.1	**–**	–
Liabilities/(assets) at 31 March	**293.8**	312.2	**(4.2)**	(5.0)

Deferred tax assets have been recognised in respect of all temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

All deferred tax assets and liabilities within the same jurisdiction are offset.

The deferred tax balance has been reduced by a credit of £22.6 million to recognise the changes in the rate of corporation tax enacted on 27 July 2010 and 29 March 2011 to reduce the rate from 1 April 2011 from 28% to 26%. If the published Government proposals to reduce the rate of corporation tax by a further by 1% for each financial year until 2014/15 had been enacted at the balance sheet date the total impact would have been a further reduction of circa £34 million.

The movements in deferred tax assets and liabilities were:

Group

Deferred tax liabilities

	Accelerated tax depreciation			
	Owned assets (Restated note 5) £m	Leased assets £m	Other (Restated note 5) £m	Total (Restated note 5) £m
At 1 April 2009	316.5	16.3	22.1	354.9
Charged/(credited) to the income statement	5.1	0.7	(1.9)	3.9
Arising on acquisitions	2.1	–	2.1	4.2
At 31 March 2010	323.7	17.0	22.3	363.0
Credited to the income statement	(18.2)	(0.6)	(2.9)	(21.7)
Arising on acquisitions	0.5	–	–	0.5
At 31 March 2011	**306.0**	**16.4**	**19.4**	**341.8**

Deferred tax assets

	Provisions £m	Retirement benefit obligations £m	Other (Restated note 5) £m	Total (Restated note 5) £m
At 1 April 2009	(5.1)	(18.5)	(2.9)	(26.5)
(Credited)/charged to the income statement	(1.8)	0.7	(1.5)	(2.6)
Credited to equity	–	(12.4)	(5.2)	(17.6)
Arising on acquisition	(1.4)	–	(2.7)	(4.1)
At 31 March 2010	(8.3)	(30.2)	(12.3)	(50.8)
(Credited)/charged to the income statement	(0.2)	5.1	(4.9)	–
Charged/(credited) to equity	–	2.9	(0.1)	2.8
At 31 March 2011	**(8.5)**	**(22.2)**	**(17.3)**	**(48.0)**
Net deferred tax liability:				
At 31 March 2010				312.2
At 31 March 2011				**293.8**

30. Deferred tax continued

Company

Deferred tax assets

	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2009	(2.0)	(0.6)	(2.6)
Credited to the income statement	–	(1.5)	(1.5)
(Credited)/charged to equity	(1.2)	0.3	(0.9)
At 31 March 2010	(3.2)	(1.8)	(5.0)
Charged/(credited) to the income statement	0.4	(0.6)	(0.2)
Charged to equity	1.0	–	1.0
At 31 March 2011	**(1.8)**	**(2.4)**	**(4.2)**

Deferred tax credited to equity during the year was:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Actuarial (gains)/losses on defined benefit schemes	**(2.9)**	12.4	**(1.0)**	1.2
Net fair value (gains)/losses on cash flow hedges	**(0.4)**	5.0	**(0.1)**	(0.3)
Deferred tax on other comprehensive loss	**(3.3)**	17.4	**(1.1)**	0.9
Share-based payments (note 35)	**0.5**	0.2	**0.1**	–
	(2.8)	17.6	**(1.0)**	0.9

31. Provisions

	Environmental and landfill restoration (Restated note 5) £m	Restructuring £m	Other provisions £m	Total £m
Group				
At 1 April 2010	98.8	3.1	0.2	102.1
Charged to the income statement	4.6	4.0	–	8.6
Landfill restoration	4.7	–	–	4.7
Utilised during year	(14.0)	(4.4)	–	(18.4)
At 31 March 2011	**94.1**	**2.7**	**0.2**	**97.0**

The amount charged to the income statement includes £4.0 million (2010 £3.8 million) charged to finance costs as the unwinding of discounts in provisions.

The addition to landfill restoration provision of £4.7 million recognised in the year has been matched with an addition to property, plant and equipment.

The analysis of provisions between current and non-current is:

	2011 £m	2010 (Restated note 5) £m
Current	**16.3**	23.9
Non-current	**80.7**	78.2
	97.0	102.1

Environmental and landfill restoration provisions are expected to be substantially utilised over the period from 2012 to beyond 2052. The provisions have been established assuming current waste management technology based upon estimated costs at future prices which have been discounted to present value.

The restructuring provision related principally to severance costs and will be utilised within one year.

32. Share capital

	2011 £m	2010 £m
Authorised		
429,975,270 ordinary shares of 40.7p each	**175.0**	175.0

Allotted, called-up and fully paid

	Number of shares		
	Treasury shares	Ordinary shares	£m
At 1 April 2009			
Ordinary shares of 40.7p each	5,724,131	349,440,143	144.5
Shares issued under the scrip dividend alternative	–	1,986,553	0.8
For consideration of £1.9 million, shares re-issued under the Company's Sharesave Scheme	(631,557)	631,557	–
At 31 March 2010 ordinary shares of 40.7p each	5,092,574	352,058,253	145.3
Shares issued under the scrip dividend alternative	–	4,129,038	1.7
Shares re-issued under the Company's Performance and Co-investment Plan	(328,240)	328,240	–
For consideration of £1.6 million, shares re-issued under the Company's Sharesave Scheme	(454,767)	454,767	–
At 31 March 2011 ordinary shares of 40.7p each	**4,309,567**	**356,970,298**	**147.0**

Shares held as treasury shares may be sold or re-issued for any of the Company's share schemes, or cancelled.

Employee share schemes

The Group operates a number of equity-settled share plans for the benefit of employees. Details of each plan are:

i) Sharesave Scheme

An all-employee savings related plan is operated that enables employees, including Executive Directors, to invest up to a maximum of £250 per month for three or five years. These savings can then be used to buy ordinary shares, at a price set at a 20% discount to the market value at the start of the savings period, at the third, fifth or seventh year anniversary of the option being granted. Options expire six months following the exercise date and, except for certain specific circumstances such as redundancy, lapse if the employee leaves the Group before the option exercise period commences.

Outstanding options to subscribe for ordinary shares of 40.7p each under the Company's share option schemes are:

	Date granted and subscription price fully paid	Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March	
			2011	2010
8 July 2003	177p	2006 – 2010	**–**	59
6 July 2004	200p	2007 – 2011	**70**	70
5 July 2005	270p	2008 – 2012	**33**	244
4 July 2006	358p	2009 – 2013	**160**	165
3 July 2007	522p	2010 – 2014	**101**	307
8 July 2008	517p	2011 – 2015	**275**	306
6 July 2009	386p	2012 – 2016	**1,242**	1,321
28 June 2010	431p	2013 – 2017	**683**	–
			2,564	2,472

32. Share capital continued

i) Sharesave Scheme continued

The number and weighted average exercise price of Sharesave options are:

	2011 Number of ordinary shares (thousands)	2011 Weighted average exercise price per share (p)	2010 Number of ordinary shares (thousands)	2010 Weighted average exercise price per share (p)
At 1 April	**2,472**	**396**	2,143	389
Granted	**699**	**431**	1,351	386
Forfeited	**(119)**	**429**	(371)	493
Exercised	**(455)**	**361**	(632)	295
Expired	**(33)**	**450**	(19)	370
At 31 March	**2,564**	**409**	2,472	396

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 478p (2010 468p). The options outstanding at 31 March 2011 had a weighted average exercise price of 409p (2010 396p) and a weighted average remaining contractual life of 2.4 years (2010 3.0 years).

The aggregate fair value of Sharesave options granted during the year was £0.8 million (2010 £1.5 million), determined using the Black-Scholes valuation model. The significant inputs into the valuation model at the date of issue of the options were:

	2011	2010
Weighted average share price	**539p**	482p
Weighted average exercise price	**431p**	386p
Expected volatility	**29.0%**	29.0%
Expected life	**4.1 years**	3.8 years
Risk-free rate	**1.4%**	2.5%
Expected dividend yield	**4.5%**	4.7%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

32. Share capital continued

ii) Performance and Co-investment Plan

Executive Directors and senior management receive a conditional award of ordinary shares in the Company and are also required to hold a substantial personal shareholding in the Company. The eventual number of shares, if any, which vest is dependent upon the achievement of conditions of the plan over the restricted period, being not less than three years.

The number and price of shares in the Performance and Co-investment Plan are:

	2011		2010	
	Number of ordinary shares (thousands)	**Weighted average exercise price per share (p)**	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**1,465**	**554**	886	598
Granted	**530**	**546**	579	486
Vested	**(328)**	**557**	–	–
Lapsed	**(108)**	**557**	–	–
At 31 March	**1,559**	**550**	1,465	554

The awards outstanding at 31 March 2011 had a weighted exercise price of 550p (2010 554p) and a weighted average remaining contractual life of 1.3 years (2010 1.4 years).

The aggregate fair value of awards granted during the year was £2.1 million (2010 £1.9 million) determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2011	2010
Weighted average share price	**546p**	486p
Expected volatility	**29.0%**	29.0%
Risk-free rate	**1.4%**	2.5%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

iii) Annual Incentive Bonus Plan – Deferred Shares

Awards under the plan to Executive Directors and senior management involve the release of ordinary shares in the Company to participants. There is no performance condition since vesting is conditional upon continuous service with the Group for a period of three years from the award. The number and weighted average price of shares in the Annual Incentive Bonus Plan are:

	2011		2010	
	Number of ordinary shares (thousands)	**Weighted average exercise price per share (p)**	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**291**	**547**	358	575
Granted	**175**	**572**	146	475
Vested	**(7)**	**529**	(213)	545
At 31 March	**459**	**557**	291	547

The awards outstanding at 31 March 2011 had a weighted average exercise price of 557p (2010 547p) and a weighted average remaining contractual life of 1.5 years (2010 1.8 years). The Company's share price at the date of the awards ranged from 473p to 620p.

The aggregate fair value of awards granted during the year was £1.0 million (2010 £0.7 million), determined from market value. No option pricing methodology is applied since dividends declared on the shares are receivable by the participants in the scheme.

Further details of the plans and options granted to Directors, included above, are shown in the Directors' Remuneration Report.

33. Share premium account

	£m
At 1 April 2009	11.7
Adjustment for shares issued under the Scrip Dividend Alternative	(0.8)
At 31 March 2010	10.9
Adjustment for shares issued under the Scrip Dividend Alternative	(1.7)
At 31 March 2011	**9.2**

34. Capital redemption reserve

The capital redemption reserve represents the redemption of B shares and cancellation of Deferred shares arising from a capital return to shareholders undertaken during 2006.

	£m
At 1 April 2009	144.2
At 31 March 2010	144.2
At 31 March 2011	**144.2**

35. Retained earnings and other reserves

	Own shares £m	Hedging reserve £m	Retained earnings (Restated note 5) £m	Total (Restated note 5) £m
Group				
At 1 April 2009	(3.0)	(17.9)	321.1	300.2
Profit for year	–	–	141.5	141.5
Other comprehensive income/(loss) for the year	–	5.0	(35.2)	(30.2)
Dividends paid relating to 2009	–	–	(73.4)	(73.4)
Adjustment for shares issued under the Scrip Dividend Alternative	–	–	9.6	9.6
Credit to equity in respect of share-based payments	–	–	2.7	2.7
Charge in respect of share options vesting	0.8	–	(0.8)	–
Deferred tax in respect of share-based payments	–	–	0.2	0.2
Equity component of convertible bond issued	–	–	10.0	10.0
Proceeds from treasury shares re-issued	–	–	1.9	1.9
At 31 March 2010	(2.2)	(12.9)	377.6	362.5
Profit for year	–	–	171.6	171.6
Other comprehensive loss for the year	–	(0.4)	(3.6)	(4.0)
Dividends paid relating to 2010	–	–	(79.6)	(79.6)
Adjustment for shares issued under the Scrip Dividend Alternative	–	–	22.8	22.8
Credit to equity in respect of share-based payments	–	–	3.4	3.4
Transfer from hedging reserve to property, plant and equipment	–	0.3	–	0.3
Deferred tax in respect of share-based payments	–	–	0.5	0.5
Proceeds from treasury shares re-issued	–	–	1.6	1.6
At 31 March 2011	**(2.2)**	**(13.0)**	**494.3**	**479.1**

The own shares reserve represents the cost of ordinary shares in Pennon Group Plc issued to or purchased in the market and held by the Pennon Employee Share Trust to satisfy awards under the Group's Annual Incentive Bonus Plan.

The market value of the 589,000 ordinary shares (2010 596,000 ordinary shares) held by the trust at 31 March 2011 was £3.7 million (2010 £3.1 million).

35. Retained earnings and other reserves continued

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 2009	(1.4)	460.7	459.3
Profit for the year	–	81.6	81.6
Other comprehensive income/(loss) for the year	1.1	(3.4)	(2.3)
Dividends paid relating to 2009	–	(73.4)	(73.4)
Adjustment for shares issued under the Scrip Dividend Alternative	–	9.6	9.6
Credit to equity in respect of share-based payments	–	0.7	0.7
Equity component of convertible bond issued	–	10.0	10.0
Proceeds from treasury shares re-issued	–	1.9	1.9
At 31 March 2010	(0.3)	487.7	487.4
Profit for the year	–	90.1	90.1
Other comprehensive income for the year	0.3	2.4	2.7
Dividends paid relating to 2010	–	(79.6)	(79.6)
Adjustment for shares issued under the Scrip Dividend Alternative	–	22.8	22.8
Credit to equity in respect of share-based payments	–	0.7	0.7
Deferred tax in respect of share-based payments	–	0.1	0.1
Proceeds from treasury shares re-issued	–	1.6	1.6
At 31 March 2011	**–**	**525.8**	**525.8**

36. Cash flow from operating activities

Reconciliation of profit for the year to cash generated from operations:

Cash generated from operations

	Group		Company	
	2011 £m	2010 (Restated note 5) £m	**2011 £m**	2010 £m
Continuing operations				
Profit for the year	**171.6**	141.5	**90.1**	81.6
Adjustments for:				
Share-based payments	**3.4**	2.8	**0.7**	0.7
Profit on disposal of property, plant and equipment	**(2.3)**	(3.6)	**–**	–
Depreciation charge	**141.0**	135.1	**0.1**	0.1
Amortisation of intangible assets	**0.7**	0.3	**–**	–
Share of post-tax profit from joint ventures	**(4.3)**	(1.1)	**–**	–
Finance income	**(45.1)**	(34.4)	**(23.6)**	(22.9)
Finance costs	**121.8**	116.0	**26.6**	21.8
Dividends receivable	**–**	–	**(93.1)**	(80.6)
Taxation charge/(credit)	**16.9**	44.3	**(0.4)**	(0.2)
Changes in working capital (excluding the effect of acquisition of subsidiaries):				
(Increase)/decrease in inventories	**(0.6)**	0.3	**–**	–
Increase in trade and other receivables	**(25.5)**	(32.4)	**(37.4)**	(123.7)
Increase/(decrease) in trade and other payables	**30.3**	9.3	**(5.8)**	9.7
Decrease in retirement benefit obligations from contributions	**(18.1)**	(4.8)	**(1.4)**	(0.3)
Decrease in provisions	**(13.6)**	(7.9)	**–**	–
Cash generated/(outflow) from operations	**376.2**	365.4	**(44.2)**	(113.8)

37. Net borrowings

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Cash and cash deposits	**555.5**	493.9	**236.6**	174.6
Borrowings – current				
Bank overdrafts	**(18.1)**	(12.7)	**–**	–
Other current borrowings	**(56.4)**	(184.1)	**(34.9)**	(70.0)
Finance lease obligations	**(24.7)**	(32.2)	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**(281.2)**	(281.2)
Total current borrowings	**(99.2)**	(229.0)	**(316.1)**	(351.2)
Borrowings – non-current				
Bank and other loans	**(948.4)**	(681.5)	**(572.9)**	(462.8)
Other non-current borrowings	**(252.5)**	(273.6)	**–**	–
Finance lease obligations	**(1,189.2)**	(1,205.1)	**–**	–
Total non-current borrowings	**(2,390.1)**	(2,160.2)	**(572.9)**	(462.8)
Total net borrowings	**(1,933.8)**	(1,895.3)	**(652.4)**	(639.4)

Bank overdrafts at the balance sheet date arise from the timing of the payment of unpresented cheques.

38. Acquisitions

On 24 June 2010 the entire issued share capital of Oakley Waste Management Limited (renamed Viridor Waste (Corby) Limited) and Basecall Limited was purchased by Viridor Waste Management Limited for a cash consideration of £4.2 million. These companies were acquired from Reconomy (Acquisition) Limited and also own Alibone Recycling Limited (renamed Viridor Waste (Earls Barton) Limited and Anglia Recycling Limited (renamed Viridor Waste (East Anglia) Limited. The acquisition has been accounted for using the acquisition method.

This acquisition contributed revenues of £27.1 million and a loss before tax of £0.1 million for the period from 24 June 2010 to 31 March 2011. If the acquisition had occurred on 1 April 2010 Group revenues for the year would have been £1,164.8 million and profit for the year would have been £172.5 million. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the fair value adjustments.

The residual excess over the net assets acquired has been recognised as goodwill. The provisional goodwill is attributed to the profitability of the acquired business.

	Fair value £m
Property, plant and equipment	9.5
Inventories	0.1
Receivables	7.7
Payables	(10.8)
Taxation – current	0.1
Cash and cash deposits	0.8
Loans	(17.3)
Leases	(0.2)
Net liabilities acquired	(10.1)
Goodwill	14.3
Total consideration	4.2
Satisfied by:	
Cash	4.2
Net cash outflow arising on acquisition	
Cash consideration	4.2
Cash and cash deposits acquired	(0.8)
	3.4
Directly attributable costs included in other operating expenses	0.5

38. Acquisitions continued

On 4 November 2010 the entire issued share capital of Pearsons Group Holdings Limited was purchased by Viridor Waste Management Limited for a cash consideration of £12.7 million. Pearsons (Thetford) Limited (renamed Viridor Waste (Thetford) Limited) is a wholly owned subsidiary of Pearsons Group Holdings Limited. The acquisition has been accounted for using the acquisition method.

This acquisition contributed revenues of £3.0 million and a loss before tax of £1.1 million for the period from 4 November 2010 to 31 March 2011. If the acquisition had occurred on 1 April 2010 Group revenues for the year would have been £1,164.2 million and profit for the year would have been £172.0 million. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the provisional fair value adjustments.

The residual excess over the net assets acquired has been recognised as goodwill. The provisional goodwill is attributed to the profitability of the acquired business.

	Fair value £m
Property, plant and equipment	11.2
Inventories	0.2
Receivables	1.4
Payables	(8.3)
Taxation – deferred	(0.4)
Cash and cash deposits	0.5
Loans	(3.2)
Leases	(1.0)
Net assets acquired	0.4
Goodwill	12.3
Total consideration	12.7
Satisfied by:	
Cash	12.7
Net cash outflow arising on acquisition	
Cash consideration	12.7
Cash and cash deposits acquired	(0.5)
	12.2
Directly attributable costs included in other operating expenses	0.3

38. Acquisitions continued

On 20 December 2010 the entire issued share capital of Adapt Recycling Limited (renamed Viridor Waste (Adapt) Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £0.7 million. The acquisition has been accounted for using the acquisition method.

Viridor Waste (Adapt) Limited contributed revenues of £0.7 million and a loss before tax of £0.1 million for the period from 20 December 2010 to 31 March 2011. If the acquisition had occurred on 1 April 2010 Group revenues for the year would have been £1,161.4 million and profit for the year would have been £172.0 million. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the provisional fair value adjustments.

The residual excess over the net assets acquired has been recognised as goodwill. The provisional goodwill is attributed to the profitability of the acquired business.

	Fair value £m
Property, plant and equipment	0.4
Inventories	0.1
Receivables	0.3
Payables	(0.5)
Taxation – current	(0.1)
Net assets acquired	0.2
Goodwill	0.5
Total consideration	0.7
Satisfied by:	
Cash	0.7
Net cash outflow arising on acquisition	
Cash consideration	0.7
Directly attributable costs included in other operating expenses	0.1

38. Acquisitions continued

On 14 January 2011 the entire issued share capital of Swinnerton Environmental Limited (renamed Viridor Waste (Bury) Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £1.9 million. The acquisition has been accounted for using the acquisition method.

Viridor Waste (Bury) Limited contributed revenues of £0.5 million and a loss before tax of £0.5 million for the period from 14 January 2011 to 31 March 201. If the acquisition had occurred on 1 April 2010 Group revenues for the year would have been £1,161.2 million and profit for the year would have been £171.7 million. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the provisional fair value adjustments.

The residual excess over the net assets acquired has been recognised as goodwill. The provisional goodwill is attributed to the profitability of the acquired business.

	Fair value £m
Property, plant and equipment	0.3
Receivables	0.3
Payables	(0.2)
Leases	(0.1)
Net assets acquired	0.3
Goodwill	1.6
Total consideration	1.9
Satisfied by:	
Cash	1.9
Net cash outflow arising on acquisition	
Cash consideration	1.9
Directly attributable costs included in other operating expenses	0.1

38. Acquisitions continued

On 4 February 2011 the entire issued share capital of Martock Waste Paper Company Limited (renamed Viridor (Martock) Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £7.3 million. The acquisition has been accounted for using the acquisition method.

Viridor (Martock) Limited contributed revenues of £1.7 million and a loss before tax of £0.3 million for the period from 4 February 2011 to 31 March 2011. If the acquisition had occurred on 1 April 2010 Group revenues for the year would have been £1,163.5 million and profit for the year would have been £172.0 million. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the provisional fair value adjustments.

The residual excess over the net assets acquired has been recognised as goodwill. The provisional goodwill is attributed to the profitability of the acquired business.

	Fair value £m
Property, plant and equipment	0.7
Receivables	0.9
Payables	(0.6)
Taxation – current	(0.1)
Taxation – deferred	(0.1)
Leases	(0.2)
Cash and cash deposits	0.4
Net assets acquired	1.0
Goodwill	6.3
Total consideration	7.3
Satisfied by:	
Cash	7.3
Net cash outflow arising on acquisition	
Cash consideration	7.3
Cash and cash deposits acquired	(0.4)
	6.9
Directly attributable costs included in other operating expenses	0.1

Restatements

At 31 March 2010 the accounting for the acquisition of London Recycling Limited (renamed Viridor London Recycling Limited) was provisional. Completion of the accounting for the acquisition has resulted in an increase to goodwill of £1.1 million, an increase in property, plant and equipment of £0.4 million, an increase in trade and other receivables of £0.1 million, a decrease in trade and other payables of £0.1 million, an increase in current tax liabilities of £0.2 million, an increase in provisions of £0.8 million and an increase in deferred tax liabilities of £0.7 million. Comparative figures at 31 March 2010 have been restated accordingly.

At 31 March 2010 the accounting for the acquisition of Intercontinental Recycling Limited (renamed Viridor Polymer Recycling Limited) was provisional. Completion of the accounting for the acquisition has resulted in an increase to goodwill of £3.3 million, a decrease in property, plant and equipment of £0.8 million, a decrease in trade and other receivables of £0.3 million, an increase in trade and other payables of £0.3 million, an increase in provisions of £1.6 million and an increase in deferred tax liabilities of £0.3 million. Comparative figures at 31 March 2010 have been restated accordingly.

In addition the acquisition accounting for Greater Manchester Waste Limited (now renamed Viridor Waste (Greater Manchester Limited) has been reanalysed at 31 March 2010 decreasing goodwill by £1.4 million and increasing property, plant and equipment by £1.4 million. Comparative figures at 31 March 2010 have been restated accordingly.

39. Principal subsidiary, joint venture and associate undertakings at 31 March 2011

	Country of incorporation, registration and principal operations
Water and sewerage	
South West Water Limited*	England
South West Water Finance Plc	England
Waste management	
Viridor Limited*	England
Viridor Waste Limited	England
Viridor Waste Exeter Limited	England
Viridor Waste Suffolk Limited	England
Viridor Waste (West Sussex) Limited	England
Viridor Waste Management Limited	England
Viridor EnviroScot Limited	Scotland
Pearsons Group Holdings Limited	England
Viridor Waste (Thetford) Limited	England
Viridor Resource Management Limited	England
Viridor Waste Kent Limited	England
Viridor (Martock) Limited	England
Viridor Oxfordshire Limited	England
Handside Limited	England
Viridor EfW (Runcorn) Limited	England
Viridor Waste (Landfill Restoration) Limited	England
Viridor Waste (Somerset) Limited	England
Viridor Waste (Thames) Limited	England
Viridor Waste (Greater Manchester) Limited	England
Viridor Parkwood Holdings Limited	British Virgin Islands†
Viridor Polymer Recycling Limited	England
Other	
Peninsula Insurance Limited*	Guernsey

* Indicates the shares are held directly by Pennon Group Plc, the Company
† Operations are carried out in England

The subsidiary undertakings are wholly-owned and all shares in issue are ordinary shares. All companies above are consolidated in the Group financial statements.

39. Principal subsidiary, joint venture and associate undertakings at 31 March 2011 continued

Joint ventures and associate

All joint ventures, the associate and the subsidiary undertakings of Lakeside Energy from Waste Holdings Limited, Viridor Laing (Greater Manchester) Holdings Limited and INEOS Runcorn (TPS) Holdings Limited are incorporated and registered in England which is also their country of operation.

	Share capital in issue	Percentage held	Activity
Lakeside Energy from Waste Holdings Limited	1,000,000 A ordinary shares	–	
	1,000,000 B ordinary shares	100%	
Lakeside Energy from Waste Limited			Waste management

Shares in Lakeside Energy from Waste Holdings Limited are held by Viridor Waste Management Limited.

	Share capital in issue	Percentage held	Activity
Viridor Laing (Greater Manchester) Holdings Limited	2 ordinary shares	50%	
Viridor Laing (Greater Manchester) Limited			Waste management

Shares in Viridor Laing (Greater Manchester) Holdings Limited are held by Viridor Waste Management Limited.

	Share capital in issue	Percentage held	Activity
INEOS Runcorn (TPS) Holdings Limited	1,000 A ordinary shares	20%	
	186,750 B1 ordinary shares	50%	
	62,250 B2 ordinary shares	–	
INEOS Runcorn (TPS) Limited			Waste management

Shares in INEOS Runcorn (TPS) Holdings Limited are held by Viridor Waste Management Limited.

40. Operating lease commitments

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
The future aggregate minimum lease payments under non-cancellable operating leases are:				
Within one year	**8.7**	7.4	**–**	–
Later than one year and less than five years	**23.1**	23.8	**–**	–
After five years	**82.3**	89.1	**–**	–
	114.1	120.3	**–**	–

The Group leases various offices, depots and workshops under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. Property leases are negotiated for an average term of 25 years and rentals are reviewed on average at five-yearly intervals.

The Group also leases plant and machinery under non-cancellable operating lease agreements.

41. Contingent liabilities

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	**–**	–	**371.8**	363.8
Contractors' claims on capital schemes	**0.3**	3.0	**–**	–
Performance bonds	**107.8**	104.8	**107.8**	104.8
Other	**6.9**	6.9	**6.9**	6.9
	115.0	114.7	**486.5**	475.5

Guarantees in respect of performance bonds are entered into in the normal course of business. No liability is expected to arise in respect of the guarantees.

Viridor Waste Management Limited has given a commitment to supply 200,000 tonnes of waste per annum (or pay market price based compensation) to the energy from waste plant of the joint venture in Lakeside Energy from Waste Holdings Limited. The Directors consider that the committed waste volume will be available in the ordinary course of business.

Other contingent liabilities relate to a possible obligation to pay further consideration in respect of a previously acquired business when the outcome of planning applications is known.

42. Capital commitments

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Contracted but not provided	**218.3**	104.1	**–**	–
Share of commitment contracted but not provided by joint ventures	**–**	135.2	**–**	–
	218.3	239.3	**–**	–

43. Related party transactions

During the year, Group companies entered into the following transactions with related parties who are not members of the Group:

	2011 £m	2010 £m
Sales of goods and services		
Lakeside Energy from Waste Limited	**–**	0.2
Viridor Laing (Greater Manchester) Limited	**82.0**	49.0
Purchase of goods and services		
Lakeside Energy from Waste Limited	**9.4**	3.8

Year end balances

	2011 £m	2010 £m
Receivables due from related parties		
Viridor Laing (Greater Manchester) Limited (loan balance)	**32.0**	20.7
Lakeside Energy from Waste Limited (loan balance)	**13.6**	19.5
INEOS Runcorn (TPS) Limited (loan balance)	**11.0**	5.7
	56.6	45.9
Viridor Laing (Greater Manchester) Limited (trading balance)	**8.8**	–
Payables due to related parties		
Viridor Laing (Greater Manchester) Limited (trading balance)	**7.0**	–
Lakeside Energy for Waste Limited (trading balance)	**1.5**	5.0

The £56.6 million (2010 £45.9 million) receivable relates to loans to related parties included within receivables and due for repayment in instalments between 2012 and 2033. Interest is charged at an average of 14.0% (2010 11.3%).

The £7.0 million payable relates to consortium relief due to Viridor Laing (Greater Manchester) Limited.

Company

The following transactions with subsidiary undertakings occurred in the year:

	2011 £m	2010 £m
Sales of goods and services (management fees)	**7.8**	7.1
Purchase of goods and services (support services)	**0.5**	0.5
Interest receivable (loans)	**18.9**	19.4
Interest payable (short-term funding)	**–**	0.1
Dividends received	**93.1**	80.6

Sales of goods and services to subsidiary undertakings are at cost. Purchases of goods and services from subsidiary undertakings are under normal commercial terms and conditions which would also be available to unrelated third parties.

43. Related party transactions continued

Year end balances

	2011 £m	2010 £m
Receivables due from subsidiary undertakings		
Loans	**457.4**	420.6
Trading balances	**1.1**	0.9

Interest on £104.8 million of the loans has been charged at a fixed rate of 5.0% and on £120.5 million at a fixed rate of 6.0% (2010 £104.3 million, 6.0%).

Interest on the balance of the loans is charged at 12 month LIBOR +1.5%. The loans are due for repayment in instalments over the period 2012 to 2015. During the year there were no further provisions (2010 nil) in respect of loans to subsidiaries not expected to be repaid.

	2011 £m	2010 £m
Payables due to subsidiary undertakings		
Loans	**281.2**	281.2
Trading balances	**15.1**	16.3
Payables due to joint venture		
Trading balances	**–**	5.0

The loans from subsidiary undertakings are unsecured and interest-free without any terms for repayment.

Five-year financial summary

	2011 £m	2010 (Restated note 5) £m	2009* £m	2008* £m	2007*† £m
Income statement					
Revenue	**1,159.2**	1,068.9	958.2	879.4	748.3
Operating profit	**260.9**	266.3	250.8	237.7	200.0
Net finance costs	**(76.7)**	(81.6)	(92.2)	(85.6)	(69.2)
Share of profit in joint ventures	**4.3**	1.1	0.8	0.2	0.3
Profit before tax	**188.5**	185.8	159.4	152.3	131.1
Taxation	**(16.9)**	(44.3)	(69.6)	(16.4)	(37.2)
Profit for the year	**171.6**	141.5	89.8	135.9	93.9
Dividends proposed	**88.2**	79.6	73.4	69.1	65.6
Underlying earnings per share (basic):					
From continuing operations					
Earnings per share	**48.4p**	40.4p	25.8p	38.9p	26.5p
Deferred tax	**(6.1)p**	0.4p	11.1p	(2.6)p	3.8p
Underlying earnings per share	**42.3p**	40.8p	36.9p	36.3p	30.3p
Declared dividends per share	**24.65p**	22.55p	21.00p	19.81p	18.55p

	2011 £m	2010 (Restated note 5) £m	2009* £m	2008* £m	2007*† £m
Capital expenditure					
Acquisitions	**25.1**	9.3	3.4	89.0	37.0
Property, plant and equipment	**199.0**	192.2	231.8	207.7	245.1
Balance sheet					
Non-current assets	**3,344.4**	3,189.4	3,036.3	2,931.0	2,728.6
Net current assets/(liabilities)	**332.2**	162.1	40.5	199.7	(56.7)
Non-current liabilities	**(2,897.1)**	(2,688.6)	(2,476.2)	(2,485.2)	(2,044.7)
Net assets	**779.5**	662.9	600.6	645.5	627.2
Number of employees (average for year)					
Water and sewerage business	**1,196**	1,191	1,227	1,276	1,301
Waste management	**3,012**	2,853	2,154	2,059	1,686
Other businesses	**44**	43	41	42	38
	4,252	4,087	3,422	3,377	3,025

* Prior to the application of IFRIC 18 'Transfer of assets from customers'
† Prior to the application of IFRIC 12 'Service concession arrangements'

Shareholder information

Financial calendar

Financial year-end	31 March
Twenty-second Annual General Meeting	28 July 2011
Ex-dividend date for 2011 Final dividend	10 August 2011*
Record date for 2011 Final dividend	12 August 2011*
2011 Final dividend payable	7 October 2011*
2011/12 Half yearly financial report announcement	November 2011
2012 Interim dividend payable	April 2012
2012 Preliminary results announcement	May 2012
Twenty-third Annual General Meeting	July 2012
2012 Final dividend payable	October 2012

* The above dates are subject to obtaining shareholder approval at the 2011 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2011

Scrip Dividend Alternative

Subject to obtaining shareholder approval at the 2011 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2011, the timetable for offering the Scrip Dividend Alternative will be as follows:

10 August 2011	Ordinary shares quoted ex dividend
12 August 2011	Record date for final dividend
26 August 2011	Posting of Scrip dividend offer
19 September 2011	Final date for receipt of Forms of Election/Mandate
6 October 2011	Posting of dividend cheques and share certificates
7 October 2011	Final dividend payment date
7 October 2011	First day of dealing in the new ordinary shares

Shareholders' analysis at 31 March 2011

Range	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1-100	2,469	10.31	0.02
101-1,000	9,528	39.78	1.39
1,001-5,000	10,158	42.41	6.04
5,001-50,000	1,459	6.09	4.45
50,001-100,000	92	0.39	1.86
100,001-HIGHEST	245	1.02	86.24
	23,951	100.00	100.00
Individuals	19,966	83.36	8.32
Companies	227	0.95	2.61
Trust companies (pension funds etc)	14	0.06	0.02
Banks and nominees	3,744	15.63	89.05
	23,951	100.00	100.00

London Stock Exchange LISTED PREMIUM

Pennon Group Plc is listed on the London Stock Exchange and meets the requirements of a Premium Listing. This is a listing that meets the more stringent UK 'super-equivalent standards' compared with a 'standard listing' which meets EU minimum standards.

Substantial shareholdings

At 13 June 2011 interests in the issued share capital had been notified pursuant to the Financial Service Authority's Disclosure and Transparency Rules:

Invesco Ltd	11.98%
Ameriprise Financial Inc	9.86%
Pictet Asset Management SA	7.15%
AXA SA and its Group Companies	5.56%
Prudential Plc	5.33%
Legal & General Group Plc	3.76%

Further shareholder information may be found at pennon-group.co.uk

Shareholder services

Share dealing service

The telephone share dealing service offered by Stocktrade enables shareholders to buy and sell shares in the Company on a low-cost basis and to make regular investments in the Company. Telephone Stocktrade on 0845 601 0995 and quote: LOW CO107. Commission is 0.5% (subject to a minimum charge of £17.50) to £10,000, then 0.2% thereafter.

Registrar

The Company's registrar, Capita Registrars, can be contacted as follows:

Capita Registrars
Pennon Group Share Register
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU

Telephone: 0871 664 9234 (calls cost 10p per minute plus network extras) Lines are open 8.30am-5.30pm Monday-Friday.
Overseas telephone: +44 800 141 2951
Email: pennon@capitaregistrars.com

Share gift service

Through Sharegift, an independent charity share donation scheme, shareholders who only have a small number of shares with a value that makes it uneconomical to sell them, can donate such shares to charity. Donations can be made by completion of a simple share transfer form which is available from the Company's registrars, Capita Registrars.

Individual Savings Accounts

By holding their shares in the Company in an Individual Savings Account (ISA), shareholders may gain tax advantages.

Scrip Dividend Alternative

The Company operates a Scrip Dividend Alternative. The Scrip Dividend Alternative provides shareholders with an opportunity to invest the whole of, or part of, the cash dividend they receive on their Pennon Group Plc shares to buy further shares in the Company without incurring stamp duty or dealing expenses. Subject to obtaining shareholder approval at the 2011 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2011, full details of the Scrip Dividend Alternative, including how to join, will be sent out to shareholders on 26 August 2011. The full timetable for offering the Scrip Dividend Alternative is given on page 114.

Online portfolio service

The online portfolio service provided by Capita Registrars gives shareholders access to more information on their investments. Details of the portfolio service are available online at capitashareportal.com

Electronic communications

The Company has passed a resolution which allows it to communicate with its shareholders by means of its website.

Shareholders currently receiving a printed copy of the Annual Report who now wish to sign up to receive all future shareholder communications electronically, can do so by registering with Capita Registrars' share portal. Go to capitashareportal.com to register, select 'Account Registration' and then follow the on-screen instructions by inputting your surname, your Investor Code (which can be found on your Form of Proxy) and your postcode as well as entering an e-mail address and selecting a password.

Shareholder information continued

Electronic Proxy voting
Shareholders also have the opportunity to register the appointment of a proxy for any general meeting of the Company once notice of the meeting has been given and may do so via capitashareportal.com Shareholders who register an 'e-mail' preference will not receive a paper proxy form. Instead they will receive an e-mail alert advising them of general meetings of the Company, with links to the Notices of Meetings and annual and half yearly accounts.

The Pennon website
Pennon's website pennon-group.co.uk provides news and details of the Company's activities plus links to its business websites. The Investor Information section contains up-to-date information for shareholders including comprehensive share price information; financial results; dividend payment dates and amounts; and Stock Exchange announcements. There is also a comprehensive share services section on the website which includes information on buying, selling and transferring shares; and on the action to be undertaken by shareholders in the event of a change in personal circumstances, for example, a change of address.

Warning to shareholders – Boiler Room Scams
A number of companies, including Pennon Group Plc, continue to be aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters which imply a connection to the company concerned. These are typically from overseas based 'brokers' who target UK shareholders offering to buy their shares or to sell them what can turn out to be worthless or high risk shares in US or UK investments. They can be very persistent and extremely persuasive and a 2006 survey by the Financial Services Authority (FSA) has reported that the average amount lost by investors is around £20,000. It is not just the novice investor who has been duped in this way; many of the victims had been successfully investing for several years.

Shareholders are advised to be wary of any unsolicited advice, offers to buy shares at a discount or offers of free reports into the Company. If you are contacted in this manner, please make sure you obtain the correct name of the person and organisation and where they are based. You should also check that they are properly authorised by the FSA before getting involved and should call the organisation back using their details in the FSA register to verify their authorisation – you can check online fsa.gov.uk/register/home.do If you deal with an unauthorised firm, you would not be eligible to receive any payment under the Financial Services Compensation Scheme. The FSA can be contacted by completing an online form at fsa.gov.uk/pages/Doing/Regulated/Law/Alerts/overseas.shtml

Details of any share dealing facilities that the Company endorses will be included in Company mailings.

Pennon Group Plc
Registered Office: Peninsula House, Rydon Lane, Exeter, Devon EX2 7HR
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