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Pennon Annual Report & Accounts 2019

Pennon

Bringing resources to life

Annual Report & Accounts 2019

As the UK's leading water and waste infrastructure business, Pennon is focused on responsible, sustainable growth. Our dedicated colleagues deliver essential services for our customers and communities across the UK.

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Find out more about Pennon

Corporate website
www.pennon-group.co.uk

Annual report
www.pennon-group.co.uk/annualreport2019

Integrated reporting
Our business touches the lives of many stakeholders, from customers, employees, investors and suppliers, to our communities and regulators.

Reflecting the integrated nature of our business, we have integrated our reporting on financial, economic, social and environmental aspects of our performance and how they contribute to long-term value creation. In preparing the integrated report, we have referred to the principles of the International Integrated Reporting Council's <IR> Framework.

Our vision is **bringing resources to life**

Our values

Trusted
We do the right thing for our customers and stakeholders

Collaborative
We forge strong relationships, working together to make a positive impact

Responsible
We keep our promises to our customers, communities and each other

Progressive
We are always looking for new ways to improve and make life better

Strategic priorities

1. **Leadership in UK water and waste infrastructure**
2. **Leadership in cost base efficiency**
3. **Driving sustainable growth**

Find out more on pages 8 and 9

Our core businesses

Pennon provides services in waste management, water and wastewater, and water retail services through our three businesses Viridor, South West Water and Pennon Water Services.

Waste management

Find out more starting on page 36

Water and wastewater

Find out more starting on page 42

Water retail services

Find out more on page 49

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Resource efficiency & natural capital stewardship

Our investment in an energy recovery facility and a plastics recycling facility at Avonmouth epitomises UK resource and energy efficiency goals. These new plants are an example of our responsible approach to natural capital stewardship, providing solutions to society's concerns about the environmental impact of plastics.

Viable alternatives to virgin plastic

Comprising a £252 million energy recovery facility and a £65 million plastics recycling facility, our energy park at Avonmouth will use non-recyclable waste to power a circular economy solution for a range of plastics, including a new process focusing on pots, tubs and trays – which a growing number of local authorities are seeking to include in kerbside collections.

As manufacturers and retailers work to achieve sustainability targets by increasing recycled content in their packaging, this innovative new facility will put used plastic back into the economy as a viable and sustainable alternative to virgin plastic.

South West Water continues to work with partners on innovative alternatives to plastic biobeads, used at a small number of wastewater treatment works.

Sustainability focus area

See sustainability strategy on page 11

Our business at a glance

We aim to provide an outstanding level of service to our customers and communities, while protecting the environment and creating value for our shareholders.

Water and wastewater

We are focused on providing water and wastewater services in the most efficient and sustainable way possible. Innovation, new technologies, and the pioneering of an holistic approach to water and wastewater management are delivering service improvements and long-term value.

Find out more starting on page 42

1. **Raw water reservoirs /water resources**
2. **Upstream catchment**
3. **Water treatment works**
4. **Drinking water mains network**
5. **Customer support**
6. **Surface water catchment**
7. **Wastewater mains network**
8. **Wastewater treatment works**
9. **Sewage sludge/bio-resources**
10. **Improved bathing and shellfish water quality**

Waste management

Our purpose is to bring resources to life. We remain at the forefront of the resource sector in the UK, transforming waste into energy, high-quality recyclates and raw materials.

Find out more starting on page 36

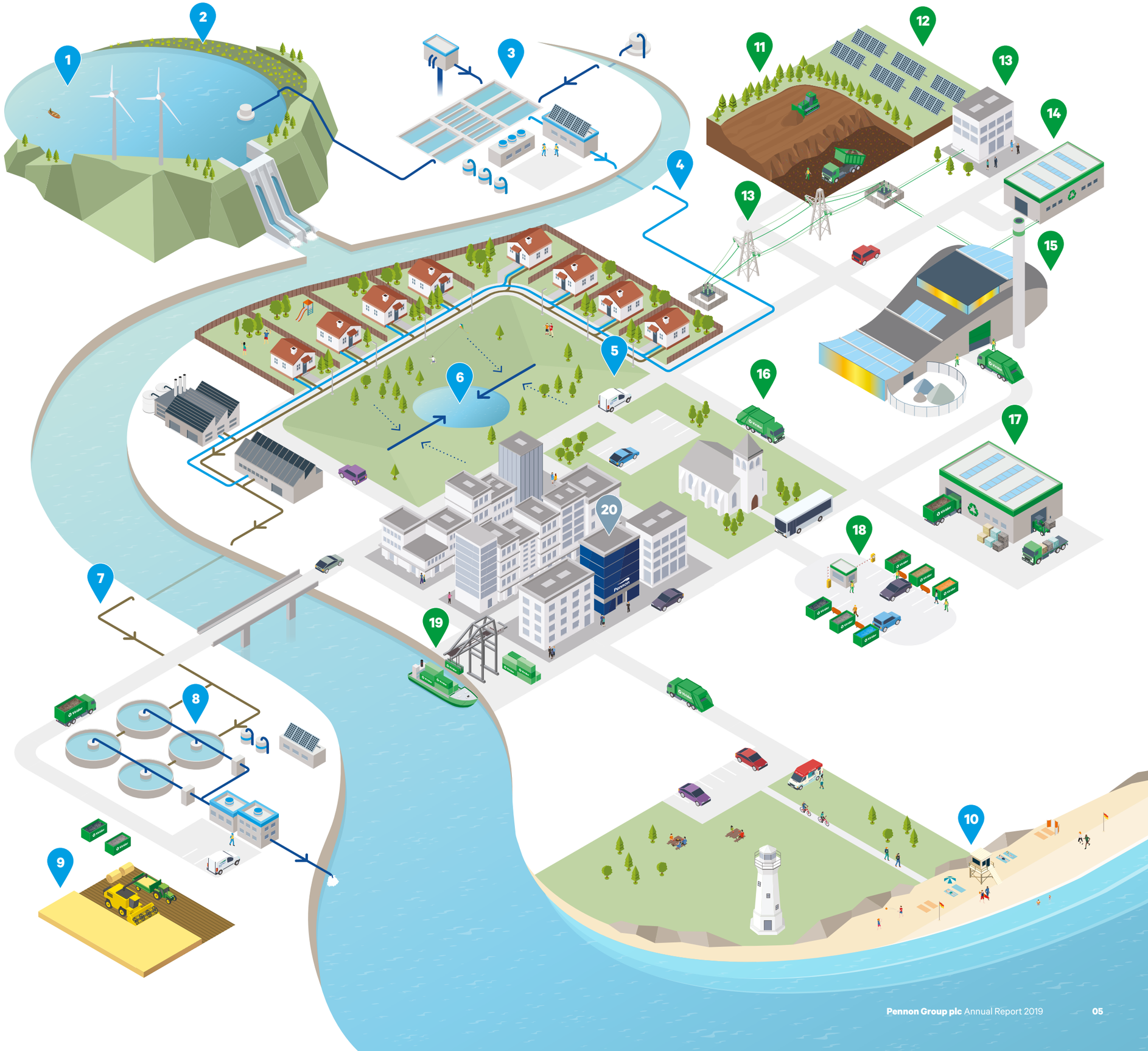
11. **Landfill sites and power generation**
12. **Energy parks**
13. **Powering homes and businesses**
14. **Plastics recycling facilities (PRFs)**
15. **Energy recovery facilities (ERFs)**
16. **A fleet of waste collection vehicles**
17. **Materials recycling facilities (MRFs)**
18. **Household waste recycling centres**
19. **Trading recycled materials**

Water retail services

Business water specialists providing water retail services for all business customers' water management needs.

Find out more on page 49

20. **UK-based customer service centre**



Business model

Through our business model, we fulfil our objective to deliver sustainable shareholder value by providing high-quality environmental infrastructure and customer service.

Our strategy is to lead in the UK's water and waste sectors, drive value through efficiency and invest for sustainable growth.

What we do...

Our core businesses

Waste management

We transform waste into energy, high-quality recyclates and raw materials.

See pages 36 to 41 for further information

Water and wastewater

We provide water and wastewater services in the most efficient and sustainable way possible.

See pages 42 to 48 for further information

Water retail services

We provide water retail services for all business customers' water management needs.

See page 49 for further information

...the strengths we rely on

Our strengths

The best people
The talent, commitment and hard work of our people is the foundation of our success. As a responsible employer, we are focused on employee retention, training and development, productivity and, above all, an unwavering commitment to health, safety and wellbeing.

Effective governance
A strong governance framework provides oversight and support to Group businesses including robust decision-making and performance management processes.

High-quality assets
We invest in the construction of world-class facilities and plants that use state-of-the-art technology. We engage the best people to maintain and operate our fleet of assets, to ensure we always maximise returns.

Efficient financing
The strength of our proposition, and investor confidence in our performance and reputation, means we are well funded with efficient long-term financing.

Environmental stewardship
We invest in the maintenance and improvement of our services, operations and assets and constantly seek more sustainable ways of working to protect, enhance and reduce our impact on the natural environment.

Strong relationships with our suppliers
We work closely with our suppliers and take the steps necessary to ensure their performance meets our expectations. We expect them to uphold our standards, align with our policies, protect human rights and promote good working conditions.

Well-managed risk
Comprehensive and fully embedded risk management processes assist us in identifying and managing risks and opportunities to deliver the Group's strategy and objectives.

...delivering our strategy

Our long-term priorities

1 Leadership in UK water and waste infrastructure

We aim to lead in the water and waste sectors by capitalising on Group strengths, capabilities, best practice and synergies, and achieving the right balance between risk and reward.

See pages 8, 26 and 27 for further information

2 Leadership in cost base efficiency

We are focused on driving down overheads and operating in the most efficient way to minimise costs.

See pages 8 and 53 for further information

3 Driving sustainable growth

We actively seek opportunities to invest for growth, whether through investment to increase our asset portfolio, initiatives to expand our customer base, or partnerships with other organisations.

See pages 8, 27 and 28 for further information

...to create value

Value created for our stakeholders

Customers
88pts
best ever customer service score for South West Water[1]

Community
98.7%
149 bathing waters out of 151 classified as 'sufficient' or better[3]

Investors
+13.6%
earnings per share increased to 57.8p[2]

Environment
4.9m
tonnes of waste materials recycled or recovered

People
19,221
formal training days

(1) As measured by the service incentive mechanism (SIM). See page 44 for details.
(2) Before non-underlying items and deferred tax. See note 6 for more details.
(3) 118 beaches (78.1%) classified as 'excellent'.

Underpinned by our values

Trusted
We do the right thing for our customers and stakeholders

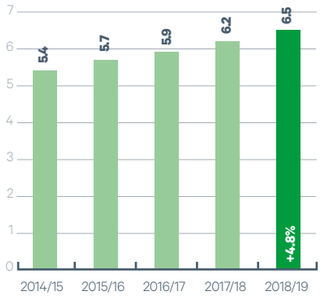
Collaborative
We forge strong relationships, working together to make a positive impact

Responsible
We keep our promises to our customers, communities and each other

Progressive
We are always looking for new ways to improve and make life better

Strategic priorities

Our strategic objectives are set and monitored through a rolling long-term strategic planning process. This takes into account potential risks and our sustainability drivers.

Long-term priorities	Near-term objectives	Progress in 2018/19	Key performance indicators (KPIs)	Sustainability drivers	Risks and uncertainties
1 **Leadership in UK water and waste infrastructure**	• Develop and fully maximise value from our infrastructure business • Improve our environmental performance • Strengthen employee engagement and trust across the Group • Mitigate the risk arising from local authority austerity and global challenges in recycling • Build on the strong track record of our water and wastewater business by delivering and outperforming the K6 (2015-20) plan and successfully delivering the K7 (2020-25) plan • Continue to develop a new model for proactive customer service that puts our customers at the heart of everything we do.	• High levels of performance and availability maintained by the ERF portfolio, which delivered £155 million EBITDA in 2018/19 • Government Resources and Waste Strategy aligned with our strategic priorities for recycling • Outperformance by South West Water continued in 2018/19 • Winner of a customer service award at the UK Customer Satisfaction Awards 2019, run by the Institute of Customer Service • Highest ever customer service score of 88 points achieved in both South West Water and Bournemouth Water regions • Reduction in serious wastewater pollution incidents, however a small rise in less serious incidents.	**91%** **average ERF availability**(1) **93%** **customer satisfaction with overall service**(2) (1) Weighted by capacity, excludes Bolton (reverting to Greater Manchester Local Authority 31 May 2019), includes joint ventures at 100%. (2) South West Water score for 2018/19. The customer satisfaction score for Bournemouth Water was 96%.	• **Health, safety and wellbeing** – investing in and protecting our people to ensure we have a skilled, diverse, engaged and motivated workforce to deliver our strategy • **Environmental leadership** – integral to our water business's regulatory contract and the promotion of the circular economy by our waste management business • **Natural capital stewardship** – delivering solutions for society is core to our strategy and helps to address the challenge of depleting natural resources.	Our aspiration to be a leader in the sectors in which we operate could be affected by the occurrence of certain events, many of which have reputational consequences: • An avoidable health & safety incident • Legal, regulatory or tax non-compliance • Poor customer service • Business interruption (for example, as a result of a failure of our IT systems) or operational failure • Failure or increased cost of a capital project • Loss or corruption of data as a result of a cyber attack.
2 **Leadership in cost base efficiency**	• Ongoing initiatives to reduce Viridor's cost base by sharing best practice and delivering synergies • Continue to drive working efficiencies across the Group and realise value from the Shared Services Programme • Continue to target totex outperformance in South West Water.	• c. £17 million p.a. of Group-wide efficiencies secured in 2019, meeting our cumulative target • Continuing to deliver cost-efficient, long-term financing – 3.6% effective interest rate on annual net debt – among the lowest in the sector • 17% reduction in real terms in Viridor indirect costs since 2016/17 • South West Water continues to deliver sector leading totex outperformance, with £237 million cumulative efficiencies to date over the 2015-20 regulatory period • Efficiencies from the Bournemouth Water integration, including delivery of key capital schemes in the region, with the c.£27 million of net synergies required by 2020 secured.	**£280m^** **underlying profit before tax including the benefit of cost efficiencies across the Group** Measures with this symbol ^ are defined in the alternative performance measures section on pages 174 to 176.	• **Community investment and benefit** – minimising disruption and inconvenience for communities means we also minimise the cost to the business • **Resource and energy efficiency** – the use of solar photovoltaics to power our facilities, and other energy saving initiatives, help us to reduce our own demand for electricity from the grid while maximising the energy generated from our core operations • **Responsible supply chain** – value for money secured through robust procurement practices and sustainable supply chains.	Risks that could impact our ability to deliver efficiencies include: • Operational failures that result in rectification costs • Changes in law or regulation that require additional expenditure to fund implementation and ongoing compliance • An increase in customer bad debt, resulting in additional debt collection costs • Failure to recruit, retain and develop people with the appropriate skills.
3 **Driving sustainable growth** Linked to remuneration targets, see pages 93 and 96	• Identify and consider opportunities for further growth, including initiatives to expand our customer base or form partnerships with other organisations • Drive future growth opportunities for Viridor by developing options for new ERFs, energy parks and plastics recycling • Build on the success of K6 by delivering K7 'New Deal' plan that meets the needs and priorities of South West Water's customers and other stakeholders • Continue to build scale and efficiency in the non-household retail market through Pennon's water retail business, Pennon Water Services.	• Sustainable dividend – increase in total dividend for the year of 6.4% reflecting strong performance of Pennon's water and waste management businesses • Three ERFs in operational ramp up and one under construction (current portfolio) • Committed to £65 million investment in new plastics recycling facility underpinned by long-term contracts • Increased stake in Runcorn I ERF joint venture • Committed to investment in contract-backed refurbishment of materials recycling facility in Suffolk • Developing options for three new ERFs (in addition to current portfolio) and a further two new plastics recycling facilities • Identified further opportunities through energy parks linked to our ERF and landfill portfolio • Well positioned for regulatory and market developments and awarded fast-track status for K7 (2020-25) business plan • Completion and commissioning of the innovative Mayflower water treatment works in Plymouth • Preparation for the Isles of Scilly transfer well advanced.	**Group assets** as at 31 March (£bn)  	• **Quality services and satisfied customers** – increased focus to improve the customer experience and help expand our customer base, while retaining existing customers • **Good governance and high standards of business conduct** – ensure our people are incentivised appropriately and exhibit the right behaviours to enable us to achieve long-term, sustainable growth.	Our ability to deliver sustainable growth could be impacted by: • Unfavourable economic conditions • Local authority austerity • Poor customer service • Loss of market share as a result of regulatory reform and increased competition • Difficulties in recruiting, retaining and developing people with the necessary commercial acumen to help our businesses grow and prosper.

Sustainability at our core

This year, we have structured our report around Pennon's sustainability strategy. Pennon's environmental, social and governance (ESG) framework is centred around how we positively impact the communities we serve, from global issues including climate change and biodiversity, through to local benefits, customer satisfaction and employee wellbeing. Our strategy, objectives and targets set out how we will drive improvements and performance in the years ahead.

As we deliver our purpose – bringing resources to life – we aim to do so in a trusted, collaborative, responsible and progressive way. We work in long-term partnerships, seek to deliver outstanding service to customers and communities, and support the creation of value for our shareholders – 65% of whom are UK investors including pension funds and savings trusts, charities and employees.

We know that there are obvious benefits to a clear, strategic and long-term approach to sustainability. This enhances our business performance, helps strengthen business resilience, protects our ongoing licence to operate via regulatory compliance and is integral to our risk management processes.

We have conducted a full materiality assessment and have identified, within our ESG framework, the nine focus areas most relevant to our business. In each we have defined our strategic objectives out to 2030. We have also set three-year targets and will monitor and report progress on each objective.

As well as resetting our sights through a refreshed sustainability strategy, we have been delivering improvements in our focus areas throughout 2018/19.

Priority programmes 2019/20

We have also chosen three important priority programmes for the year ahead in order to accelerate progress in these key areas:

Plastics

Read more on page 02

Biodiversity

Read more on page 24

Sustainable finance

Read more on page 72

We will report on progress towards our commitments in the Pennon Plastics Programme, promote and increase finance raised through our Sustainable Financing Framework to support sustainable investment in the Group's operations, and showcase good practice via partnerships and responsible stewardship to protect and improve biodiversity on our sites.

Find out more online at www.pennon-group.co.uk/sustainability

Mapping our contribution to the UN Sustainability Development Goals (SDGs)

All 17 of the UN SDGs are important, so we encourage our customers, suppliers, employees and other stakeholders to familiarise themselves with the Global Goals and see how we can all contribute towards them.

We have mapped our sustainability focus areas to the SDGs that are most materially relevant to us, which enables Pennon to measure and demonstrate its performance and contribution to the SDGs. We have also assessed and aligned our objectives and targets against the most relevant of the UN SDGs and will increasingly monitor our performance using the SDGs and KPIs.

Find out more about our targets online at www.pennon-group.co.uk/sustainability

THE GLOBAL GOALS

Our sustainability focus areas and objectives

Environmental leadership
- Leadership in minimising carbon emissions and developing climate change adaptation strategies
- Ensure a positive economic, social and environmental impact and continuous positive action to prevent pollution, and ensure regulatory compliance.

Healthy places and habitats
- Proactively protect and enhance biodiversity in our operational areas through quality habitat creation, good stewardship and environmental partnerships.

Resource efficiency and natural capital stewardship
- Leadership in resource productivity and stewardship, best practice in waste prevention, resource and water efficiency
- Services and innovative solutions for society that help to protect natural capital and resources.

Community investment and benefit
- Measurable positive investment and support for local business and communities through our services, active sponsorship, partnership and donation programmes, education services and employee volunteering scheme.

Health, safety and wellbeing
- Strive for the highest standards of health, safety and wellbeing in the workplace
- Continuously improve performance to create a safe and healthy working environment for our employees, contractors and visitors.

Skills, diversity and development
- Achieve a diverse and productive workforce reflecting the communities in which we work
- Develop, upskill and empower our employees. Treat them fairly and ensure that they are fully engaged in all aspects of Pennon Group's objectives and high standards.

Quality services and satisfied customers
- Aim to exceed expectations and engage with our customers, clients and other stakeholders to build good relationships and to continuously improve our services
- Work with and support our most vulnerable customers.

Responsible supply chain
- Enable sustainable supply chain practice and partnerships including human rights, equal opportunities, and positive social and environmental values.

Good governance enabling investment, innovation and sustainable growth
- A sustainable and successful business with transparency, respect and integrity for the benefit of our customers, shareholders, employees and other stakeholders
- Continue to invest in vital infrastructure and innovation for strong performance and sustainable growth, via our Sustainable Financing Framework.

Group highlights

Sustainable finance

Highlights of the year

- Robust performance in 2018/19, in line with management expectations
- EBITDA growth of 19.1% at Viridor supported by the build out and performance of our energy recovery facilities (ERFs)
- Higher revenues and EBITDA at South West Water reflecting increased customer demand over the summer
- c.£17 million p.a. Group efficiencies secured, in line with expectations
- Cash flow from operations reflecting robust operational performance, while significant capital investment continues
- Development of our Sustainable Financing Framework, with £600 million of £830 million secured linked to the sustainable nature of the business, reducing our cost and reflecting our environmental and social credentials
- Dividend per share up 6.4% to 41.06p
- Cumulative return on regulated equity (RoRE) at 11.8%.

See pages 50 to 57 for further information

Alternative performance measures (APMs)
Measures with this symbol ^ are defined in the alternative performance measures section of the annual report on pages 174 to 176.

(1) Underlying earnings are presented alongside statutory results as the Directors believe they provide a more useful comparison on business trends and performance. Note 6 to the financial statements provides more detail on non-underlying items.

Revenue statutory
£1,478m
2017/18: £1,396m (+5.9%)

EBITDA statutory
£521m
2017/18: £513m (+1.6%)

EBITDA underlying^(1)
£546m
2017/18: £510m (+7.2%)

Profit before tax statutory
£260m
2017/18: £263m (-1.0%)

Profit before tax underlying^(1)
£280m
2017/18: £259m (+8.3%)

Effective interest rate^
3.6%
2017/18: 3.7% (-0.1pts)

EPS statutory
51.1p
2017/18: 48.0p (+6.5%)

EPS underlying^(1)
57.8p
2017/18: 50.9p (+13.6%)

Dividend
41.06p
2017/18: 38.59p (+6.4%)

Capital investment^
£396m
2017/18: £398m (-0.6%)

Shareholder profits(1)

	£m
Profit before tax and non-underlying items	280
Non-underlying items before tax	(20)
Statutory profit before tax	260
Tax charge	(38)
Profit attributable to perpetual capital security holders	(8)
Profit after tax attributable to shareholders	214

Sustainable operations

Highlights of the year

- LTIFR reduced by 32.2% to 1.37
- Created 256 new graduate and apprenticeship development opportunities across the Group
- Construction at Avonmouth ERF well advanced
- Plans well progressed for an orderly transition at the end of the Greater Manchester contract, with anticipated non-material financial impact
- Commitment to recycling resulting in £65 million plastics recycling facility and refurbished materials recycling facility supported by 10-year local authority contract
- Operational ramp up for Glasgow, Dunbar and Beddington ERFs progressing well
- Continued strong performance from ERFs with availability again >90%(2) on operational assets
- 'New Deal' business plan for K7 (2020-25) awarded fast-track status, the only water company to achieve this for two successive price reviews
- WaterShare delivering c.£110 million of outperformance for sharing with customers.

See pages 32 to 49 for further information

(2) Weighted by capacity, excludes Bolton (reverting to Greater Manchester Local Authority 31 May 2019), includes joint ventures at 100%.
(3) Gigawatt hours, being an amount of energy equivalent to delivering 1 billion watts of power for a period of one hour.
(4) LTIFR for employees and agency staff per 200,000 hours worked.

Total low-carbon energy generation
1,617GWh(3)
2017/18: 1,560GWh (+3.7%)

Average ERF availability(2)
91%
2017/18: 92% (-1 pt)

Waste recycled and recovered (tonnes)
4.9m
2017: 4.9m (unchanged)

Total waste material inputs (tonnes)
6.8m
2017/18: 7.0m (-2.9%)

Lost time injury frequency rate (LTIFR)(4)
1.37
2017/18: 2.02 (down 32.2%)

Drinking water quality South West Water
99.99%
2017: 99.96% (+0.03pts)

Drinking water quality Bournemouth Water
100.00%
2017: 99.98% (+0.02pts)

Bathing water compliance ('sufficient quality' or higher)
98.7%
2017/18: 97.9% (+0.8pts)

Chairman's statement

> Sustainability has always been at the heart of what we do. The Board has given its wholehearted support to Pennon's new long-term sustainability strategy, shaped by the needs and priorities of our stakeholders.

Sir John Parker
Chairman

I am pleased to report once again that the Group achieved a strong overall performance during the year.

We achieved a sector-leading return on regulated equity at South West Water and our 2020-25 business plan received a fast-track green light from Ofwat, the water industry regulator, making South West Water the only company to have achieved fast-track status for two consecutive price reviews. We are proud of the energy and commitment that went into producing our innovative plan and we were encouraged that the regulator regarded it in such a positive light.

At Viridor, progress continued in bringing energy recovery facilities (ERFs) on stream, with three in operational ramp up and the latest facility under construction. These facilities are the culmination of an ambitious £1.5 billion ERF investment, which began in 2010, to build 11 plants across the UK. This reflects an enormous amount of effort by the Viridor team and they should be proud of an impressive achievement.

Transparent stakeholder engagement

We welcome the changes to the UK Corporate Governance Code requiring companies to better understand the views of key stakeholders and report how their interests have been considered and taken into account. This move to increased transparency fully aligns with our values and we continue to develop strong relationships with our full range of stakeholders. We have a particularly close dialogue with our regulators, as well as excellent communications with government, investors, customers and employees. We engage with our stakeholders to understand their needs and priorities, which in turn shape our strategy and purpose. Further details on how we have taken steps to embrace this new development of the Corporate Governance Code will be presented in our 2020 annual report.

Sustainability is at the heart of what we do

Sustainability has always been at the heart of what we do and I am pleased to report that the Board has given its wholehearted support to a new long-term sustainability strategy. The strategy is backed up by initial three-year objectives, targets and action plans and ties together the knowledge of environment, social and governance (ESG) requirements that exist across the Group. We continue to invest and focus management efforts on further improvements to environmental performance at South West Water. 2018/19 saw the lowest number of serious and significant (Category 1 and 2) pollution incidents for 10 years. We expect our substantial investments and measures to ensure further reductions across all wastewater pollution categories to meet our ambitious targets.

In addition to the HomeSafe and People strategies, our pioneering Sustainable Finance Framework, which we began to implement during the year, complements our refreshed sustainability strategy. This framework formally recognises our commitment to investments which bring significant environmental and social benefits across a range of areas. It allows Pennon to access future funding opportunities in a manner that is aligned with Green Loan Principles, Green Bond Principles and Social Bond Principles.

Giving customers a stake and a say

We work hard to build strong relationships with our customers and to deliver excellent services to those served by Viridor, South West Water, Bournemouth Water and Pennon Water Services. The 2020-25 business plan that we submitted to Ofwat was all about empowering customers and offering a New Deal. A striking feature of this New Deal is an innovation called WaterShare+, which builds on our established WaterShare financial mechanism for sharing outperformance with our customers. Through WaterShare+, we will go even further, offering eligible South West Water customers a shareholding in Pennon Group in 2020, along with a greater say in how South West Water is run through a separate customer annual general meeting. I wholeheartedly support this bold and imaginative initiative.

See pages 70 and 71 for more details

Strong governance

Our governance structure has matured and is performing well as we continue to refine Board processes. We have a transparent corporate structure and our Board is focused on providing strong financial control, sound administration and good governance. I am particularly pleased with the professional debates we have in both the Group Board and our South West Water board. All our Independent Non-Executive Directors have clear line of sight into South West Water, Viridor and Pennon Water Services.

See the Governance sections starting on page 74 for more details

Experienced Board

It is fundamentally important to ensure our Board has a broad skill set and deep experience.

In September 2018, we announced the appointment of Iain Evans to the Board as an Independent Non-Executive Director. Iain has 40 years' global experience in advising companies and governments on issues of complex corporate strategy. In 1983 he co-founded LEK Consulting in London and built it into one of the world's most respected corporate strategy consulting firms. He was appointed as a non-executive director of Welsh Water plc in 1989 and served on the board for nearly 10 years, including five years as chairman. As announced in last year's annual report, after nine years on the Board, Martin Angle stood down in December 2018. On behalf of the Board, I would like to thank him for his hard work and commitment to Pennon over the past nine years.

We are pleased to have recruited Claire Ighodaro to our Board. Claire's extensive background in finance and across both regulated and non-regulated industries will be a great asset to the Group and will complement the broad range of skills of the current Board. Claire will join us in September.

Board members regularly visit operational sites and take the opportunity to meet employees, learn more about the processes and see a facility in action.

Bringing resources to life

Since developing our new vision and values, with extensive involvement from employees across the Group, we have moved our focus to truly embedding these.

Our single vision – bringing resources to life – and our four values, have been communicated in a variety of ways: through our quarterly leadership forums, regular features in our staff magazine, our Big Chats (dial-in for all employees to engage with the Pennon Executive) and Town Hall sessions hosted by each business.

We have also developed the behaviours to support our values, with our senior leaders demonstrating these behaviours in all that they do, making sure they are setting the tone for the business, both internally and externally.

Our values

Trusted
We do the right thing for our customers and stakeholders

Collaborative
We forge strong relationships, working together to make a positive impact

Responsible
We keep our promises to our customers, communities and each other

Progressive
We are always looking for new ways to improve and make life better

Chairman's statement
continued

Ambitious health & safety road map
The Group set an ambitious road map for our HomeSafe initiative. Designed to deliver the highest standards of health & safety performance, HomeSafe enjoys high visibility across our operations. We have been pleased to see that the investment we are making has resulted in such strong engagement from our people. We are determined to sustain the momentum and, in September, the Board approved a longer-term HomeSafe strategy with ambitious targets and independent benchmarking which I believe will help us achieve our goal to be the health & safety leader in the UK water and waste industries by 2025.

Promoting diversity
The Board promotes equality and diversity in the workplace. We remain committed to the search for Board candidates being conducted (and appointments being made) on merit, and with consideration given to the benefits of gender and ethnic diversity.

The latest *Hampton-Alexander Review: FTSE Women Leaders* (November 2018) listed Pennon at number 85 in its FTSE 250 rankings for women on boards and in leadership with a score of 28.6%. This was lower than the previous year as a result of a brief period at the end of 2018 during which Iain Evans in his new role overlapped with Martin Angle. This has now increased to 33% and will increase to 43% in September with the appointment of our new Non-Executive Director, Claire Ighodaro.

Both Chris Loughlin and I continue to be enthusiastic members of the 30% Club, a forum with a goal of achieving a minimum of 30% women on FTSE 350 boards by 2020.

Developing and retaining talent
More than a year ago we announced our new vision – bringing resources to life – with its strong supporting values of trusted, collaborative, responsible and progressive. Good work was done during the year in embedding these values across the Group.

Great people make great organisations and developing and retaining talent is integral to the Group's future success. Overcoming competition for top talent in the marketplace is a priority for the Group, so we enlarged our graduate recruitment programme during the year. Alongside our management trainee scheme at Viridor, we will extend the progress of our graduate recruitment across the Group in 2019 supporting our pool of internal talent. The Government's apprenticeship reforms and apprenticeship levy, introduced in 2017, are also helping us to prioritise development programmes for employees. We are particularly proud of our apprenticeship scheme and started 226 apprentices through this route in 2018/19.

> "We engage with our stakeholders to understand their needs and priorities, which in turn shape our strategy and purpose."

Balancing returns and investment
The Group's dividend of 41.06 pence per share is an increase of 6.4% and continues our 10-year, sector-leading dividend policy to 2020 of retail price index plus 4% year-on-year growth. This has been achieved while investing more than £3.2 billion in our businesses over the 10-year period to date. The dividend growth is increasingly supported by growth in Viridor's earnings. In addition, we continue to share our success with customers through South West Water's innovative WaterShare mechanism with £110 million of total cumulative benefits identified since 2015 to be shared through future bill reductions, service improvements, reinvestment or our 2020-25 WaterShare+ scheme.

Outlook: Delivering for all our stakeholders
As we look ahead, Pennon is well placed for the future as it draws on its many strengths. We are poised to reap the benefits of our significant investment in waste to energy, as the next four ERF plants come on stream. In recycling, we were pleased to see the Government's Resources and Waste Strategy was aligned to Viridor's strategy and our confidence in that market is reflected in the £65 million investment in a new plastics recycling facility at Avonmouth near Bristol, which will be powered by the new ERF.

In the water business, with our fast-track status, we expect to make a strong start to the next regulatory period starting in April 2020.

We are making strong progress in our health & safety strategy as we work towards our goal of being a health & safety leader in our industries by 2025.

Our People strategy to attract and retain top talent is bringing greater diversity and experience to our Group, which is reflected all the way up to the Board. We believe our strong culture will give us a competitive advantage, deliver a high level of service to our customers and ultimately lead to outstanding business performance. We continue to operate in the interests of all our stakeholders, delivering significant community investment and benefit. From April 2020, this will include giving eligible South West Water customers a stake and a say in our business with WaterShare+ offering customers the chance to receive shares in Pennon.

Our new Group-level sustainability strategy will deliver even greater focus on the big strategic themes of our time from climate change to plastics and biodiversity. Over the coming years, we will deliver sustainable growth to the benefit of all our stakeholders as we pursue our vision and live our values.

We remain committed to transparency, independent governance and sharing financial outperformance with our customers. As we pursue our vision and live our core values, I am confident the Board, the Pennon Executive and Pennon's people will deliver the broadest range of benefits to all our stakeholders.

Sir John Parker
Chairman

Community investment & benefit

Part of the communities we serve
We are part of the communities we serve, seeking opportunities to contribute and deliver tangible community investment and benefit. Our engagement is partnership-based, working with selected charities and through Pennon's volunteering and community outreach. We work with our partners to protect and enhance our environment, we want to make a positive difference to our society.

Our community and education programmes include 18 learning centres across the country, where we hosted more than 9,000 visitors during the year. Through our partnership with the South West Lakes Trust, our reservoirs welcome more than two million visitors a year. We also have an active community and schools outreach programme. Our BeachCare partnership with Keep Britain Tidy has delivered 1,280 beach cleans and removed 174 tonnes of waste since it started in 2010.

In 2018/19, Pennon spent almost £7.4 million on community sponsorship and charitable donations including £6.9 million contributions to Viridor Credits (an independent not-for-profit organisation that administers Viridor's contributions to the Landfill Communities Fund).

Sustainability focus area

See sustainability strategy on page 11

Market and regulatory overview

With clear market opportunities for both our water and waste businesses, the Group is well prepared to capitalise on the changing regulatory water markets and is in a strong position to deliver growth through its increasing market share of the UK's energy recovery operations.

Water sector

The water industry serves more than 50 million household and business customers in England and Wales, who are supplied with drinking water and have their wastewater taken away and treated. These services are provided by 16[1] core regional companies, of which 10 are providers of both water and wastewater services.

(Source: Ofwat.gov.uk).

The UK water industry supplies clean water to properties through a mains network that is more than 340,000km long. It manages 567,000km of sewers and 6,000 wastewater treatment plants.

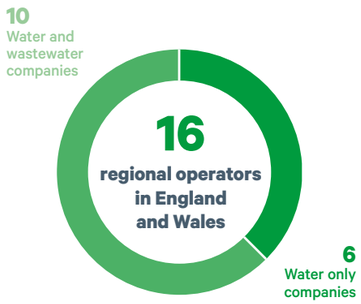
(Source: Water UK).

Regulatory framework

As a provider of water and waste water services, we operate within a regulatory framework which contains a variety of regulators. This regulatory framework is in place to safeguard the best interests of customers and the environment.

Defra sets the overall water and sewerage policy framework in England while other regulators focus on specific aspects including water and sewerage policy, economic, environmental, drinking water quality and the customers we serve.

Water industry (2018)



Water regulators

defra

Ofwat

Environment Agency

dwi

Consumer Council for Water

(1) Hafren Dyfrdwy acquired by Severn Trent in 2016.

Our approach

South West Water is focused on demonstrating leadership within the water sector, pioneering new technologies and methods to improve customer service, efficiency and resilience while working closely with industry peers, as appropriate, and the supply chain to identify and implement best working practice across all areas of the business.

South West Water has mature and robust processes to ensure compliance with regulatory requirements.

We engage with our regulators at all levels and are committed to ensuring trust and transparency within these relationships.

Non-household retail market

On 1 April 2017, the non-household retail market was opened, allowing up to 1.2 million businesses and other non-household customers across the country to choose which retailer they buy water and wastewater services from.

The non-household market operates through a controlled portal operated by Market Operator Services Limited. It has required the separation of the wholesale and retail arms of water businesses.

Pennon Water Services was established to manage the non-household retail business for Pennon via a retail venture with South Staffordshire plc.

Recycled waste materials

There is an increased public awareness around the importance of recycling following high profile documentaries and media campaigns.

In 2018, the Government launched its 25 Year Resources and Waste Strategy for England to minimise waste, promote resource efficiency and move towards a circular economy in England.

The most recent statistics published by the UK Government show that UK households produce 27 million tonnes of waste annually, with 12.3 million tonnes being recycled; a rate of 45.7%.

Residual waste

Waste that cannot be reused or recycled is typically recovered and converted to energy via ERFs or disposed of at landfill sites.

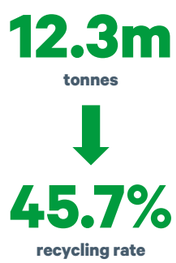
In 2018, UK household and commercial and industrial waste activities produced an estimated 54 million tonnes of non-recyclable waste.

27.9 million tonnes was combustible waste, of which approximately 11.5 million tonnes was processed by ERFs (11 million tonnes in 2017), demonstrating a continued capacity gap in the UK market.

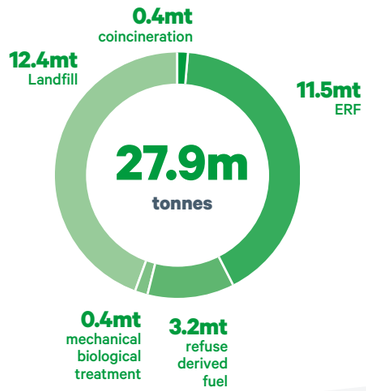
In addition to inert and other residual waste, 10.5 million tonnes of active waste was also sent to landfill, a slight decrease on 2017 (11 million tonnes).

Market choice

UK household waste recycled (published March 2019)



UK combustible waste processed (2018)



Pennon Water Services has focused on offering high-quality retail customer service and a broad range of services that enhance value.

Viridor is a founder signatory of the UK Plastics Pact, an initiative to create a circular economy for plastics.

We are upgrading our existing sites, investing in a new plastics recycling facility and exploring options to invest in a further two facilities.

We also work closely with our customers to maximise the quality of recyclate material inputs and seek to share the pricing risk with them.

Viridor's programme of investment in ERFs continues as planned with 11 facilities due to be operational by 2020/21. We are also exploring opportunities for a further three ERF facilities.

We continue to maximise gas yields from our landfills and our external grid connections. Mothballed sites are reopened as demand requires and we maintain sites in areas of landfill scarcity.

Our stakeholders

Water and waste management are high profile industries with a wide stakeholder group.

We are committed to listening, engaging and reflecting our stakeholders' needs and priorities in our business plans and operations.

Our engagement approach involves regular dialogue that is timely and open, building meaningful relationships based on trust and transparency.

We use a wide range of methods to reach our stakeholders, ranging from formal independent research, focus groups and workshops to real-time conversations.

We engage with our stakeholders in order to understand their needs and priorities, which in turn shape our strategy and social purpose:

Innovate and develop our business – by knowing how our business is experienced, perceived and understood by our stakeholders we learn how to improve

Identify our risk profile – an open and transparent approach helps us to see potential problems before they materialise

Build loyalty and satisfaction – engagement, particularly with staff, customers and investors, builds understanding and appreciation of our business

Develop advocates – strong stakeholder relationships mean we have more advocates helping us shape our reputation and the environment in which we operate

Our Board – reviews the impact of its decisions on its stakeholders interests.

Our customers

Our water businesses supply water and wastewater services to around one million household customers and over 160,000 business customers and our waste and recycling business services 150 local authority and major corporate clients in addition to 32,000 customers.
We regularly conduct customer satisfaction surveys, convene forums and meetings, providing feedback to our teams to reward good service and make improvements where needed

Our engagement approach

We engage regularly with our customers on service quality, cost of service, value for money and our strategy.

We regularly conduct customer satisfaction surveys, convene forums and account management meetings, providing ongoing feedback to our teams to recognise good service and make improvements where needed. We engage with key trade and customer bodies including the Consumer Council for Water.

We also have our well-established independent water customer challenge panel which represents customer views and engages with the Executive.

Find out more on pages 28, 41 and 44

Quality services and satisfied customers

South West Water's customer service score is
88pts
+3pts its best ever quality service score. Target: year-on-year increase in customer satisfaction scores

Viridor's Trustpilot score is
7.1
Target: year-on-year increase in customer satisfaction scores

South West Water engaged with
c.1m
customers
on its most recent business plan

Our
WaterFuture
Customer Panel (WFCP) meets quarterly

Skills, diversity and development

LTIFR 1.37 is down
32.2%
from 2017/18. Target of 0.50 by 2025, which would make Pennon a health & safety leader in water and waste

Trust Index score
62%
+2pts on 2017/18. Target is to be Great Place to Work accredited

Engagement score
68%
+1pt on 2017/18

Gender diversity at Board level has remained at
33.3%
Ahead of our 2020 30% 'Club' target

7 STEM
partnerships delivered
in line with 2017/18.
Long-term target to increase the reach of our STEM and community education programme by 10% per year

Our people

Our employees are our greatest asset. We provide the opportunity for them to be engaged at multiple levels of the business and through a variety of two-way dialogue and feedback channels

Our engagement approach

We continually engage and communicate with our people on their health, safety and well-being, our organisational culture, promoting diversity and inclusion, training and development.
We use our annual employee trust and engagement survey as our cornerstone, with regular quarterly pulse surveys. Our senior leaders meet once a quarter, Viridor and South West Water have established engagement forums where staff representatives discuss business challenges and every other month all employees are invited to Group-wide calls to hear directly from the Pennon Executive, asking any questions they wish.

Find out more on pages 32 to 35

You can find our gender pay gap report online: www.pennon-group.co.uk/about-us/gender-pay-gap-report

Our communities

Our businesses operate in the heart of local communities, so we work closely with these stakeholders through regular liaison meetings and community events. Our education facilities and outreach programmes support environmental learning and our charity donation schemes support hundreds of good causes in communities where we operate

Our engagement approach

We engage regularly with our communities on local projects and initiatives. We hold regular community liaison groups around our sites. We also engage with our communities through print, digital and social media and use these channels to great effect with our behavioural change campaigns including Love Your Loo, and Think Sink! South West Water holds a Conservation and Recreation Forum twice a year to get input from a range of stakeholders including South West Lakes Trust, National Farmers Union, Dartmoor National Park, the Royal Yacht Association and others.

We work closely with the South West Lakes Trust to support access to our land and sites for recreation in the South West.

Find out more on pages 17, 41 and 48

Community investment and benefit

£7.4m
community investment
across Pennon, including £6.9 million to Viridor Credits

c.9,000
visitors to South West Water and Viridor's 18 education and learning centres

c.2m
visitors to South West Water's reservoirs
in line with 2017/18

26
community liaison groups held at Viridor

98.7%
of bathing water classified as 'sufficient' or better
up from 97.9% in 2017/18.
Our long-term target is 100%

174
beach cleans
removing 14.8 tonnes of waste

Our stakeholders
continued

Healthy places and habitats

2
Category 1 and 2 wastewater pollution incidents,
down from 3 in 2017/18

2020
establish clear targets towards carbon neutrality
taking into account the UK Government and water sector 2030 targets

TCFD[1]
Implement recommendations
by 2020/21

4.9m
tonnes of material recycled or recovered
4.9m in 2017/18

Our environment

We work closely with a range of environmental partners including South West Lakes Trust, Westcountry Rivers Trust, The Wildlife Trust and various Non Government Organisations to ensure we deliver our environmental commitments

Our engagement approach

We meet regularly with our environmental stakeholders on resource efficiency and natural capital stewardship. Viridor is a founder and active member of the Business in the Community and Green Alliance cross-sector Circular Economy Task Forces and the UK Plastics Pact. We hold a twice yearly BeachWise Forum with key stakeholders including Surfers Against Sewage. We meet regularly with the Wildlife Trusts in our operational areas and with the West Country Rivers Trust. We hold both formal and informal meetings with the Environment Agency, Scottish Environment Protection Agency and Natural Resources Wales including review meetings during the year to assess environmental performance.

Find out more on page 24

(1) Task Force on Climate-related Financial Disclosures

Good governance enabling investment, innovation and sustainable growth

49.2%
of our shareholder register met over 2018/19

83
meetings and calls were held

9
roadshows were held and six conferences attended

72%
of finance raised under Pennon's new Sustainable Financing Framework
against a target of 25%

2018 Sustainalytics score
72
up from 61 in 2017, target of year on year improvement

Our investors

We run an extensive investor relations programme ensuring debt and equity investors, shareholders, analysts and financial media are informed of our business strategy and key developments

Our engagement approach

We engage regularly with our financial community including equity investors and debt providers on financial performance, strategy, risks and opportunities and macro themes. We hold roadshows across the UK, Europe and the US each year in addition to conferences, investor and analyst briefings, twice yearly results presentations and CFO updates. We continue to provide trading updates between results.

Our suppliers

Our supply chain partners play a vital role in supporting sustainable growth and cost base efficiency across the business. Through rationalising and segmenting our supply chain partners to reflect either strategic, key, preferred or transactional relationships, we are developing an approach that maximises our engagement with each supply chain partner.

Our engagement approach

We have formal contracts and framework agreements with all supply chain partners that meet the appropriate balance between commercial, quality and sustainably focused delivery. Our e-procurement platforms support a structured, fair and transparent approach to supplier engagement and as a signatory to the EU Skills Accord we work collaboratively to support skills development and investment throughout the supply chain.

We have also launched our sustainable procurement policy and supplier code of conduct during the year.

Responsible supply chain

2021/22 target continue delivery of supply chain rationalisation to achieve a supply base of

c.3,000
suppliers
to reflect a 70% decrease from the 2017/18 figure (c.9,500 suppliers)

Ensure
internal investment
and projects approval processes contain appropriate sustainability criteria by end 2019/20

Incorporate
sustainability-focused questions
within the standardised procurement compliance questionnaire by end 2019/20

Following supplier segmentation and rationalisation, work with all suppliers to ensure
100%
compliance with the five objectives
identified within our Sustainable Procurement Policy by end 2021/22

Following supplier segmentation and rationalisation, monitor and report compliance across
100%
of suppliers
against the key principles identified within our Code of Conduct for Supply Chain Partners by end 2021/22

Our regulators

We have an open dialogue and meet regularly with our regulatory bodies: Ofwat, Defra, Environment Agency, Scottish Environment Protection Agency, Natural Resources Wales, Drinking Water Inspectorate and the Health & Safety Executive to ensure that our business plans address their priorities and concerns

Our engagement approach

We engage regularly with all our regulators on our Business Plans, strategy, performance, risks and opportunities and delivery for customers. We attend regular meetings, provide reports and reviews, respond to consultations and join workshops, to ensure trust and transparency within these relationships.

Find out more on page 18

Environmental leadership

Our policy makers

Engaging with national and local government, MPs and Peers, Local Enterprise Partnerships, the Health & Safety Executive, HM Revenue & Customs, Department for Business, Energy & Industrial Strategy (BEIS) and Department for Environment, Food & Rural Affairs (Defra), we have a good ongoing dialogue with policy makers and stakeholders who influence shape our social contract.

Our engagement approach

We regularly discuss our strategy, performance and risks and opportunities with policy makers and key opinion formers. We engage through a regular meeting programme, briefings, round tables, consultation responses, trade bodies including Water UK, the Environmental Services Association, Waste & Resources Action Plan (WRAP), Recycling of Used Plastics Limited (RECOUP) and others.

Environmental social and governance

110
meetings and site visits
held in 2018/19, a 52% increase on 2017/18

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Healthy places & habitats

Our revised biodiversity strategy and our proposals for the Water Industry National Environment Plan help towards improving healthy places and habitats.

Focus on biodiversity

Our customers place a high value on the environment and support improvements in biodiversity. Tourism dominates the South West regional economy with visitors attracted by the high quality of the environment. Agriculture is an important activity along with food industries and a biodiverse landscape delivers improved outcomes for all key parts of the economy. Our Upstream Thinking and biodiversity programmes, including quality habitat creation on restored landfills contribute to the targets set out in the Government's 25 Year Environment Plan.

Sustainability focus area

See sustainability strategy on page 11

Chief Executive Officer's review

> Above all we know it is not just about what we do, but how we do it. We have a special responsibility to the communities that we serve.

Chris Loughlin
Chief Executive Officer

I am pleased to report another year of excellent progress against our strategic objectives. We want to lead in the UK's water and waste infrastructure sectors, investing for sustainable growth and driving value through efficiency. South West Water's 2020-25 business plan received a green light from the water industry regulator Ofwat in January 2019, giving us fast-track status that allows us to plan and provide early certainty to our customers. Viridor reported an excellent year across its UK recycling and residual waste operations. Throughout the year, we continued to deliver on our promises to customers and communities and our investment across the Group is driving tangible and positive results.

How we do business

Our two core businesses – South West Water and Viridor – each provide essential services to their local communities. We have a responsibility to deliver those well and our customers depend on our ability to operate over the long term as a stable and sustainable service provider. While delivering our services forms an essential part of serving our customers, we have a special responsibility to ensure we make a positive difference to our communities. Delivering in a way that reflects our values – trusted, collaborative, responsible and progressive – emphasises how we want to do that and the contribution we want to make to society.

Delivering sustainability

We already have expertise in, and understanding of, sustainability and it is a highlight of the past year that we formulated our new long-term, Group-wide sustainability strategy. This will ensure we continue to build on our strengths and achievements in sustainability under a unifying framework built on environment, social and governance (ESG) principles.

There are many aspects of our operations each year that underline how we are living our values. A good example is our Sustainable Financing Framework, which is our platform for reducing the cost of capital while reflecting our environmental and social credentials.

Another example of how we are living our values is the Group's accreditation under the Fair Tax Mark. The Group always strives to be transparent about its tax affairs. We are the first water and waste management utility to secure this recognition and this initiative underlines that we are committed to following both the spirit and the letter of the law regarding our tax contributions. We do this because our customers tell us that it is important to them and because it is the right thing to do.

Environmental sustainability is also fundamentally important to us. Our operations in water and waste all have a potential (positive or negative) impact on the environment and we recognise our responsibility to act in a benign manner. In our water operations, for example, our pioneering Upstream Thinking programme delivers landscape-based solutions sympathetic to the environment. We have demonstrated that we can store water in an environmentally friendly way without automatically resorting to concrete for reservoirs or treating water with chemicals. We lead the sector in this and 80% of our water abstractions are positively impacted by Upstream Thinking.

Health & safety

When I reflect on 2018, it was a year in which significant progress was made embedding our health & safety improvement programme, HomeSafe, across the full spectrum of our operations. Delivered through manager-led training modules and e-learning, we are already seeing benefits flowing through, evidenced by reductions in our lost time injury frequency rate, which has fallen 32.2% in the reporting period (see page 31), and high health & safety scores from our employee engagement survey. Our ambitions do not end with the successful deployment of the initial phase of HomeSafe, though; as noted in the Chairman's statement, we have approved a progressive health & safety agenda, which I believe will deliver sector-leading health & safety performance by 2025 and maintain the momentum of HomeSafe. The Pennon Executive remain committed to ensuring that everyone who works for, with and in connection with our operations goes HomeSafe every day.

People

The Group's people strategy is showing good progress on several fronts. Our aim is to attract, develop and retain a highly skilled and customer-centric workforce. At the end of the year under review, Pennon had over 5,000 employees across the UK and we continue to be a large employer in the south west of England.

There is a sharper focus than ever before on the Group's long-term talent needs with our new approach to graduate recruitment, our fast-growing apprenticeship intake, which set a record in 2018/19, and other training and development opportunities. Our work in communicating with all employees in a more interactive manner is paying dividends with a pleasing improvement in employee engagement. We have also started to conduct 360° feedback surveys among our operational teams to assess how well they believe the Group's leaders are living our new values. We are promoting equality of opportunity and diversity across all areas, including gender and ethnicity. These are all aspects of an ambitious cultural change that is underway. Such change takes time, but I am confident our approach and determination will reap rewards and play a robust role in the Group's future development.

Dr Stephen Bird

In May 2019, we were shocked and saddened by the death of our Managing Director of South West Water, Dr Stephen Bird. Stephen joined us in 1992 as a Regulations Manager and subsequently moved up through Operations to become Operations Director in 2000 and was appointed to the South West Water board. In 2016, Stephen was appointed Managing Director. Stephen made an immense contribution to South West Water, the region and the water industry in his twenty-seven year career with us. A proud Plymouthian, Stephen's commitment to the communities we serve was an inspiration. Stephen is greatly missed by all his colleagues at Pennon and South West Water.

We continued to support the communities in which we operate through our education programmes, sponsorship and charitable donations. Our employees enhanced this contribution with 317 days of volunteering across projects such as litter picks, beach cleaning and tree planting. Employees across the Group also undertook fundraising for their chosen charities, through activities including mountain climbs, marathon runs and many cake sales.

Our ongoing success relies on the hard work and professionalism of our employees and I would like to thank them for their dedication and support during the year.

Setting the standard in the water industry

The approval of South West Water's 2020-25 plan was excellent news. Ofwat described the submission as setting 'a new standard for the sector'. The fast-track was significant because South West Water is the only company to have achieved this status for two consecutive price reviews.

Our New Deal plan will see the average water and wastewater bill fall by 11% in real terms between 2020 and 2025, with the average bill in 2025 being lower than it was in 2010, and extra steps being taken to eliminate water poverty altogether. South West Water also plans to spend more than £1 billion to improve services, enhance the environment and strengthen resilience. All of this responds to extensive research among customers, which shows they would like more empowerment and want to be involved in decision making.

While we commence groundwork for implementing our 2020-25 plan, we are of course entering the final year of the current regulatory period. The targets set for 2015-20 were challenging, but we have managed to outperform in every aspect and South West Water is one of only three companies in the water sector to do that. Strong operational and financial performance has once again underpinned our sector-leading return on regulated equity, which remains at 11.8% cumulatively since the start of the plan period. South West Water achieved overall outperformance against its outcome delivery incentives resulting in a net reward of £4.1 million for the year.

As in previous years, we are sharing the benefits of outperformance with our water customers through WaterShare. Since 2015, we have delivered £110 million of benefits to be shared. Customers will continue to benefit from reinvestment in services and lower bills in the next period. Our focus on efficiency and cost savings means South West Water's average annual bill is lower than it was 10 years ago and this underlines the Group's overriding commitment to ensuring customers receive the highest possible service levels.

Chief Executive Officer's review
continued

We know that delivering a resilient service is a key promise to our water customers. Despite the challenges of the March 2018 freeze and thaw and the unprecedented demand during the hot dry summer that followed, we continued to deliver excellent service throughout the year. This is reflected in our best ever customer service score with South West Water ranked second among all water and sewerage companies in England and Wales.

Our legacy of major investment to protect bathing waters continues to be reflected in excellent results for the 2018 bathing season. In addition, serious pollution and flooding incidents continued to fall. We maintain gearing at a level that aligns with Ofwat's notional view of an efficient company. South West Water is the only UK water company to share the benefits of lower interest rates with customers.

Delivering our strategy and committing to the next growth phase

Our current portfolio of energy recovery facilities (ERFs), which transform waste into electricity and heat, is supporting growth and performed well during the year. We now have three ERFs at Glasgow, Beddington and Dunbar in operational ramp up and our final facility at Avonmouth near Bristol under construction. Viridor increased its economic interest in its TPSCo joint venture, which owns the Runcorn I ERF, from 37.5% to 75%. The operational ERF portfolio, for the third year running, achieved availability from current operational assets in excess of 90%[1] including joint ventures during the year under review. The work on our portfolio of ERFs is a significant achievement for the Group and we expect them to support Pennon's earnings growth to 2020 and beyond.

In recycling, the market dynamics are favourable with the 'Blue Planet' effect prompting support from the UK Government. We believe the Government's Resources and Waste Strategy – published at the end of 2018 – will bring positive changes. The strategy sets out a framework for minimising waste, promoting resource efficiency and moving towards a circular economy. Our recycling activities have shown strong recovery from the challenging position we experienced in the second half of last year. We are investing in a new plastics recycling facility, co-located with our ERF in Avonmouth, and are refurbishing our materials recycling facility in Suffolk, supported by long-term contracts.

The forecast for landfill demand is robust into the medium term. Volumes and gate fees were stable over the year. We are forecasting that six sites will remain open into the medium term.

Outlook

We are on track to deliver all the commitments we made in the 2015-20 regulatory period. Looking beyond this, our focus is to capitalise on the certainty provided by our fast-track status for our next five-year business plan with its new benchmarks for service and efficiency.

We expect long-term demand for ERFs to exceed capacity by around seven million tonnes by 2035. We have successfully delivered increased capacity at our existing facilities in Glasgow, Cardiff, Ardley and Runcorn II. We also believe the market supports another phase of ERF development and, as a result, we are analysing opportunities for three new ERFs. Moreover, we are looking at energy park opportunities across the landfill and ERF portfolios that would capitalise on existing grid connections. These energy parks would be able to service a range of energy-intensive facilities, such as a third-party data centre or our own plastics processing plants.

Health, safety & wellbeing

Engaging employees with HomeSafe

The roll-out of our HomeSafe programme continues across the Group with all recycling and integrated assets sites now having completed the programme. Roll-out across our energy recovery and water facilities is well underway.

We have used a variety of approaches to engage employees. The CEO's HomeSafe Awards were created to recognise excellence in health & safety across the Group. Our winner in South West Water invented a piece of equipment to mitigate the risks of people falling into wastewater treatment tanks.

The equipment has been designed, installed and fitted onto tanks, with operating and risk assessment instructions provided as part of onsite HomeSafe training.

Sustainability focus area

See sustainability strategy on page 11

Quality service & satisfied customers

South West Water achieved its best-ever customer performance

South West Water achieved its best-ever performance against the service incentive mechanism (SIM) – the industry-wide measure of customer satisfaction – with 88 points, beating the 2020 target score of 85 points a year ahead of target and being placed second in the overall industry customer experience league table. Our service was also recognised when we won the prestigious 2019 UK Customer Satisfaction Awards run by the Institute of Customer Research.

Bournemouth Water continued its excellent performance against SIM with a score of 88. This included a further 15% reduction in residential written complaints.

Viridor continues to score highly on Trustpilot and is currently extending its customer surveys across its wider customer base.

Sustainability focus area

See sustainability strategy on page 11

The UK Government's Resource and Waste Strategy for England will stimulate more demand for recycling. The immediate focus will be on plastics with a potential doubling of the size of the recycling processing infrastructure required to service market demand. The Group is uniquely placed to help find innovative long-term solutions regarding plastics waste and we are exploring the possibility of investing in two additional new plastics recycling facilities.

I am confident the strong momentum in our water and waste operations will ensure Pennon Group has an excellent future. The Group's core businesses have real stature, with South West Water a best-in-class company and Viridor having 20% market share of the UK's energy recovery market. We see distinct growth opportunities for energy recovery in the UK, and we are confident we can deliver sustainable, long-term returns.

Chris Loughlin
Chief Executive Officer

(1) Weighted by capacity, excludes Bolton (reverting to Greater Manchester Local Authority 31 May 2019) includes joint ventures at 100%.

Pennon, a regional leader in the South West

Recognising the key role Pennon plays in the South West – as a provider of essential services, environmental stewardship and one of the region's largest employers – the Group continues to champion the campaign for South West Growth (#backthesouthwest) which it co-founded in 2016 with the Western Morning News, the region's Local Enterprise Partnerships and the CBI.

Now in its third year, the campaign calls for greater investment, a pathway to future growth and improved Government commitments for the South West. The campaign is actively supported by the region's MPs and has been the subject of several parliamentary debates.

Sustainability focus area

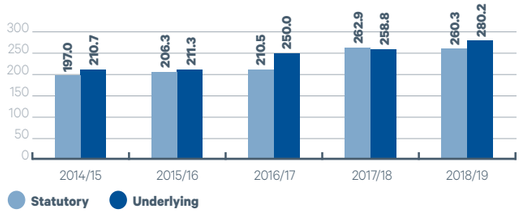
See sustainability strategy on page 11

Key performance indicators

Annual[1]

Operational

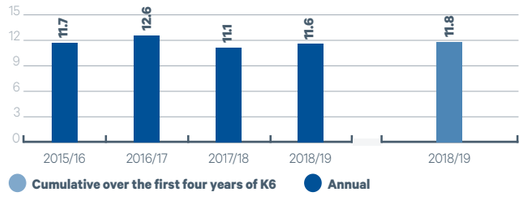
Profit before tax (£m)



Alignment to strategy
1, 2, 3

For more information and discussion of our performance during the year see the Report of the Chief Financial Officer, pages 50 to 57.

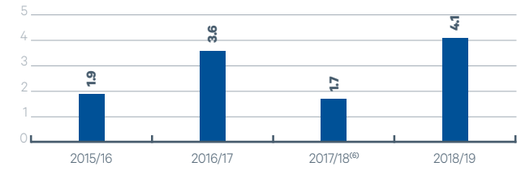
Return on regulated equity (RoRE) (%)



Alignment to strategy
1, 2, 3

For more information and discussion of our performance during the year see Our operations, Water and wastewater, pages 44 and 46.

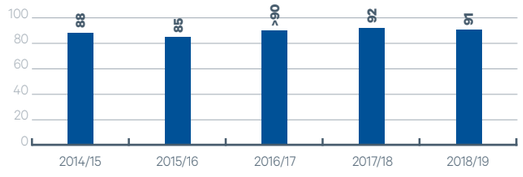
ODI net rewards (£m)



Alignment to strategy
1, 3

For more information and discussion of our performance during the year see Our operations, Water and wastewater, page 46.

ERF availability (%)[2]

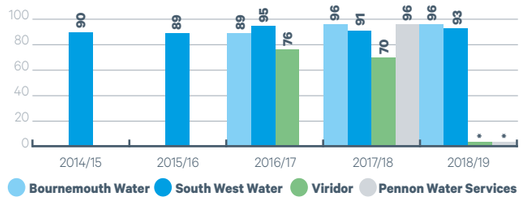


Alignment to strategy
1, 3

For more information and discussion of our performance during the year see Our operations, Waste management, page 38.

Sustainable business

Customer satisfaction with overall service (%)

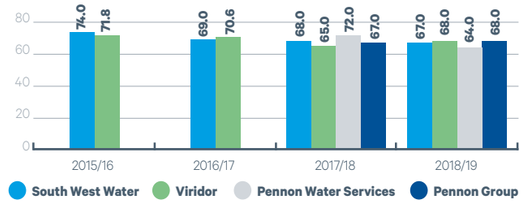


Alignment to strategy
1, 3

For more information and discussion of our performance during the year see Our operations, pages 41, 44 and 49.

* Basis of measurement for Viridor and Pennon Water Services changed during the year and data no longer available on a comparable basis.

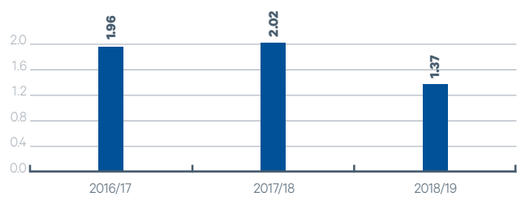
Employee engagement (%)[3]



Alignment to strategy
1, 3

For more information and discussion of our Group-wide employee survey see People, page 32.

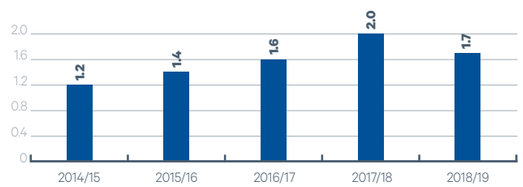
Health & safety (LTIFR)[4]



Alignment to strategy
1, 2, 3

For more information and discussion of our approach to health & safety during the year see the Chairman's statement, page 16, the Chief Executive Officer's review, page 27 and People, page 35.

Carbon emissions (million tCO_2e)[5]

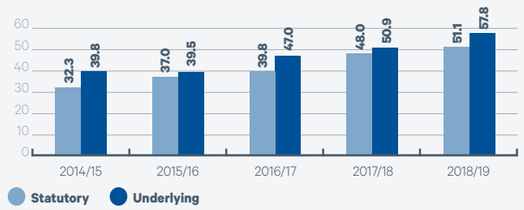


Alignment to strategy
1, 3

For more information and discussion of our performance during the year see the Directors' report, pages 106 to 108.

Long-term[1]

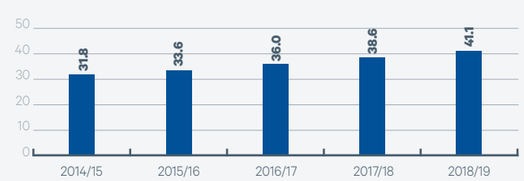
Earnings per share (pence)



Alignment to strategy
1, 2, 3

For more information and discussion of our performance during the year see the Report of the Chief Financial Officer, pages 50 to 57.

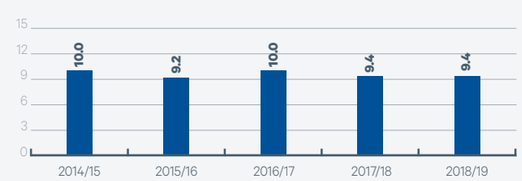
Dividend per share (pence)



Alignment to strategy
1, 2, 3

For more information and discussion of our performance during the year see the Report of the Chief Financial Officer, pages 50 to 57.

Return on capital employed (RoCE) (%)



Alignment to strategy
2, 3

New metric introduced for the LTIP in 2017.

Our strategic priorities

1 Leadership in UK water and waste infrastructure

2 Leadership in cost base efficiency

3 Driving sustainable growth

Our KPIs are aligned to our three strategic priorities.

For more information on our strategic priorities see pages 08 and 09.

(1) For further information on the relevance to Executive Directors' remuneration see pages 93 and 96.
(2) Average availability for the year for the five ERFs constructed by Viridor plus our two joint ventures weighted by capacity (joint ventures at 100%) and excludes Bolton.
(3) In 2017/18 we introduced a Group-wide employee survey, which changed the methodology for calculating employee engagement. See page 32 for more information.
(4) Lost time injury frequency rate (LTIFR) for employees and agency staff per 200,000 hours worked.
(5) Tonnes of carbon dioxide equivalent.
(6) Reflects prior year reassessment of £0.9 million for supply interruption relating to the extreme cold weather in March 2018.

People

We continued to embed our Group-wide people strategy, vision and values during the year and announced a health & safety roadmap that builds on our HomeSafe achievements.

Embedding the Group's vision and values

We launched the Group's new vision of Bringing our resources to life last year; our focus in 2018/19 was on embedding this more deeply across the Group. We also built a broader understanding of how employees at all levels can live our values of Trusted, Collaborative, Responsible, and Progressive.

We measure the progress we are making in living our values through our Group-wide employee engagement survey and supported by our Group HR strategy.

Becoming a great place to work

This was the second year we asked employees how it feels to work for Pennon using Great Places to Work Best Workplace Survey™. We were pleased to see an improved Trust Index© score of 62%, an improvement on the previous year of 2 points and significantly higher than the national average of 54%. Our Engagement score of 68% was also higher than last year's 67% achieved by the Group. These results show that we are well on the journey in embedding the Group's HR strategy and making continued progress in living our values and being recognised as a UK Best Workplace™.

High trust cultures enjoy better financial results. Research shows best workplaces outperform the market by 2 to 3% a year over a 25-year period. They have strong leadership, a talented workforce, are more collaborative and more innovative.

The 2018 Great Place to Work survey asked employees to comment on a wide range of topics including communication and involvement, job security, culture, diversity, recognition, strategy, talent management, teamwork and well-being, as well as work environment and processes.

The Group scored 96% favourable in response to the question *'I understand my safety-related responsibilities'* demonstrating the effectiveness of HomeSafe. For the second year running there were strong results in the area of diversity and inclusion, with a 90% favourable response to the question *'People here are treated fairly regardless of their race or ethnic origin'*, and similar results in response of gender, age and sexual orientation demonstrating our inclusive culture.

Our biggest improvements on the previous year were for job security, talent management and recognition.

The survey also revealed the areas where continuing focus is required. Communicating our strategy and direction continues to be the biggest opportunity for improvement. Demonstrating that we are living by our values will move the Trust Index forward and we also have work to do to ensure employees feel that reward and benefits are reflective of their efforts.

Incorporating employees' views

Under the Financial Reporting Council's updated code of standards, companies are now required to explain how they are incorporating employee views in board decisions. We welcome this.

This was the second year of Employee Voice Forums in Viridor, with employee representatives from all parts of the business discussing business challenges with representatives from the Viridor leadership team. This has been supported with town-hall events regularly throughout the year. This has resulted in a 4% increase in the Trust Index score compared with last year.

Similarly, to ensure employees in the water and wastewater business can share their views, the South West Water Employee Engagement Forum was established in February 2019. Our employees designed the new format, which replaces a previously established staff council, and nominations for engagement champions are made by peers.

Our Speak Up whistleblowing policy, which operated throughout 2018/19, provides another engagement channel. Speak Up helps to create an open, transparent and safe working environment, where workers feel able to speak up and are supported if they do so.

The Pennon Big Chat continued throughout 2018, increasing in frequency from four to six times a year. This provides all employees across the Pennon Group the chance to put any question direct to the Pennon Executive. Now in its second year, this initiative has been well received by employees. Topics typically covered in the Big Chat include progress being made against our business plans and strategy, HomeSafe rollout and questions in response to media items concerning Pennon as well as any local operational questions employees may have.

Skills, diversity and development

Building a sustainable, agile and diverse workforce is a key pillar of our HR strategy. We have a strong commitment to investing in the development of our staff and want to build and recognise talent across the Group. Training and development are available for employees at a variety of levels. Our aim is to increase productivity, job satisfaction and safety, and to equip the next generation of leaders with appropriate knowledge, skills and competencies.

To ensure we can compete for top talent in the marketplace, the Group ran a national campaign for the first time to attract suitably qualified graduates in 2018/19 to work in Viridor. Recognising that innovative use of technology is playing a wider role in recruitment, we invited graduates to send in personal videos rather than conventional CVs and were pleased to select 30 high calibre graduates to join Viridor. Based on Viridor's success, we are planning to grow our programme during the coming year and recruit a further cohort of graduates. All successful applicants were offered permanent roles demonstrating our commitment and investment in them on either a management trainee pathway or a functional pathway for more specialised roles. Our graduates are deployed in a variety of locations that reflect the nationwide distribution of Viridor's operations but meet regularly for mentoring and support. This sharper focus on graduates is an important step forward for the Group. It will strengthen our talent pipeline in the mid and long term in support of the Group's growth-oriented strategy that seeks leadership in the UK's waste and water sectors. We will continue to invest in this area and build on the success of this first step across the Group.

We have always embraced the introduction of the Apprenticeship Levy and, since its inception in 2017, have offered 384 new apprenticeships across the Group. In Viridor, our apprenticeship focus has resulted in providing 90 new and existing employees with large goods vehicle (LGV) training, an area which traditionally has seen a national skills shortage.

Our Group-wide turnover rate in 2018/19 was 16.4%.

Skills, diversity & development

Our people strategy supports our sustainability goals

Our investment in apprenticeships, graduates and MBA training enhances productivity and strengthens skill sets. We offered 30 new graduates permanent roles in the business this year demonstrating our commitment and investment in them on either a management trainee or functional pathway.

Sustainability focus area

See sustainability strategy on page 11

To complement our investment in leadership development, we have partnered with Exeter University and Cranfield School of Management to develop and offer 16 of our aspiring future leaders the opportunity to study for an MBA alongside their current role.

We were pleased that our work in the area has been noted with Pennon winning the Large Employer of the Year category at the South Devon College Apprenticeship Awards recognising our commitment to both the South West and skills development.

Community

Pennon has a significant community and educational programme across the regions where we operate. Viridor has 11 educational centres which welcomed 8,455 visitors last year in addition to delivering 52 outreach events. South West Water has seven learning and education centres.

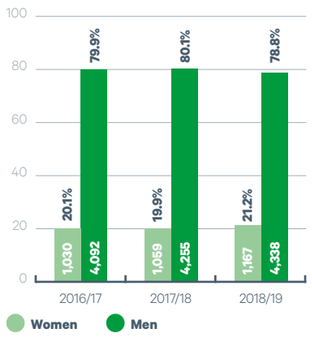
Last year our multi award-winning science, technology, engineering and mathematics (STEM) projects included mentoring 34 students and hosting 42 work experience placements. Our work experience students have successfully transitioned into new starters in Viridor.

We are a leading sponsor of Go4Set across Scotland enabling student teams to tackle 10-week STEM projects using business management techniques.

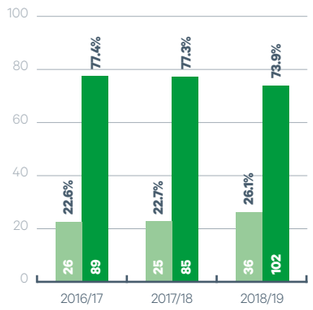
We have been a lead partner in the South Devon University Technical College since it opened in 2016. This specialist school has a curriculum focused on careers in water, engineering and the environment and South West Water provides work experience and real-life challenge projects.

Gender diversity as at 31 March

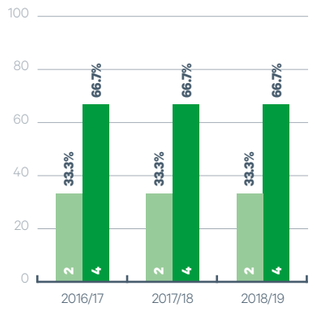
Employees



Senior management



Board



People
continued

We are a sponsor for the Tamar Engineering Project which provides financial and mentoring support to talented and ambitious students whose background or circumstances might be a barrier to higher education advancement and a career in engineering.

By inspiring school children, Pennon is helping to get pupils interested in these vital subjects and future STEM careers in the water and waste management industry.

Gender, diversity and equal opportunities

The Board promotes equality of opportunity and diversity across all areas, including gender and ethnicity. The Group has more to do in this area which remains a key focus – see both the Nomination Committee report on page 90 and the Directors' report on page 106 for further details.

Across Pennon Group, the workforce comprises 79% male and 21% female employees. This gender split reflects the traditionally male-dominated nature of our industry. While changing the diversity landscape across an organisation the size of Pennon needs awareness and action at all levels, we are making some progress. The Group's female population saw a 1.3% increase on the 2018 figure. We were pleased to see in our recent graduate recruitment a 34% female representation with good ethnic diversity. According to the latest EU skills demographics, we are slightly ahead of the sector in both gender and BAME (black, asian and minority ethnic) terms.

This was also the second year in which publication of gender pay gaps for larger organisations became mandatory. Our gender pay data for 2018/19 shows an improved position against 2017/18 with the Group recording a gender pay gap of 2.7%, which is lower than the national average. We believe that improving our overall diversity holds the key to ultimately closing the gender pay gap as we recognise that the pay gap will fluctuate over time. While our diversity landscape is gradually beginning to take shape, and comparing more than favourably with our industry peers, we do not intend to become complacent in this area.

> "Our people are our greatest strength as they deliver the essential services to customers every day."
>
> **Chris Loughlin**
> Chief Executive Officer

Active volunteering

Pennon has an active volunteering programme which encourages staff to take part in agreed community projects. There were 317 volunteer days in 2018/19, in which 279 staff participated.

South West Water has continued to fund Keep Britain Tidy's BeachCare programme, which helps to sustain voluntary beach clean groups across the South West peninsula. From these litter picks, as much of the recyclable content as possible is taken out of the litter haul and placed into recycling – usually about 25% of the litter found.

Viridor's volunteering activities continue to support Somerset Wildlife Trust, which included planting trees for each of the 11,281 soldiers from Somerset who died during World War I.

Sustainability focus area

See sustainability strategy on page 11

Instead, our aim is to put ourselves in a prime position to attract the top talent each of our sectors has to offer, thereby further improving our diversity mix.

We have developed a six-point plan which focuses on improving reporting, mentoring, recruitment and training to ensure that this remains a key commitment for the Group.

Responsible employer

One of our four values is 'responsible' and to further demonstrate our commitment in this area we have signed up to two employer campaigns in 2018/19. Pennon has joined the Slave-Free Alliance, which is part of Hope for Justice, the global anti-slavery charity. Our membership demonstrates our commitment to the highest employment standards for both our direct employees and those within our supply chain. We also signed up to the Social Mobility Pledge, the cross-party campaign to improve social mobility in the UK established by Rt Hon Justine Greening MP. This pledge reflects our social commitments through our partnerships with local schools, our open door approach to visitors and our provision of work experience opportunities.

Health & safety

Following the initial success in the previous year with the pilot at Viridor for the Group's HomeSafe health & safety programme, the Group progressed to full roll-out in 2018/19 for both Viridor and South West Water. As the name implies, HomeSafe is about ensuring staff get to work safely, enjoy a safe and healthy working environment, and arrive home without incident at the end of each working day.

Initial HomeSafe training was conducted on a face-to-face basis but the teaching tools and materials were adapted for e-learning so that staff in back-office roles and working in lower-risk environments could participate fully. The Group substantially completed the initial phase of HomeSafe during the year under review.

To build on the current momentum and the HomeSafe vision set in March 2017, the Pennon Board signed off a longer-term HomeSafe strategy in September 2018. The Group now has a comprehensive and ambitious roadmap running to 2025 to look after employees and keep them free from harm. A core aim is to improve a key safety measure known as LTIFR (lost time injury frequency rate*) from 2.02 the Group recorded in March 2018 to 0.50 by 2025.

We have already seen a significant improvement in our LTIFR in the review period, returning a 32.2% improvement when compared to the previous year. This has come about through the deployment of HomeSafe; bringing refreshed focus to safety leadership, assurance and compliance, and by equipping our people to spot hazards, intervene when they observe something unsafe and eliminate risks at source. We have also targeted resources to facilities where upgrades and improvements have been identified. The longer-term HomeSafe strategy is based on six themes: managing risk, sharing and learning; working together; protecting health; enabling leaders and being resilient. With the strategy, including appropriate timelines and milestones, everything hones in on the ambitious target of 0.50 LTIFR by 2025, which would place Pennon in the top quartile of water and waste peers.

Measuring our 2025 strategy effectiveness

The Group will measure progress carefully and Pennon's Sustainability Committee approved five new key performance indicators in March 2019. These include the core health & safety measure as well as targets on leadership, occupational ill-health, hazard removal and the Engagement Score from the annual Great Place to Work survey. We will also arrange independent benchmarking of its approach and outcomes.

* A lost time injury is defined as any work-related injury that results in a person being unfit for work on any day beyond the day of the incident. Lost time injuries are expressed as a frequency rate (LTIFR) per 200,000 working hours.

Embracing apprenticeships

The apprenticeship reforms, which have taken place in recent years, have provided significant opportunities to bring in new talent and develop existing employees within the business.

The programme has been particularly beneficial in helping us fill some of our more challenging skill gaps – especially roles where there is a national shortage, like LGV drivers and engineers.

As well as creating posts for new employees, we are also offering a number of specialised apprenticeship programmes to upskill and develop current employees in our core business functions such as engineering, project management, leadership and operations.

We have started 226 new apprenticeships during the last year which brings the total number on the programme to more than 380.

Find out more online at www.southwestwater.co.uk/careers/apprenticeships

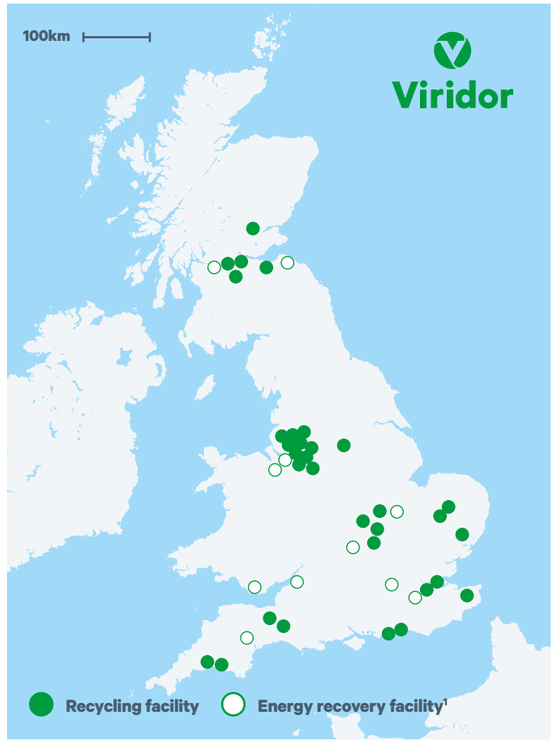
Non-financial information statement

This People section of this annual report contains a wide range of non-financial information about employees, environmental and social matters. As required under the new non-financial reporting directive, the table opposite sets out where you can find further information on the key areas of disclosure within the rest of this annual report as well as on our website. The information listed is incorporated by cross-reference. The due diligence carried out for each policy is contained within each policy's documentation

		Where to find it
Environmental, social and employee-related matters	• Principal risks and uncertainties: A, B, E, J	pages 63 to 66
	• Social and Environment Policy	www.pennon-group.co.uk/sustainability
	• Code of Conduct	www.pennon-group.co.uk/sustainability
	• Gender Pay Gap Report 2018	www.pennon-group.co.uk/sustainability
	• Whistleblowing Policy (Speak Up)	www.pennon-group.co.uk/sustainability
	• Health and Safety Policy	www.pennon-group.co.uk/sustainability
	• Sustainable Financing Framework	www.pennon-group.co.uk/sustainability
Business model, principal risks and KPIs	• Business model	pages 04-11
	• Discussion of our approach to risk and our principal risks	pages 58-68
	• KPIs	pages 30-31
Human rights and anti-bribery related matters	• Statement on Anti-Slavery and Human Trafficking	www.pennon-group.co.uk/sustainability
	• Anti-bribery and anti-corruption policy	www.pennon-group.co.uk/sustainability
	• Code of Conduct	www.pennon-group.co.uk/sustainability
Diversity policy and approach	• Nominations Committee report: Board diversity policy	page 90
	• Diversity, Respect and Inclusion Policy	www.pennon-group.co.uk/sustainability

Our operations
Waste management

Viridor is at the forefront of UK recycling and residual waste processing and transformation.



(1) Bolton excluded, reverting to Greater Manchester Local Authority 31 May 2019.

11
energy recovery facilities including one under construction[1]

c.300
recycling, energy recovery and waste management facilities

400,000
potential homes powered by energy produced by our portfolio

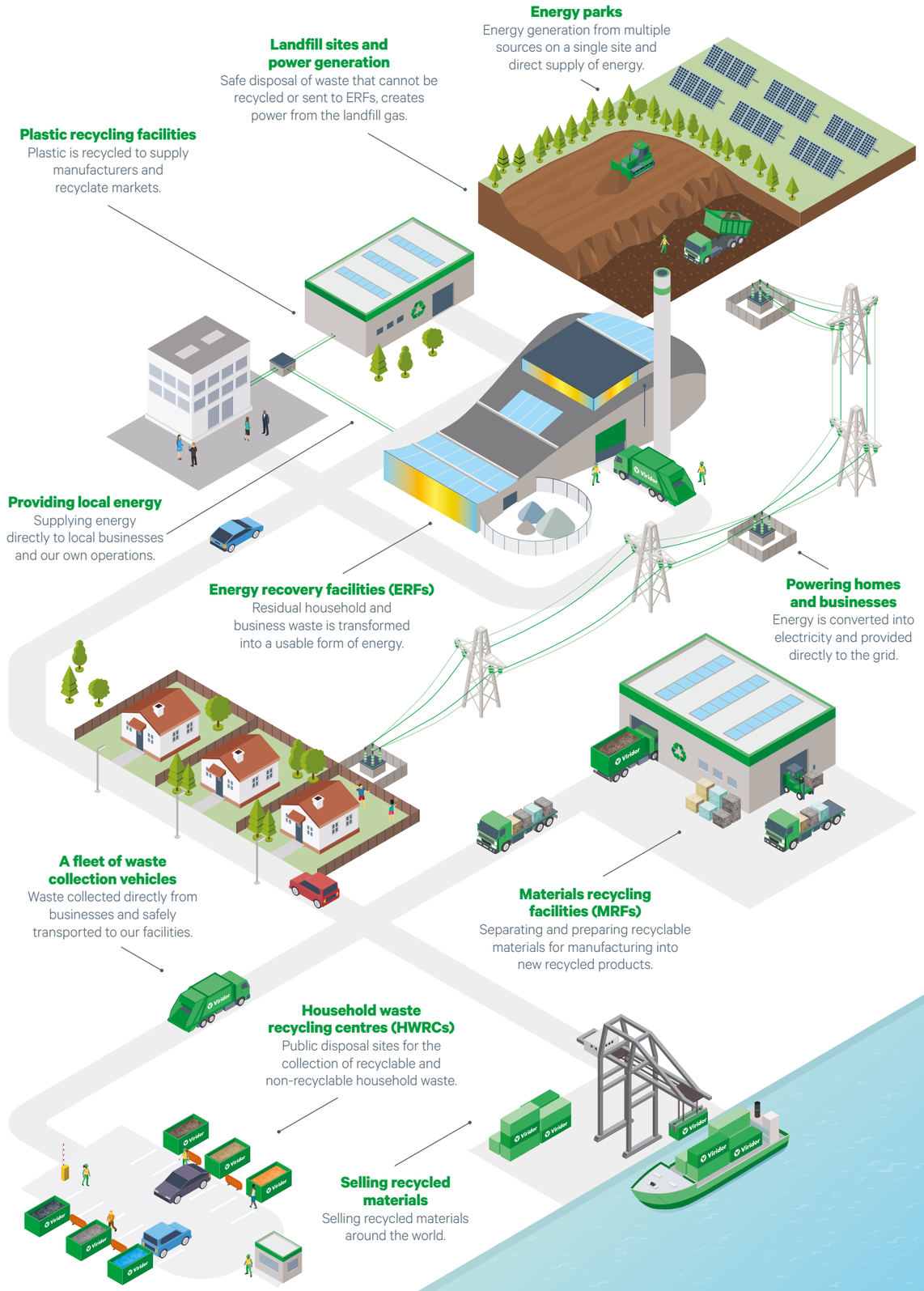
600
waste collection vehicles securing materials for our network of assets

150
local authority and major corporate clients

6.8
million tonnes of waste materials input

32,000
customers across the UK

4.9
million tonnes of material recycled or recovered



Our operations
Waste management continued

Viridor is at the forefront of the resource sector in the UK, transforming waste into energy, high-quality recyclates and raw materials. We provide services to around 150 local authorities and major corporate clients as well as around 32,000 customers across the UK. Our activity supports growth of a regenerative circular economy that seeks to keep resources in use for as long as possible and recover and regenerate materials at the end of their service life.

Total waste inputs for 2018/19 were 6.8 million tonnes, with 2.3 million taken by our ERFs, 1.5 million going to landfill and 3.0 million taken by our recycling and other facilities.

Viridor is one of the UK's largest independent power generators from waste. We had 327 megawatts (MW) of operating capacity from ERFs, anaerobic digestion, solar and landfill gas (including 100% of joint ventures) at 31 March 2019. Viridor exported 1.6 terawatt hours of power during the year.

Strong momentum for Viridor

A key achievement in the year under review is our increased engagement with the UK Government and other stakeholders on resource efficiency. We have actively lobbied for a more sustainable and circular economy around the waste value chain and welcomed the direction set out in the UK Government's Resources and Waste Strategy for England published at the end of 2018.

The initial focus on plastics aligns with our latest investment, commitment to a plastics recycling facility with a significant proportion of inputs and outputs secured with contracts into the medium term.

We saw strong momentum in 2018/19 with the £1.5 billion ERF portfolio nearing completion and with operating facilities outperforming. At year end, construction of our latest ERF at Avonmouth was on track for takeover in line with the planned costs and timetable. Growth capex invested to date is supporting increased earnings in Viridor now and into the future.

We continued to maximise value from landfill and invest in landfill gas for improved longer-term yields.

There was a continuing focus on enhancing health and safety and on increasing our customer service. To ensure we bring in sufficient talent for the future, and increase diversity within our workforce, we increased our graduate intake during the year with recruitment of 30 new employees, assigning them to management programmes or more specialised engineering roles across the UK.

A more sustainable waste value chain

A significant development in 2018 was the publication in December of the UK Government's Resources and Waste Strategy for England. This has provided strong and positive momentum, including the adoption of the 'producer pays' principle to cover the costs of recycling, steps to get plastics producers to include more recycled content in their products, recognition of the role of energy recovery, and a more consistent approach to council collections.

In April 2018, Viridor became a founder signatory to the UK Plastics Pact, which has targets including 100% of plastic packaging to be reusable or recyclable. Supported by the UK Government, this initiative brings consumer brands, packaging, retail and recycling companies together to tackle plastic pollution and to maximise recycling and reprocessing opportunities. We welcome the establishment of the Plastics Pact because it enables all stakeholders to facilitate meaningful change on plastic. Collaboration across the supply chain is increasingly important, especially in view of the October 2018 Budget announcement of a tax on plastic packaging which uses less than 30% recycled content and European targets for 75% of the UK's plastic packaging to be effectively recycled.

Viridor will continue to play a leading role in support of the UK's resource and energy efficiency goals, putting more recycled material back into a low-carbon, circular economy.

The 2018 Viridor UK Recycling Index released in September showed clearly that public concern over plastics use, for example, is at an all-time high.

We made excellent progress with customers from the fast moving consumer goods sector during the year in developing 'closed-loop' solutions that supply high quality recycled plastics reducing the volume of virgin material required. These relationships are already established and we expect to collaborate further so that we lead major change in this market.

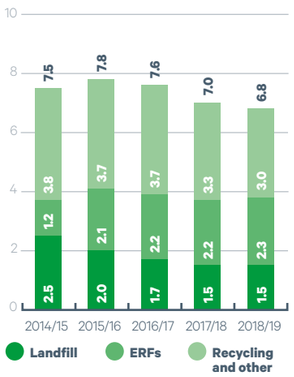
Strong ERF performance

The market fundamentals for ERFs remain robust, with the gap between combustible residual waste arisings and ERF capacity forecast to remain around seven million tonnes per annum to 2035. The autumn 2018 UK Budget noted that, 'the Government recognises the important role energy recovery currently plays in waste management in the UK'. The Viridor portfolio processes around a fifth of the UK's combustible waste tonnage processed at an ERF, and we continue to optimise our assets through capacity expansions, heat transfer and electricity offtake opportunities.

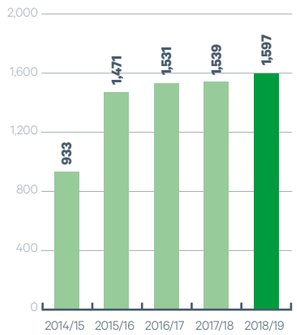
Our ERF portfolio offers the potential for establishing integrated energy parks, providing heat and power to Group companies and third parties, and so creating further value from these assets.

The ERFs performed well during the year with availability exceeding 90% across our operational portfolio (including joint ventures) for the third consecutive year. We are successfully leveraging our operational experience and capabilities to enhance ERF efficiency and expand throughput, typically in the range of between 3% and 5%. We have successfully increased the permitted capacity at Runcorn (combined for Runcorn I and Runcorn II) by c.15% providing headroom for future growth in input volumes.

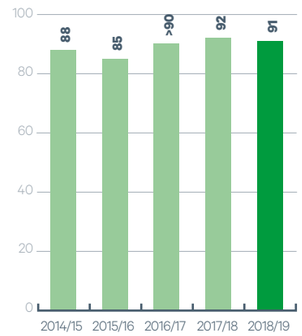
Total waste material inputs (million tonnes)



Total low carbon energy generation (GWh)



ERF availability (%)



As we continue to optimise our performance, we completed more of our planned maintenance outages in the first half of the financial year, when electricity demand and pricing is lower. We are also sequencing these planned shutdowns to make that process as efficient as possible. Our ERF teams have done excellent work delivering planned outages on time and on budget while carefully coordinating operations with our customers and our supply chain.

Glasgow, Beddington and Dunbar became operational during the year. We have invested at Glasgow which will increase capacity. As we have previously reported, construction at Glasgow required a higher level of remediation and expenditure than predicted. Viridor is contractually entitled to recover incremental costs from the original principal contractor, Interserve Construction Limited, under certain circumstances. We are looking to recover up to £97 million of this additional expenditure (contractual receivable from Interserve £72 million; other, including all contractors and advisors £25 million).

Our latest ERF at Avonmouth is progressing well and upon completion in 2020/21 will allow local authorities and businesses to transform 320,000 tonnes of non-recyclable residual waste each year into low carbon energy. Viridor has secured an additional 120,000 tonnes p.a. of waste from the West of England Partnership resulting in 85% of Avonmouth inputs now being contracted.

Our ERF operational design capacity is now 2.8 million tonnes of waste (including joint ventures) and 233MW per annum. When Avonmouth comes on stream, this will extend to 3.1 million tonnes of waste and 267MW.

Landfill sites are integral to our residual waste strategy

Our analysis indicates a requirement for a landfill solution into the medium term and, as landfill sites close, some parts of the country will experience a capacity shortage. Against this background, Viridor's landfill sites are well positioned to support future market requirements. The available void on operating sites is approximately 27 million cubic metres, with six sites providing capacity into the medium term.

Viridor continues to operate nine landfill sites following the planned closure of two sites during the year. Total consented landfill capacity (including mothballed sites) was 35 million cubic metres at 31 March 2019. We have a good track record of restoring our sites for alternative uses with three landfill sites repurposed for development in recent years in a manner that meets or exceeds our environmental duties. Since the year end, agreement has been reached to transfer a further closed landfill site for alternative use, mitigating long-term liabilities, and we continue to seek opportunities for similar transactions.

Landfill volumes and average gate fees were comparable with the prior year at 1.5 million tonnes and around £20 per tonne. We continued to maximise the value of landfill gas power generation and explored alternative commercial development opportunities and other renewable energy solutions at our landfill sites, such as photovoltaic (PV).

We continue to manage our landfill gas business with the aim of maximising the value of landfill gas power generation. We direct gas collected from our landfill sites to engines that generate electricity. The natural decline in underlying landfill gas volumes has continued, but the rate of decline in electricity volumes generated is lower than in recent years at c.5%. This is a result of our planned preventative maintenance programme and investment of over £5 million in our Engine Optimisation Strategy. Together these have improved engine availability, the gas collection process and matched engine capacity to the gas yields. We will continue to invest in landfill gas to provide reliable generation and improve the longer-term yields. The benefit of higher year-on-year hedged electricity prices helped support overall performance.

At present, our landfill gas engines contribute 86MW of landfill gas generation capacity, a small decrease from 88MW at the end of March 2018. Viridor also has a PV capacity of 3.2MW. We currently have surplus grid connection capacity at some sites, which presents an opportunity for growth subject to suitable capital investment.

Average revenue per megawatt hour (MWh) increased by 4% to £97 (2017/18 £93). Average operating costs increased to £48 per MWh (2017/18 £41) reflecting increased investment in planned preventative maintenance.

Our UK plastics commitments

Viridor is already one of the UK's leading recyclers of plastics. Every year we transform more than 1.5 billion bottles and packaging items into high-grade recycled plastic products. South West Water is a progressive and responsible water and wastewater company and is accustomed to dealing with the need to stop plastics from getting into the water system. The Group is uniquely placed to help consumers, manufacturers and communities to find innovative, long-term solutions that tackle the challenge of plastics waste. Viridor is playing its part by committing to Pennon's Plastics Programme that includes five clear commitments across investment, innovation, collaboration, campaigning and engagement.

This is part of our sustainability strategy and it contributes to the UN SDG 12 – striving for more sustainable consumption and production. We want to help deliver the targets set out in the UK Government's 25 Year Environment Plan as well as its Resources and Waste Strategy, and the UK Plastics Pact (of which Viridor is a founder signatory).

Sustainability focus area

See sustainability strategy on page 11

Our operations
Waste management continued

Investing in recycling
Viridor has committed to a new £65 million plastics recycling facility, with the investment reflecting a derisked infrastructure model backed by index-linked contracts. The 80,000 tonne capacity facility represents around 8% of current market requirement and will be co-located with the Avonmouth ERF that is currently under construction. The new facility will handle multi-stream plastics (including polyethylene terephthalate, high density polyethylene and polypropylene) and produce output pellets directly for manufacture. Building on our existing commercial relationships, we have already secured around three-quarters of the input requirement (Viridor and third party) and half of the plastic offtake (third party) of the plant. The investment has been assessed based on a hurdle rate IRR (internal rate of return) of 15% real, post tax and has a payback of under four years.

We are also investing £15 million in a full refurbishment of our Masons materials recycling facility (MRF) near Ipswich, which will support a 10-year contract with Suffolk County Council to process recyclate into high-quality output.

Existing recycling operations
There was a partial recovery of global recycling markets in 2018/19 following import restrictions by China in the prior year and we see ongoing value in high quality recyclate. We focused throughout the year on producing higher quality recyclates, through investing over £9 million in our assets, including our reliability-centred maintenance programme, WorkSmart. Enhancement of the quality of recycled paper was the main aim of the upgrade at our Crayford MRF near Dartford. The global quality standard for recycled output has increased, especially for paper, card and plastic, and we have aligned with market requirements. In the UK, input quality has remained poor, largely as a result of councils reducing their collection schemes due to austerity cost pressures.

Our emphasis on producing high quality outputs contributed to an increase in revenue per tonne to £115 from £97 per tonne in the prior year. We have incurred higher costs in producing the right quality recyclate, but recycling margins have improved year on year.

Viridor is seeking to sell recyclate close to the point of recycling and an increasing proportion of our output now stays in the UK or is taken by European markets. For recycled paper, we have successfully reduced our reliance on China but have also ensured we can meet China's quality requirements as required.

To help mitigate our exposure to recyclate price volatility, we continue to share commodity risks and rewards with our customers. Over 60% of our ongoing contracted input volumes continue to share commodity risk.

Our recycling business finished the year in line with our expectations.

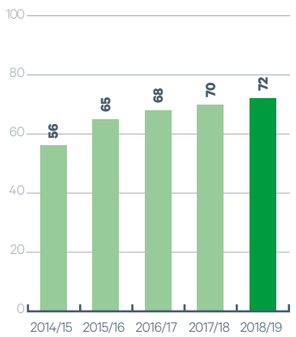
Contracts, collections & other
We continued to work closely with local authorities to ensure the long-term sustainability of our business relationships. For example, we agreed with Somerset Waste Partnership a nine-year, £80 million extension of their comprehensive waste management contract to 2031. Viridor strengthened its recycling partnership with Kent County Council in August with a two-year recycling contract extension.

Our collections business continues to provide a valuable service to our customers, sourcing both recycling and residual waste for treatment and processing at our own ERF, landfill and recycling assets as well as at third-party facilities.

In September 2017 we successfully negotiated a reset to the contract with Greater Manchester Waste Disposal Authority, now the Greater Manchester Combined Authority (GMCA), achieving a positive outcome. The contract to operate the recycling assets on behalf of the GMCA then entered a run off period of no less than 18 months from 1 October 2017, which is now set to end on 31 May 2019.

In November 2018, Viridor withdrew from the new Greater Manchester waste operating contract tender process. As we near the end of the successful operation of the run off period, we are well positioned for an orderly transition at the end of the contract. The financial impact of not continuing with this operating contract is not material to the Group, and our position with the ERFs at Runcorn is unaffected.

Waste recycled and recovered (% of inputs)



Viridor investment supports recycling in Suffolk
A £15 million Viridor investment to modernise the Masons MRF, near Ipswich, will transform the plant to support recycling. The investment is part of a 10-year Viridor/Suffolk County Council contract renewal and part of the council's plans to make the most of residents' recycling efforts at the kerbside. The upgrade will increase the MRF's capacity by 10,000 tonnes to 75,000 tonnes per annum. It will use 11 optical sorters to efficiently sort recycling into specific waste streams. Viridor is determined to put quality recycling materials back into the economy where they belong, and this new investment will help make the most of the county's recycling opportunities.

Sustainability focus area

See sustainability strategy on page 11

Community engagement through education, sponsorships and donations
Viridor plays a highly visible role in communities surrounding operational sites. Our 11 educational centres received 8,455 visitors in the year ending 31 March 2019 and we helped to deliver 52 outreach events.

Our visitor centre at Ardley ERF, near Oxford, runs tailored educational programmes to teach children and adults about sustainable waste management. We also run community liaison groups to provide updates on our operations and respond to feedback.

During 2018/19, Viridor provided £7.2 million to community support, sponsorship and charitable donations. Some £6.9 million of this was paid to Viridor Credits, an independent, not-for-profit organisation that administers Viridor's contributions to the Landfill Communities Fund.

Our charitable donations scheme helped projects supporting STEM (science, technology, engineering and mathematics), environmental, resource and recycling education initiatives, communities coming together through sport and community events, and communities focused on improving the quality of life for disadvantaged and priority groups.

We also continued our local community volunteering activity with our employees donating 124 days of their time in 2018/19.

Sustainability focus area

See sustainability strategy on page 11

Joint ventures performing well
The TPSCo joint venture (between Viridor and Inovyn) has performed strongly during the year with availability again in excess of 90%.

In December 2018, Viridor exercised its pre-emption rights and paid a total cash consideration of £54.8 million to acquire John Laing Investments Limited's 37.5% economic interest and 20% voting rights in the Runcorn I ERF. The acquisition consolidates further Viridor's leading market position in UK energy recovery and results in an increase to Pennon's economic interest in INEOS Runcorn (TPS) Holdings Limited from 37.5% to 75.0%, with the associated voting rights moving from 20% to 40%.

Operational and financial performance at our Lakeside ERF (a 50:50 joint venture with Grundon Waste Management) again exceeded expectations for both waste processing and power generation.

Enhancing safety and environmental performance
Viridor focused heavily on enhancing safety throughout the year by implementing the Group's HomeSafe initiative, which seeks to deliver the highest standards in health & safety. We achieved a 40% improvement in a key safety measure known as lost time injury frequency rate and continue to implement training with the aim of becoming a leader in this field.

The Company is committed to its compliance culture and to ensuring positive and measurable environmental impact and regulatory compliance. We maintain a proactive and positive relationship with our environmental and performance regulators. 90% of all Viridor's permitted and licenced sites achieved the top two compliance bandings, as assessed by the Environment Agency, Scottish Environmental Protection Agency (SEPA) and Natural Resources Wales (2017 91%).

During 2018, we had no pollution incidents or Category 1 (major) environmental permit non-compliances. We received three Category 2 non-compliances (2017 one), one of which is contested, the other two being for paper storage and litter management at a recycling facility and for odour at a landfill site. We also received a significant non-compliance from SEPA for a plastics storage fire. We have agreed action plans with the regulators to upgrade infrastructure at these sites to further reduce environmental and amenity risk.

Improving customer service
We continue to recognise the value of feedback from our customers to help us continue to deliver improvement in customer service. We ask customers to provide feedback about Viridor's service on the Trustpilot review platform. In 2018/19, we received a rating of 7.1 out of 10. We continue to gather customer reactions to our performance through online and offline channels and are looking at introducing customer user groups.

Our customer wins during the year include a waste management contract at Hinkley Point C power station in Somerset, which seeks to deliver a zero-to-landfill service for EDF Energy and principal contractors. We also won a new waste management contract for Safestore, one of the UK's largest self-storage providers.

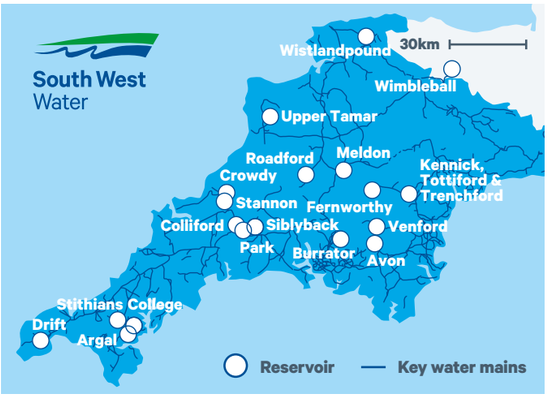
Viridor's new strategic options
Against a positive market backdrop, we have developed three new strategic options for Viridor. First, recognising that under-capacity in the UK residual waste market varies by geography, we have identified three new ERF opportunities for further analysis. For landfill, we see strong medium-term demand and are keeping sites open for longer while creating new landfill cells where there is commercially attractive demand. We are also continuing to invest in landfill gas.

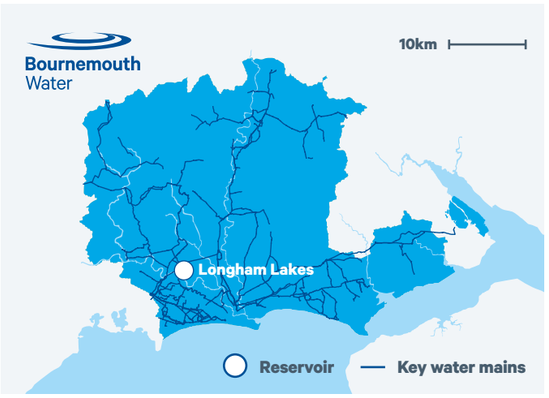
Second, we see new opportunities in recycling that are akin to our residual waste operations and we are therefore conducting feasibility studies into building two further plastics processing facilities. Our intention in plastics would be to implement the contract-backed, index-linked return model we have successfully developed in our ERF operations.

Third, we are exploring opportunities for integrated energy parks at our ERF and landfill sites. The energy parks would provide competitively priced heat and power as an alternative to the national grid, potentially involving provision of wind and solar power. We already have several such connections, including our Runcorn ERF that has a heat and power offtake to Inovyn, Peterborough ERF where we provide a heat connection to a council depot, and our landfill gas engines and ERF at Beddington, which provides heat offtake into a community heating network. We believe there is significant potential to do more with energy parks supporting Viridor's own activities, other Pennon Group operations such as South West Water's treatment plants, or third-party energy intensive facilities.

Our operations
Water and wastewater

We are focused on providing services in the most efficient and sustainable way possible. Innovation, new technologies and a holistic approach underpins our commitment to delivering service improvement and long-term value.





1.7
million total population served

0.8
million customers

21
raw water reservoirs

15,462
km of drinking water mains network

650
wastewater treatment works with 65 ultraviolet (UV) treatment facilities

29
drinking water treatment works with 3 UV treatment facilities

17,490
km wastewater mains network

151
bathing waters and 24 shellfish waters

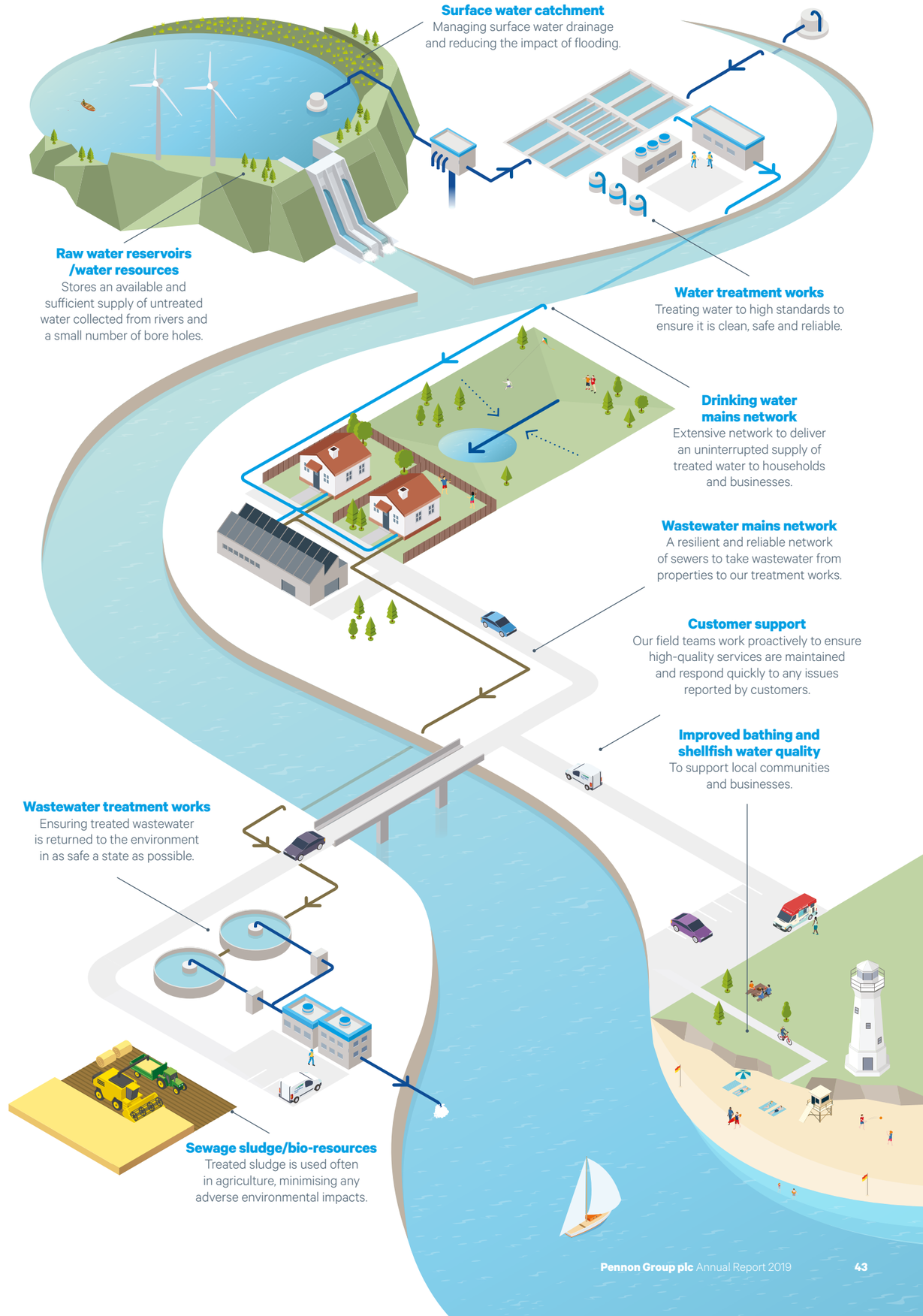
0.5
million total population served

2,838
km of drinking water mains network

0.2
million customers

5
treatment works with 4 UV treatment facilities

2
raw water reservoirs



Our operations
Water and wastewater continued

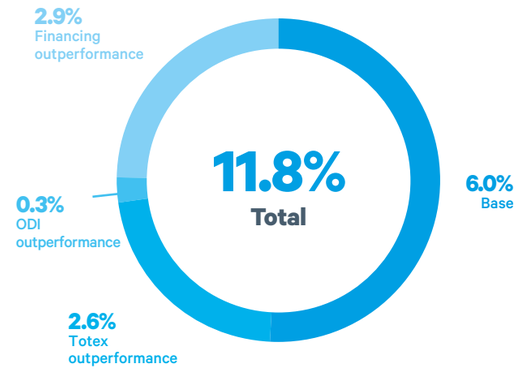
Delivering excellent customer service
Once again, improving customer service was at the heart of our delivery plans. We achieved our best ever quality service score during the year, with a ranking of second out of all water and wastewater companies in England and Wales. Our customer service score (SIM) improved to 88 points with no penalty forecast for the K6 (2015-20) period. The SIM score is calculated against a qualitative element (based on a customer survey) across the sector and a quantitative element that includes the number of complaints received in writing or by phone, which have reduced by half since 2015/16. The improvement in service is driven by improved operational performance, an enhanced capability in our call centres to reduce waiting times along with investment in training and systems to improve our ability to resolve customer calls quickly. These have increased customer query resolution and expanded the channels that customers can use to contact us to include online and social media. We made all these improvements in consultation with our customers and we were recognised for our excellent customer service in the prestigious 2019 UK Customer Satisfaction Awards run by the Institute of Customer Service.

We continued to focus on providing support to customers in vulnerable circumstances and those who struggle to pay their bills. At the end of the year we were providing support to more than 23,000 customers through reduced tariffs, with around 57,000 customers supported through this and other programmes and we have extended our Priority Services Register to make it easier to identify customers in vulnerable circumstances. This level of assistance puts us in a good position to deliver on our 2020-25 business plan aim to eliminate water poverty in our region by 2025. Ofwat has described this aim as 'industry leading'.

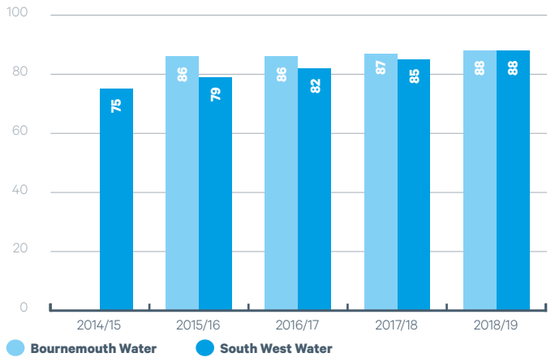
WaterShare
South West Water continues to share the benefits of business outperformance between customers and shareholders through its unique WaterShare mechanism. We have identified around c.£6 million of customer benefits during the year.

Since 2015, £110 million of cumulative benefits have been identified to share with customers through future bill reductions, ODI service improvements and investment in services in addition to funding of our new Watershare+ share scheme. This reflects £80 million of totex savings, £11 million of net outcome delivery incentives (ODI) benefits and £19 million of other benefits (including financing). These totex savings and efficiencies (including the forecast to 2020) have been reflected in the 2020-25 business plan, lowering bills for customers over the next regulatory period.

Cumulative K6 RoRE



SIM (pts)



> "Our 2020-25 business plan was fast-tracked by the industry regulator Ofwat, who said it 'set a new standard for the sector.'"

Drinking water
We demonstrated excellent service resilience during the year. The exceptional cold weather of March 2018 resulted in the first red weather warning for snow ever issued in the South West. With good planning and flexible management, we successfully managed the impact of this freeze-and-thaw weather event. Ofwat praised South West Water in their 'Beast from the East' wrap-up report stating that, 'South West Water demonstrated good communication with wider stakeholders to respond to the needs of customers in vulnerable circumstances.' We also maintained supplies to customers despite the unprecedented demand during the hottest and driest summer on record. The warm weather resulted in an estimated 20% increase in visitors to the region over the summer period. Water production was increased by around 6% during this period and we were able to distribute water across our flexible strategic water network so that we could maintain supply to our customers while also meeting our leakage target of 84 megalitres per day. We supported the Isles of Scilly over the summer months to help them maintain supplies when ground water levels fell to extreme lows. Water resources in the South West Water region remained unrestricted for a 22nd consecutive year and the Bournemouth water region maintained its position of exercising no water restrictions since privatisation. As the weather has continued to remain drier than usual, South West Water has been actively conserving and replenishing water resources by operating its artificial recharge storage schemes in order to protect future supplies.

We continued to maintain our high standards of drinking water quality and achieved all our targets. The Drinking Water Inspectorate has confirmed that our water quality was among the best in the industry this year.

Investment in drinking water infrastructure
We commenced commissioning of the state-of-the-art Mayflower water treatment works during the year. This important investment will meet the needs of Plymouth's growing population for generations to come. Mayflower is a landmark project for many reasons. The facility uses advanced technology that has not been deployed in the UK before. The construction work was completed without any lost time due to injury with over a million hours of work time going into the project. South West Water also signed the UK's first green finance lease to support the Mayflower project as part of Pennon's Sustainable Financing Framework which supports positive social, economic and environmental outcomes.

Other investments include the upgrade to water treatment works in Falmouth and improving land management in 11 river catchments as part of our Upstream Thinking strategy for healthier rivers and lower-cost water treatment. South West Water's listing for the Business in the Community Environmental Sustainability Award in April 2018 recognised the successful transformation the multi award-winning Upstream Thinking programme has had on the natural environment of the southwest of England.

Wastewater
We aim to ensure the safe and efficient removal and disposal of wastewater, while minimising the possibility of sewer flooding or pollution affecting homes, businesses or the environment. We achieved our best ever compliance in wastewater treatment with 99% of our works meeting their permit conditions.

Protecting the environment
We delivered a reduction in serious pollutions with only two Category 1 and 2 incidents. This was among the lowest number of such incidents in the industry. Disappointingly, the number of less serious incidents (Category 3 and 4) increased on the previous year. We have continued to implement our pollution incident reduction strategy and associated investment, which should reduce minor incidents (Category 3 and 4) in future years.

To help address the issue of blocked sewers, we continued our targeted 'Love your Loo' campaign to increase awareness of the problems caused by flushing inappropriate items. An incident that also focused extensive attention on the issue of keeping sewers clear was the discovery of Devon's largest ever 'fatberg' in a Sidmouth sewer. Our staff worked for several weeks to remove this obstruction which was estimated to be 64 metres long.

Harnessing real-time data to improve leak detection
Alongside investment in technologies for network monitoring (including telemetry, sensors and data loggers) South West Water is pioneering the use of real-time data to help identify and tackle leakage on its drinking water network.

The company is among the first to use live hydraulic models which provide a fully up-to-date picture of how sections of the network are performing. This improves the efficiency and accuracy of operational responses to any issues, enabling repair work to be carried out in a more proactive way and minimising the impact on customers.

South West Water is currently working on expanding the system region-wide and increasing its functionality to enable better forecasting of issues before they occur. Future plans also include the deployment of the technology to mobile field teams and customer-facing staff.

Sustainability focus area

See sustainability strategy on page 11

Our operations
Water and wastewater continued

Health & safety
South West Water continues to roll-out the HomeSafe initiative that will continue into next year as we drive for improved standards in health & safety. During the year South West Water delivered a 23% reduction in our key safety measure known as lost time injury frequency rate and are targeting further reductions next year.

Investment in wastewater infrastructure
We commissioned our £20 million investment in Plymouth to improve the already high level of bathing water quality. Our largest single wastewater investment in the current K6 programme, will help protect the bathing waters in the Plymouth Sound through the installation of our largest ever ultraviolet disinfection facility for treating storm water.

Our investments to protect bathing waters continue to reap benefits with extremely encouraging results for the 2018 bathing water season. Of the 151 bathing waters tested in the South West Water region, 149 (around 99%) were classified as sufficient or better, with more than 78% classified as excellent. Neither of the two bathing waters rated as poor were attributed to any failure of South West Water's assets.

Wholesale services
Since the opening of the non-household retail market in April 2017, South West Water has successfully engaged with 21 different retailers, and our wholesale service desk has been operating effectively.

Sector-leading outperformance
In 2018/19, we once again delivered sector-leading financial performance maintaining a cumulative return on regulated equity (RoRE) of 11.8% since the start of K6.

This industry-leading performance comprises 6.0% as the base return, 2.6% totex savings and efficiencies, with 0.3% reflecting a net reward on ODIs. The remaining 2.9% reflects the difference between actual and assumed financing costs using a cumulative forecast retail price index over K6 of 2.8%, consistent with the way we calculate our innovative WaterShare mechanism. Cumulatively, this WaterShare RoRE outperformance is broadly consistent with the approach adopted by Ofwat.

Total expenditure savings
During 2018/19, we continued to deliver efficiencies with £237 million of cumulative totex savings in the first four years of K6 (2015-20). We are on track to deliver around £300 million of totex savings by 2020, which supported our efficiency position in our K7 business plan.

We use new technology, innovative processes, skills training and equipment to deliver both water and wastewater improvements. Savings are driven by continuing advantages from our strategic alliances including our water distribution framework and H5O capital alliance. We are ensuring efficient capital investment through the use of data analytics, optimising capital and operating solutions while promoting efficient off-site build techniques. The integration of Bournemouth Water continues to deliver totex efficiencies, with secured £27 million synergies secured.

Our 2020-25 business plan, continues to target cost efficiency, supporting a 11% real reduction in customer bills by 2025.

ODI rewards
Operational performance resulted in a net ODI reward of £4.1 million (£11.3 million cumulatively over four years of K6), reflecting an annual equivalent RoRE outperformance of 0.3% to date.

We have maintained good overall asset reliability and stable serviceability across all water and wastewater areas and received rewards for bathing water quality and water restrictions, as well as significant improvements in external and internal sewer flooding.

The cumulative net reward of £11.3 million comprises £14.4 million of net rewards recognised at the end of the regulatory period and £3.1 million of net penalty which may be reflected during the regulatory period.

We are on track to meet all of our ODI commitments for 2020.

Green light for 2020-25 business plan
In September 2018, South West Water submitted its K7 business plan for 2020-25. Ofwat published their initial assessment in January 2019, awarding us fast-track status with our draft price determination received in April 2019.

We are delighted Ofwat's view was that our business plan 'set a new standard for the sector'. South West Water is the only water company to have achieved this status for two consecutive price reviews. Customers can look forward to lower bills, further investment and more of a say in how their water company is run. We are also addressing key social and sustainability themes of protecting the environment, improving services to customers and ensuring a strong and transparent approach to governance.

The next regulatory period includes specific comparative service and environmental targets which will be measured consistently across the whole industry on an annual basis. Based on existing performance, we are well placed to deliver into the next period.

South West Water leads ReFill revolution to combat plastic pollution
As a co-founder and ongoing supporter of ReFill – the award-winning campaign to encourage the use of refillable bottles – South West Water is helping to reduce the use of plastic bottles.

The campaign was launched in the UK in Bude, Cornwall in 2014. Since then, more than 1,200 locations (such as cafés, hotels, restaurants and shops) have registered with ReFill in Devon and Cornwall, allowing the public to top-up their water bottles for free.

South West Water is supplying 3,000 stainless steel bottles to Keep Britain Tidy, South West Water's BeachCare partner, for onward distribution to local communities. The company is also working with councils and other partners to support the expansion of ReFill across the South West, the first of which was founded at Bude earlier this year. More are planned in locations such as Plymouth and Exeter.

Sustainability focus area

See sustainability strategy on page 11

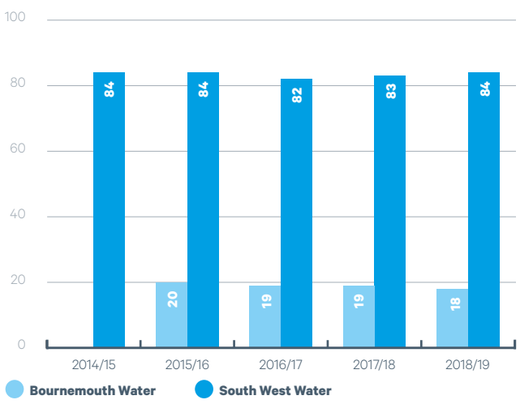
The ODIs for K7 are a mixture of bespoke performance measures which are proposed and designed by South West Water and 15 measures which are common across all of the water companies. South West Water has a strong base for outperformance in K7 with two thirds of ODIs currently upper quartile or above industry average.

As a responsible and transparent water business, a key feature of our proposals is to deliver a 'New Deal', which will empower our customers by giving them the option of a tangible stake through equity shares in Pennon, and the ability to hold us to account through a customer annual general meeting and quarterly public meetings. We believe our New Deal redefines the relationship between the water company and its customers and recognises our societal responsibilities.

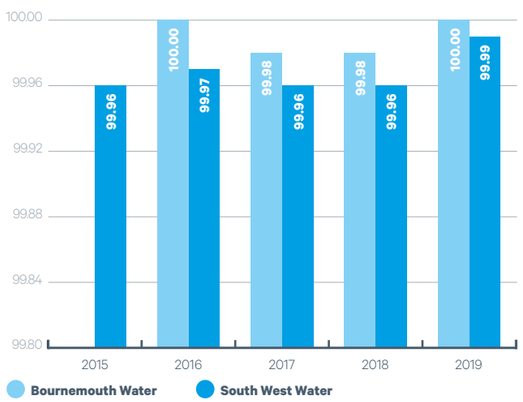
Key partnerships are already in place, including our strategic consultants and capital delivery partners, wildlife and river trusts, customer groups and charities. Our Resilient Service Improvement (RSI) transformation project is already underway, pilot trials for new water treatment technology has been completed and preparation for the expansion of our licence into the Isles of Scilly are well advanced.

Our community
As well as providing essential water services, South West Water supports the area's economic sustainability, supporting the employment of some 5,000 people either directly or indirectly through our supply chain. Working with partners and through our own events we fundraise and support community activities, conservation and wildlife programmes and environmental education campaigns. We are also active supporters of the region's economic aspiration, and contributed to the Local Enterprise Partnerships responses to the Government's Industrial Strategy.

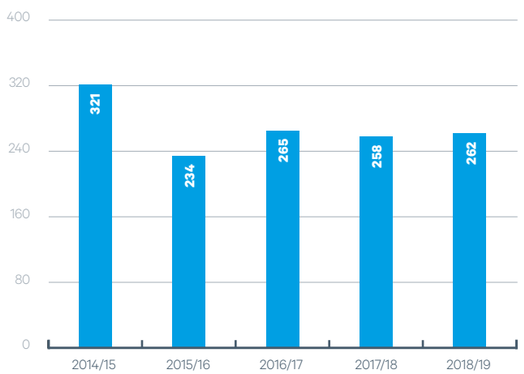
Leakage megalitres per day



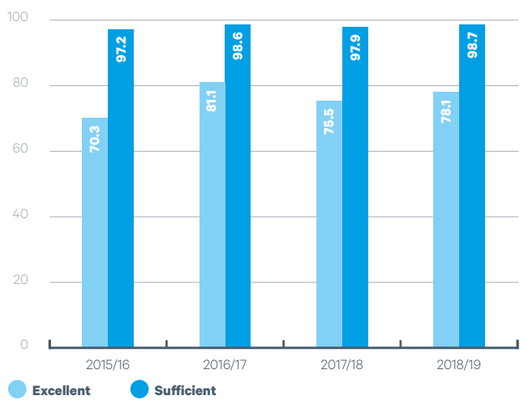
Drinking water quality mean zonal compliance (%)



Pollutions (Categories 1-4)[1]



Bathing water compliance[2] (%)



(1) Category 1-4 water and wastewater pollutions.

(2) New standards introduced in 2015 under the EU's revised Bathing Water Directive. The classifications are 'poor quality', 'sufficient quality' (the new minimum standard), 'good quality' and 'excellent quality' (the new guideline standard).

Our operations
Water and wastewater continued

Sponsorship and campaigns
In 2018/19, South West Water provided c.£210,000 in community sponsorship and charitable donations. This ensures that South West Water is on track to deliver its Business Plan ODI commitment of spending £80,000 per annum as part of its Community Scorecard. In addition, Pennon sponsors the Theatre Royal Plymouth and #BacktheSouthWest regional economic growth campaign for a further c.£60,000.

South West Water's eight sponsorship partners for the current Business Plan period have been chosen to deliver tangible benefit to our communities as well as protecting and enhancing the natural environment. These include The South West Coast Path Association and Beach Schools South West.

Through its charitable donations programme, South West Water supports five charities including Age UK and the Devon & Cornwall Air Ambulance that have been chosen by employees for their social purpose.

Working with key campaign partners such as Keep Britain Tidy and ReFill, South West Water is working hard to help in the fight against marine pollutions, particularly single use plastics. Since 2010, our campaign has helped deliver 1,287 beach cleans with 174 tonnes of waste removed.

Community relations over 2018/19 has benefited from South West Water's highest ever media profile, helping to promote its behavioural change campaigns Think Sink! and Love Your Loo, which encourage people to take a responsible approach to fats, oils, greases and wet wipes in order to reduce unnecessary blockages.

Bournemouth Water continued its support of the Hampshire & Isle of Wight Wildlife Trust, the Bournemouth 2026 initiative and the New Forest National Park Authority's Living Waters project.

We also partnered Dorset-based educational charity Life Education Wessex to run curriculum-based Waterwise programmes for primary schools in the Bournemouth area.

Community access, conservation and recreation
Our partnership with South West Lakes Trust ensures that our reservoirs are managed for environmental improvements and for the benefit of our customers and communities. During the year, we welcomed more than two million people to our recreational estates.

Our reservoirs continue to offer health and wellbeing opportunities with 71,000 people taking part in organised recreation and 4,600 participants learning new skills at the sites through the Trust's heritage and environmental education programme. We have co-developed projects to ensure all our Sites of Special Scientific Interest are in favourable condition by 2020 and we are also running an awareness campaign at the reservoirs to inform all watersports participants and fishermen about the management and control of invasive non-native species.

Devon's largest ever fatberg discovered in Sidmouth sewer
In autumn 2018, a 64-metre 'fatberg' – comprised largely of hardened fat, oil, grease and wet-wipes – was discovered beneath the seaside town of Sidmouth.

It took the South West Water team around eight weeks to dissect and remove it for processing, from which a sample was sent to the University of Exeter for analysis. While sewer workers carried out the removal using a combination of manual clearance and special jetting equipment, a pop-up shop was set up nearby to provide information to residents and visitors.

The substantial national and international media coverage provided an opportunity to remind people of the importance of only flushing 'the three Ps – pee, paper and poo'.

Sustainability focus area

See sustainability strategy on page 11

Our operations
Water retail services

Pennon Water Services provides retail water, wastewater and value added services across England and Scotland. We are focused on achieving long-term, sustainable growth.

100%
of new tendered contracts renewed

£35m
in national customer contracts served

The business retail market for water and wastewater opened in 2017.

Pennon Water Services has delivered against a number of its original strategic objectives working towards its goal of retailer of choice; delivering strong service while achieving revenue growth. It has faced challenges to its cost base as a result of significant headwinds from market systems, low customer knowledge of the market and data accuracy which have restricted opportunities to exploit economies of scale. The market has developed differently to the way it was originally expected with low and eroding margins, greater consolidation, price-based switching rationale and a higher regulatory cost burden. Despite this, the business has built a sound reputation and platform from which IT and process investment will improve its financial performance.

The business has successfully grown through winning both national tenders with multiple sites and dual service offerings to SMEs, demonstrating a strong track record in the healthcare, agricultural, tourism and manufacturing sectors. In the past 12 months we have continued to grow, winning and renewing national contracts including Fullers, Shearings, Unite Students, Pets at Home, Britannia Hotels and the Grafton Group. Through our strong service credentials, we have one of the lowest customer loss rates among associated retailers in the UK. Our approach has meant we have been able to secure more than £35 million of our revenue in a competitive market place, renewing 100% of new nationally tendered contracts signed since 1 April 2017.

While we operate in a relatively new market with a business strategy that is based on long-term growth, we have grown our revenue by around 5% and have a strong pipeline of opportunities over the next three years. Our goal is to be the water retailer of choice, trusted by customers and stakeholders, delivering exceptional customer service. We have sent more than 900,000 simple, clear and transparent bills to customers since April 2017 and offer our customers the chance to publicly rate their experiences with us.

We are seeking to grow our share of the non-household market, to become the leading service provider through the provision of a high-quality service.

During the year we changed the way in which we measure customer service and now use Trustpilot, which we believe gives a more accurate picture as a wider number of customers can take part in giving independent feedback. Our current score is 8.5 out of 10.

Pennon Water Services also offer a range of added value services. These include legionella testing, leakage reduction and repair, water auditing and contingency planning which creates an opportunity for synergies across the Group.

Community and sustainability is important to us and our experts are helping businesses to use water more efficiently. We are investing in water refill stations that will benefit a host of community groups and individuals as well as saving plastic bottles from being used. In addition, we are long-term supporters of the South West region's tourism sector through our support of the South West Tourism Awards. Employee wellbeing and performance is a priority for us and we have been recognised at the national finals of both the Utility Week Stars Awards and the British Chambers of Commerce Awards.

Source for Business
Source for Business is the national trading brand of Pennon Water Services covering both England and Scotland.

www.sourceforbusiness.co.uk

Source for Business

Report of the Chief Financial Officer
Financial review

> We have delivered strong financial performance through aligning our approach with our values, including launching a Sustainable Financing Framework and being accredited with the Fair Tax Mark.

Susan Davy
Chief Financial Officer

Overview

Delivering strong sustainable financial performance across the Group

We have delivered strong financial performance in 2018/19 through aligning our approach and financial strategy with our values, including launching a Sustainable Financing Framework and being accredited with the Fair Tax Mark.

We believe, as one of the UK's largest environmental infrastructure businesses, that our sustainable business approach is an integral part of Pennon's success. All companies must now consider the impact of issues such as water scarcity, natural resource constraints, climate change and labour conditions in the supply chain on their bottom line and future viability. For debt providers it is no different. Financial institutions too are considering how these same issues impact the ability of their portfolio to repay debt, and how that impacts on their own measures of success. At Pennon Group we have become the first utility business to pioneer a Sustainable Financing Framework which links financial impact to sustainability impacts. The Framework aligns with the Green Bond Principles, Social Bond Principles and Green Loan Principles.

The Framework is designed to provide the ability for the Group to finance projects which drive improvements in sustainability – primarily in the categories of pollution prevention and control, sustainable water and wastewater management and climate change adaptation – with interest rates being linked to Pennon Group's annual environment, social and governance (ESG) performance. In 2018/19 £600 million of new facilities signed are linked to the sustainable nature of the business, comprising:

- £110 million European Investment Bank (EIB) loan
- £325 million other loan facilities
- £105 million revolving credit facilities
- £60 million Green long funding finance leasing.

At Pennon, we know the taxes we pay help fund vital public services and investment in people and infrastructure to support future growth. In 2018/19, the Group's taxes borne and collected resulted in a total tax contribution of £281 million being paid to the Government.

To support our second published tax strategy, we once again consulted with customers and members of the public through focus groups to assess their opinions and thoughts of Pennon in general and on our Group tax strategy. Customers welcome our transparent approach and commitment to pay our fair share of taxes.

The Fair Tax Mark is the UK's accreditation scheme for businesses paying their fair share of corporation tax and reporting on their tax practices transparently. This year we applied to the Fair Tax Mark organisation to seek their independent accreditation of our approach. We are delighted to be the first water and waste group to secure the Mark.

Further information on our tax strategy and the total tax contribution are shown on pages 55 to 57.

Focusing on the financial performance for 2018/19, Pennon Group has again had a successful year of earnings growth, robust cash flows, strong liquidity and a sound balance sheet position underpinned with low cost, flexible and sustainable funding. These successes form the background to the delivery of our 10-year, sector-leading dividend policy of 4% year-on-year growth above retail price index (RPI) to 2020.

Underlying[1] earnings per share rose by 14%, and by 7% on a statutory basis, reflecting a 7% increase in underlying EBITDA and an 8% increase in underlying profit before tax. The earnings growth for 2018/19 has been driven by our energy recovery facilities (ERF) portfolio expansion, weather-related higher revenue in South West Water and a strong focus on cost savings, benefiting both customers and shareholders. Pennon remains focused on driving greater synergies and savings across the Group, sharing best practice and ensuring it is well placed to capitalise on emerging opportunities.

During the year our effective interest rate on average net debt remained relatively low at 3.6%. One of our key financial objectives is to ensure we maintain strong liquidity and have access to the most efficient and effective funding to support our capital investment programme and, at 31 March 2019, the Group continued to have a strong funding position with £1,170 million of cash and committed facilities.

South West Water continues to deliver sector leading totex outperformance and is on track to deliver c.£300 million over the K6 (2015-20) regulatory period. Together with delivery of net ODI rewards and outperformance in our cost of financing, momentum has been maintained to deliver a cumulative return on regulated equity (RoRE) for K6 of 11.8% (11.6% for 2018/19). The expansion of the service area to encompass the Isles of Scilly also gives South West Water further opportunity for incremental growth.

South West Water's performance creates a sound platform for the next regulatory period. Receiving fast-track status in two consecutive price reviews – the only water company to achieve this – allows us to make an early start on the new plan with a continued focus on cost efficiency and customer outcomes.

Throughout our operations, we align the interests of investors and customers in sharing the financial benefits of good performance. At Viridor we have gain-share mechanisms in place with corporate customers.

In South West Water, our long-established WaterShare mechanism offers customers extra investment or lower bills. Subject to shareholder approval, one of our innovative initiatives WaterShare+ will give eligible South West Water customers the option to receive Pennon Group plc shares in 2020, aligning customers and investors more closely.

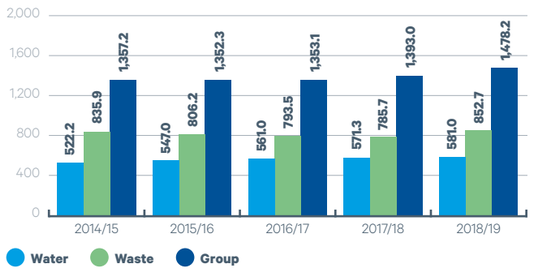
Viridor is delivering sustainable growth in UK recycling and residual waste. With a de-risked infrastructure model, our investment is backed by profitable long-term contracts.

Viridor's ERF portfolio remains a key differentiator for the Group compared with our water industry peers. The successful build out of the ERF portfolio, in a market showing under-capacity, will strongly support the Group's earnings growth to 2020 and beyond. During the year Viridor acquired a further 37.5% stake in the joint venture at Runcorn I ERF for a total cash consideration of £54.8 million, bringing its total economic interest to 75%. The associated voting rights moved from 20% to 40%. There is potential for further momentum from ERF portfolio expansion and development of energy park opportunities across the landfill and ERF portfolio.

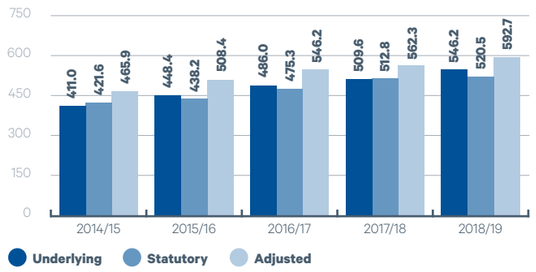
Balancing operational risk and reward remains a key component of our financial and business strategy. Across our operations, we are successfully reducing Group risk by overlaying our long-term assets with long-term commercial arrangements and supporting these with long-term financing. This applies to every aspect of the Group's operations – new investments in our water business, working with local authorities on long-term waste solutions, or our investment in developing the ERF portfolio. This approach is enhancing the Group's resilience and sustainability.

(1) Underlying earnings are presented to provide a more useful comparison on business trends and performance. A reconciliation of underlying and statutory earnings is set out in the alternative performance measures section on page 174.

Revenue (£m)

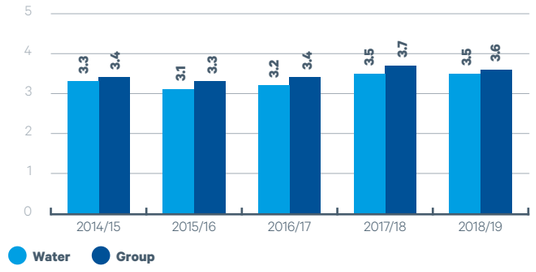


EBITDA (£m)



Capex (£m)

Interest rate on average net debt (%)



Report of the Chief Financial Officer
continued

Statutory financial performance
The Group's statutory profit before tax at £260.3 million was broadly comparable with the prior year (2017/18 £262.9 million), with earnings per share increasing to 51.1p (2017/18 48.0p). This reflects strong earnings from both South West Water and Viridor, supported by sector-leading efficiencies in the water business and high availability from Viridor's ERFs. The performance of the underlying business is set out in more detail below in the financial performance section.

The statutory results include the impact of non-underlying items totalling a charge after tax of £14.9 million (2017/18 £7.5 million credit). The Directors believe excluding non-underlying items and deferred tax provides a more useful comparison of business trends and performance.

The net non-underlying charge of £14.9 million is a result of:

- The movement in the fair value of long-dated derivatives associated with South West Water's 2040 bond which results in a credit of £5.8 million (2017/18 charge of £2.4 million)
- Increased provision in respect of the receivable due for recovery of rectification and completion costs for Glasgow Recycling and Renewable Energy Centre (GRREC). This reflects our assessment of the credit loss (under IFRS 9) and results in a charge of £22.7 million
- Past pension service cost for Guaranteed Minimum Pension equalisation which applies to all affected UK employers and results in a charge of £3.0 million
- Taxation on the non-underlying items above totalling a credit of £5.0 million.

Further details of non-underlying items are given in note 6 to the financial statements.

Financial performance (before non-underlying items)[1]
Revenue
Group revenue has increased by 6.1% (£85.2 million) to £1,478.2 million (2017/18 £1,393.0 million).

Viridor revenues increased by 8.5% (£67.0 million) to £852.7 million primarily due to the ERF build out and IFRIC 12 construction revenue. Revenue from South West Water increased by 1.7% (£9.7 million) to £581.0 million[2] due to customer demand increases of 1.4% from the hot and dry weather over the summer, net tariff increases of 1.0%[3] and increased infrastructure connections.

Adjusted EBITDA[4]
Group EBITDA and adjusted EBITDA were ahead of last year by 7.2% at £546.2 million (2017/18 £509.6 million) and 5.4% to £592.7 million (2017/18 £562.3 million) respectively, with both South West Water and Viridor ahead of 2017/18. The gap between EBITDA and adjusted EBITDA narrowed in the period as expected due to the reduced share of joint venture EBITDA following the reset of the Greater Manchester waste contract in 2017/18, net of the increased holding in Runcorn I ERF (TPSCo).

Viridor's EBITDA increased by 19.1% (£28.7 million) compared with 2017/18.

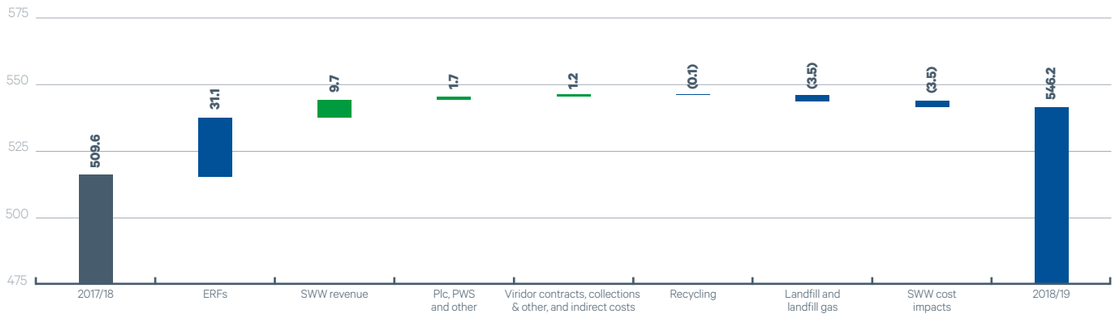
The ERF business has performed strongly during the year, in line with expectations. The EBITDA generated from our portfolio was 25.1% higher at £154.8 million (2017/18 £123.7million) reflecting financial contributions from three new ERFs in the year and increased like for like performance at established facilities. ERF earnings include contractual compensation in the form of liquidated damages of £33.2 million (2017/18 £12.1 million) arising where construction was completed post the original contractual completion date.

While landfill volumes are comparable year on year, landfill EBITDA has decreased by 14.3% to £4.8 million since 2017/18 (£5.6 million) reflecting the mix of waste deposited at our sites. We continue to see demand for a landfill solution into the medium term, and have sites well positioned to meet these demands, with nine sites operational at the year end. As part of the planned closure profile, two sites were closed in the year and we anticipate operating at a level of six sites in the medium to long term.

In our landfill gas business we are currently progressing our engine replacement strategy, including investing in maintenance and more efficient engines. This is improving reliability and securing generation for the longer term, while optimising the generating capacity potential at our sites. EBITDA for the year at £20.6 million is down 11.6% from the prior year (2017/18 £23.3 million), reflecting the natural decline in gas volumes produced from sites (although at 5% this is at a lower rate than previous years), and higher maintenance costs. The benefit of higher year-on-year hedged electricity prices has helped support the overall performance.

Recycling EBITDA at £14.9 million is in line with expectations and prior year guidance (2017/18 £15.0 million). Viridor's focus continues to be on the production of higher quality and value recyclates through our reliability-centred maintenance programme 'WorkSmart' to create margin improvement. While recyclate volumes traded have decreased year-on-year, EBITDA margin has increased by over a £1 per tonne (9%) to £12 per tonne (2017/18 £11) reflecting recovery in the global recycling markets for high quality recyclate, net of the costs of challenging input quality. We continue to share commodity risks and rewards with our customers, with risk/reward share arrangements in place for above 60% of inputs.

Group EBITDA (£m)



In the year contracts, collections and other EBITDA was broadly comparable with the previous year at £39.0 million (2017/18 £39.3 million). Following last year's contract reset, the Greater Manchester run-off operating contract results are in line with our expectations. The Greater Manchester run off contract is due to end on 31 May 2019 and we continue with the orderly transition towards its cessation, while maintaining high levels of service. The financial impact of not continuing with this operational contract is not material to the Group.

Viridor's indirect costs continued to fall with a reduction of £1.5 million to £55.2 million (2017/18 £56.7 million) in 2018/19 and are 17% lower in real terms than 2015/16.

Joint venture EBITDA has reduced to £31.9 million (2017/18 £38.9 million) as a result of the contract reset at Greater Manchester in September 2017, net of the £2.7 million impact of the Group increasing its investment and economic share in Runcorn I ERF joint venture in the year from 37.5% to 75.0%. The contract reset in 2017 saw both the disposal of our Viridor Laing joint venture and the introduction of a lower contractual EBITDA for the Runcorn I ERF joint venture following the repayment of external debt as part of the reset. This reduction in EBITDA was offset by interest savings in the joint venture profit after tax result. Runcorn I ERF continues to deliver strong operational and financial performance.

IFRIC 12 interest receivable at £14.6 million is broadly comparable with 2017/18 at £13.8 million.

South West Water's EBITDA and operating profit increased by 1.7% and 1.3% respectively. Strong cost management and efficiency delivery has resulted in lower than inflation (average inflation 3.1%) cost increases, despite the c.£5 million increased cost challenges posed by the extreme weather and replenishment of water resources in the second half of the year. In addition, South West Water's debt collection performance remains strong resulting in a charge of 0.4% of revenues (2017/18 0.8%) reduced from 1.7% at March 2015. This continues to be driven by efficient cash collections as we work with our customers to manage their debt and strive to support those customers in vulnerable circumstances with affordability challenges. South West Water has continued to record strong performance against the K6 regulatory contracts, outperforming regulatory assumptions resulting in a cumulative RoRE of 11.8%.

Pennon Water Services has continued to generate new customer gains during its second year of trading with revenue increasing by 4.7% to £173.7 million (2017/18 £165.9 million). Overall EBITDA for the year was £1.0 million (2017/18 £1.0 million), with opportunities to improve operating cost efficiencies continuing to be targeted.

Group efficiencies achieved as a result of our Shared Services initiatives have delivered a further £4.0 million of cost savings and synergy benefits during the year, meeting our targeted c.£17 million per annum from 2019.

Net finance costs
Underlying net finance costs of £83.2 million are £8.7 million higher than last year (2017/18 £74.5 million). This is attributable to higher net debt from continuing capital investments and lower interest receivable on shareholder loans following the Greater Manchester contract reset.

We have secured funding at a cost that is efficient and effective with the effective interest rate[5] continuing to be among the lowest in the sector, reducing to 3.6% (2017/18 3.7%). The effective interest rate for South West Water is consistent with the prior year at 3.5%.

During 2018/19 underlying net finance costs were covered 4.1 times[5] by Group operating profit (2017/18 4.2 times).

Profit before tax
Group underlying profit before tax was £280.2 million, an increase of 8.3%, compared with the prior year (2017/18 £258.8 million). Included in profit before tax is our share of joint venture profit after tax of £12.4 million (2017/18 £9.4 million). On a statutory basis, profit before tax was £260.3 million (2017/18 £262.9 million) reflecting a non-underlying charge before tax of £19.9 million (2017/18 credit of £4.1 million).

Tax charge
On an underlying basis the net tax charge of £42.7 million (2017/18 £44.4 million) consists of:

- Current year current tax charge of £32.4 million, reflecting an effective tax rate of 11.6% (2017/18 £29.7 million, 11.5%). The lower effective rate versus the UK's mainstream corporation tax rate of 19% reflects the accelerated level of capital allowance claims available to the Group compared with the depreciation charge
- Current year deferred tax charge of £23.2 million (2017/18 £20.7 million) primarily reflecting capital allowances across the Group in excess of depreciation charged.

Recognising the resolution of minor outstanding tax items with HMRC, the following prior year credits have been recognised:

- Current tax credit of £3.0 million (2017/18 credit of £3.6 million)
- Deferred tax credit of £9.9 million (2017/18 £2.4 million credit), reflecting finalisation of capital allowance claims.

The 2018/19 non-underlying items result in a £5.0 million net tax credit (2017/18 £3.4 million credit).

Overall, the total tax charge for the year of £37.7 million was lower than the prior year (2017/18 £41.0 million).

Earnings per share
Earnings per share on both a statutory and underlying basis has been positively impacted by a reduction in hybrid costs[6] compared with last year. As a consequence, earnings per share on both a statutory and underlying basis has increased by 6.5% to 51.1p (2017/18 48.0p) and 13.6% to 57.8p (2017/18 50.9p) respectively.

Dividends and retained earnings
The statutory net profit attributable to ordinary shareholders of £214.3 million has been transferred to reserves.

The Directors recommend the payment of a final dividend of 28.22p per share for the year ended 31 March 2019. With the interim dividend of 12.84p per share paid on 4 April 2019 this gives a total dividend for the year of 41.06p, an increase of 6.4% over 2017/18 and maintaining our long-standing sector-leading dividend policy of RPI +4% year-on-year growth. We set that policy for the 2010-15 regulatory period and confirmed its continuation through to 2020.

This policy reflects the Board's confidence in our sustainable growth strategy and is underpinned by the highest potential Return on Regulated Equity in the water sector over K6 (2015-20) and the growth in earnings delivered by Viridor's ERFs. We are actively seeking further opportunities for growth beyond 2020 with the aim of sustaining a sector-leading dividend policy over the longer term.

Proposed dividends totalling £172.7 million are covered 1.4 times[5] by net profit (before non-underlying items and deferred tax) (2017/18 1.3 times). Dividends are charged against retained earnings in the year in which they are paid.

(2) Including wholesale revenue for non-household customers.
(3) Net tariff increase reflects the net position post Wholesale Revenue Incentive Mechanism pass back of £12 million for 2018/19.
(4) EBITDA and adjusted EBITDA are set out in the alternative measures section on page 174.
(5) Calculation is set out in the alternative measures section (pages 174 to 176).
(6) Perpetual capital securities (hybrid) cost in 2018/19 was £8.6 million (2017/18 £21.5 million).

Report of the Chief Financial Officer
continued

Group capital investment
Group capital investment[5] was £395.9 million 2018/19 compared with £398.2 million in 2017/18.

Viridor
Viridor's capital spend in the year was £241.7 million (2017/18 £213.0 million), an increase of £28.7 million over 2017/18.

The majority of capital investment continues to relate to growth projects driving increased earnings now and into the future, with £207.7 million of total spend relating to the ERF portfolio. As well as reflecting the move into operation of three ERFs and continuing construction at Avonmouth, the expenditure in the year included additional investment at Glasgow ERF of c.£21 million securing incremental throughput capacity. Also included are lifecycle capital expenditure on our operational ERFs and development of our Clyde Valley ERF fuel supply facility.

On-going restoration and remediation programmes continue for our landfill assets, ensuring we meet or exceed our environmental duties and responsibilities.

South West Water
South West Water's capital expenditure in the year was £154.0 million, compared with £184.2 million in 2017/18 with the profile aligned with the K6 capital plan reflecting the completion of specific large investment programmes at Mayflower Water Treatment Works and the bathing and shellfish water improvements.

Key areas of drinking water investment and activity during 2018/19 included:

- Completion of the new state-of-the-art Mayflower water treatment works which has entered commissioning
- Investment in the resilience of our infrastructure to reduce the number of bursts and leakage, impacted by the freeze and thaw in March 2018 and costs associated with the hot dry summer.

Key areas of wastewater investment and activity during 2018/19 included:

- Finalisation and completion of the Plymouth bathing water scheme
- Continued improvements at wastewater treatment works including flood resilience
- Investment for growth in order to meet increases in supply and demand.

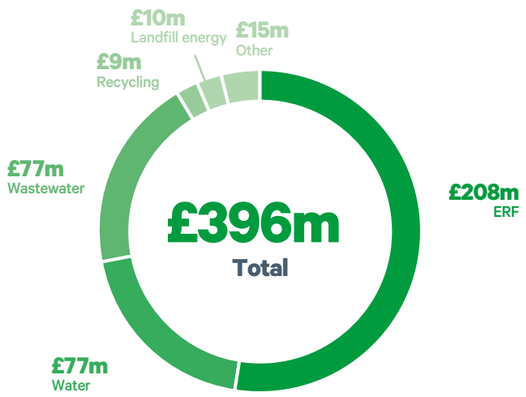
Cash inflow from operations, continuing investment in future growth
The Group's operational cash inflows[5] in 2018/19 were £649.0 million (2017/18 £672.4 million). These funds have been put to use in efficiently financing the Group's capital structure and investing in future growth. This capital investment has resulted in higher Group net debt.

Sustainable funding position underpinning investment
The Group has a strong liquidity and funding position with £1,170 million cash and committed facilities at 31 March 2019. This consists of cash and deposits of £570 million (including £204 million of restricted funds representing deposits with lessors against lease obligations) and undrawn facilities of £600 million. At 31 March 2019 the Group's borrowings totalled £3,650 million. After the £570 million held in cash, this gives a net debt figure of £3,080 million, an increase of £278 million during the year (2017/18 £2,802 million).

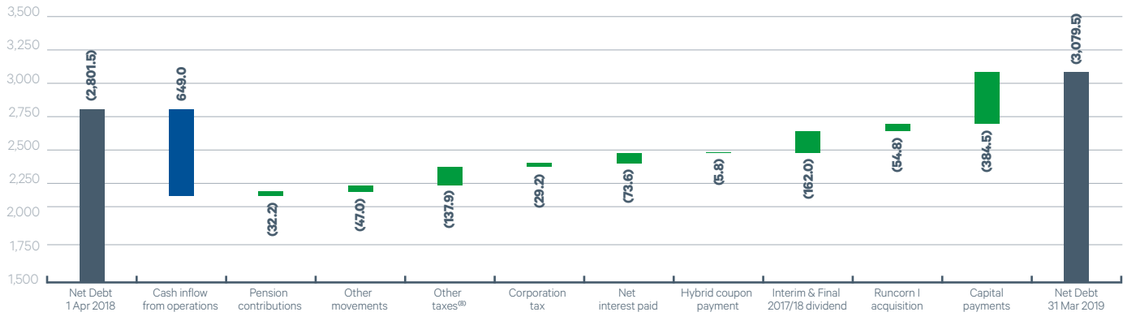
Pennon has pioneered a Sustainable Financing Framework to integrate commitments to environmental and social objectives into a variety of funding opportunities across the Group. The framework allows Pennon to access future funding opportunities aligned with the Green Loan Principles, Green Bond Principles and Social Bond Principles. The framework has been certified by DNV GL a leading sustainability verifier. Pennon is committed to continuous annual improvements in sustainability ratings and KPIs which may lead to improved interest rate margins.

During the year, £830 million of new and renewed facilities have been signed, £665 million in Pennon Group plc and £165 million in South West Water. In total, £600 million of the new facilities signed in the year are linked to the sustainable nature of the business. Included in these facilities is an inaugural Pennon Group loan from the EIB of £110 million.

Major categories of capital expenditure



Net debt movements (robust cash inflow from operations, £m)



Pennon has cash and committed facilities providing funding for Viridor's committed growth projects and South West Water's regulatory capital programme into K7, with c.£725 million headroom for investment.

Efficient long-term financing strategy
The Group has a diversified funding mix of fixed (£1,936 million, 63%), floating (£576 million, 19%) and index-linked borrowings (£568 million, 18%). The Group's debt has a maturity of up to 38 years with a weighted average maturity of c.18 years. Much of the Group's debt is floating rate and derivatives are used to fix the rate on that debt. In line with the Group's updated policy of maintaining at least 60% of interest bearing liabilities at fixed rates, the Group has fixed, or put swaps in place to fix, the interest rate on a substantial portion of the existing water business debt for the entire K6 period.

Additionally, following the submission of the K7 (2020-25) South West Water business plan and the resulting Draft Determination from Ofwat the Group is aligning the hedging for the next regulatory period with the changed regulatory methodology. A proportion of new debt will be hedged in K7 on a rolling ten-year basis while still maintaining flexibility within the overall portfolio. Embedded debt hedging is aligned with the five year regulatory delivery period. Around 50% of South West Water's embedded floating net debt has already been hedged into K7 during the past six months, taking advantage of falling swap rates.

South West Water's cost of finance is among the lowest in the industry. Around two-thirds of South West Water's net debt is from finance leases which provide a long maturity profile. Interest payable benefits from the fixed credit margins which are secured at the inception of each lease. £517 million (c.25%) of South West Water's net debt is index-linked. This is below Ofwat's notional assumption of 33%, giving an advantageous position as there remains uncertainty over how transitioning from RPI to CPIH may be translated into future funding rates.

Net debt position
The Group's net debt has increased by £278 million to £3,080 million.

The gearing ratio at 31 March 2019, being the ratio of net debt to (equity plus net debt) was 64.7%[7] (31 March 2018 63.1%).

The combined South West Water and Bournemouth Water debt to RCV ratio is 58.9%[7] (31 March 2018 60.3%) which is lower than Ofwat's K6 target for efficient gearing of 62.5%, but aligns with the new K7 notional assumptions of 60.0%

Group net debt includes £2,057 million for South West Water with the remaining £1,023 million primarily supporting investment in Viridor growth and expansion including the amount invested in joint ventures, through shareholder loans of £73 million for Runcorn I and Lakeside ERFs.

In the year, cash inflow from operations[5] was £649.0 million (2017/18 £672.4 million).

Cash outflows relating to the capital programme[5] totalled £384.5 million (2017/18 £463.9 million). IFRIC 12 service concession payments (in respect of GRREC, gross of amounts subject to legal contractual process). In addition, a cash consideration of £54.8 million was paid to acquire an increased interest share in our Runcorn I ERF joint venture.

Net interest payments totalled £73.6 million (2017/18 £61.3 million).

Pension contributions were £32.2 million (2017/18 £17.0 million).

Dividend payments and coupon payments on the perpetual capital securities were £162.0 million (2017/18 £107.8 million) and £5.8 million (2017/18 £22.9 million) respectively.

Corporation tax payments were £29.2 million (2017/18 £21.7 million) while payments of all other operational taxes were £137.9 million (2017/18 £129.0 million).

Included in other movements of £47.0 million is the 2017 unwind settlement of the Peninsula MB Limited (PMB) derivative of £44.3 million.

Internal borrowing
South West Water's funding is treated for regulatory purposes as ring-fenced. This means that funds raised by, or for, South West Water are not available as long-term funding for other areas of the Group.

Taxation strategy
All Group operations and subsidiaries are subject to tax in the UK and a detailed and accessible tax strategy is published annually. Our annual tax strategy and tax disclosure has been cited as good practice by the Financial Reporting Council. At Pennon we are transparent, sharing details of how we optimise our tax position without entering into artificial tax arrangements or taking an aggressive stance in the interpretation of tax legislation.

Fair Tax 2017-18

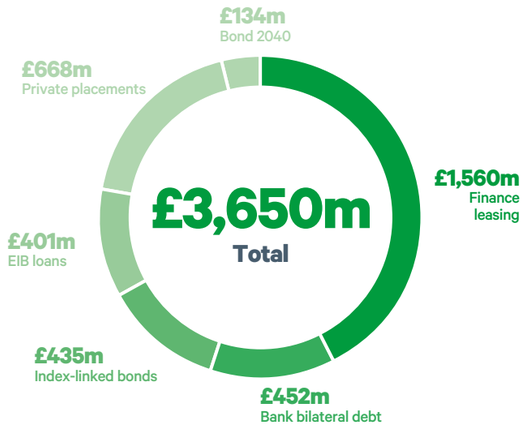
In December 2018 Pennon became the first water services and waste management utility to secure the Fair Tax Mark, an independent certification scheme which recognises organisations that demonstrate they are paying the right amount of corporation tax at the right time.

(7) Calculations set out on page 132.

(8) Other taxes include business rates, employers national insurance, fuel excise duty, carbon reduction commitment, environmental payments, climate change levy and external landfill tax.

Report of the Chief Financial Officer
continued

Major components of the Group's debt finance at 31 March 2019



Under our Tax strategy we:

- At all times consider the Group's corporate and social responsibilities in relation to its tax affairs and operate appropriate tax risk governance processes to ensure that the policies are applied throughout the Group
- Comply with our legal requirements, file all appropriate returns on time and make all tax payments by the due date
- Consider all taxes as part of ongoing business decisions
- Not enter into artificial tax arrangements or take an aggressive stance in the interpretation of tax legislation
- Not undertake transactions which are outside the Group's low risk appetite for tax or not in line with the Group's Code of Conduct
- Engage with HMRC in a proactive and transparent way and discuss our interpretation of tax laws in real-time, such interpretations following both the letter and spirit of the laws.

Although the Group does not expect its tax strategy to change significantly year on year, it is reviewed and updated annually. In preparation for our second strategy document we once again sought customer feedback on the approach we take.

Further details are given in the Group's Tax Strategy document available on the Pennon Group website.

Tax contribution 2018/19 – borne/collected

The Group's total tax contribution (TTC) for 2018/19 amounted to £281 million (2017/18 £265 million). TTC is a standardised measure of a group's total tax contribution, having been developed by PwC and the 100 Group (FTSE 100 finance directors). It is acknowledged as being a fair and comparable representation of total tax cost.

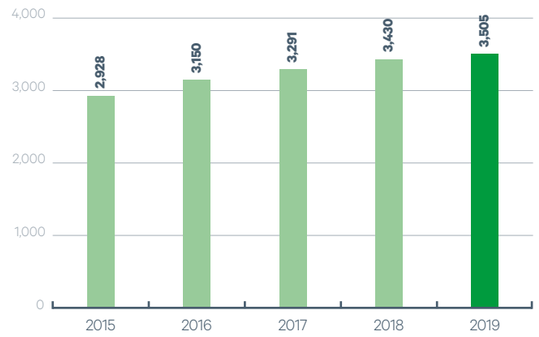
TTC looks at taxes borne and taxes collected. Taxes borne includes all taxes which are a cost to the Group, such as business rates, corporation tax and employer's National Insurance contributions (NICs) as well as taxes collected and recovered highlights where the business is collecting tax on behalf of HMRC. A net amount of £34 million (2017/18 £23 million) was collected on behalf of the authorities for employee payroll taxes and VAT.

Landfill tax of £121 million (2017/18 £127 million) was collected and paid on waste material deposited at our landfill sites. A slight reduction year-on-year reflects the nature of the waste materials disposed. This amount includes £7 million (2017/18 £7 million) paid to local environmental bodies via the Landfill Tax Credits Scheme. Landfill tax is an operating cost which is recovered from customers and is recognised in revenue.

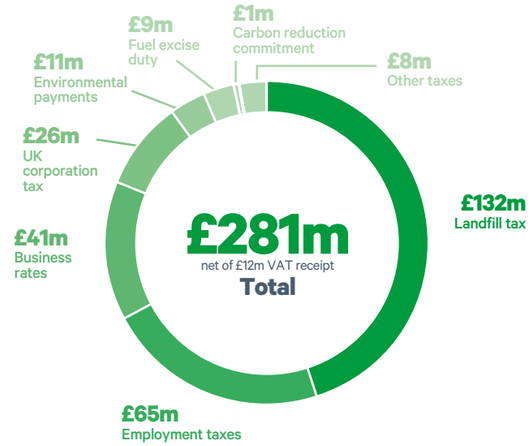
In addition, the Group incurred landfill tax of £10 million (2017/18 £5 million) on the disposal of waste to third parties. This is an operating cost for the Group and reduces profit before tax. The net amount of landfill tax paid to HMRC by the Group and via third parties represents 18% of HMRC's landfill tax receipts in the year.

Employment taxes totalled £65 million (2017/18 £59 million) including employees' Pay As You Earn (PAYE) and total National Insurance Contributions (NICs). Employer NICs of £19 million (2017/18 £17 million) were charged approximately 73% to operating costs with 27% capitalised to property, plant and equipment. The Group also paid £1 million in apprentice levy (2017/18 £1 million). The total amount of £65 million includes PAYE of £3 million (2017/18 £3 million) on pension payments made by the Group pension scheme. A net amount of £45 million (2017/18 £41 million) was collected on behalf of the authorities for employee payroll taxes.

Regulatory capital value as at 31 March (£m)



Tax contribution 2018/19 (borne/collected)



Business rates of £41 million (2017/18 £41 million) were paid to local authorities. This is a direct cost to the Group and reduces profit before tax.

The main elements of the £26 million UK corporation tax payment to HMRC in the year (2017/18 £22 million) were £14 million in relation to 2018/19 instalment payments and £12 million in relation to earlier years. (An additional £3 million of corporation tax payments were made to third parties in respect of consortium relief).

VAT of £12 million has been received (2017/18 £19 million received) by the Group from HMRC. VAT has no material impact on profit.

Payments to the Environment Agency and other regulatory bodies total £11 million (2017/18 £11 million). This reduces profit before tax.

Fuel Excise Duty of £9 million (2017/18 £9 million) related to transport costs. This reduces profit before tax.

Carbon Reduction Commitment (CRC) payment for the Group of £1 million (2017/18 £3 million). This reduces profit before tax.

Pensions

The Group operates defined benefit pension schemes for certain employees of Pennon Group. The main schemes were closed to new entrants on or before 1 April 2008.

At 31 March 2019, the Group's pension schemes showed an aggregate deficit (before deferred tax) of £60.8 million (March 2018 £49.5 million), an increase of £11.3 million as a result of:

- Increase in liabilities of £76 million due to lower corporate bond yields
- Reduction in liabilities as a result of latest CMI mortality assumptions of £42 million
- Increase in liabilities from other factors, including service cost, of £13 million
- Increase in net asset values of £36 million, reflecting good asset returns and deficit contributions of £13 million.

For the Group's principal scheme, of which South West Water accounts for around 80%, the latest actuarial valuation was at 2016. Contributions, including the recovery plan of annual deficit contributions up to 2022, remain in line with 2014 Final Determination allowances.

The net aggregate liabilities of £50.5 million (after deferred tax) represented around 2% of the Group's market capitalisation at 31 March 2019.

Impact of low yields at 31 March 2019

At 31 March 2019 forward interest rates and yields fell significantly, to some extent reflecting Brexit uncertainty.

This resulted in a number of impacts for the Group:

- Low corporate bond yield used to value pension scheme liabilities increased our present value of pension obligations by £76 million (as noted above)
- Fair value of our borrowings increased by c.£100 million or c.3% of gross debt
- The valuation of our derivative contracts, put in place to manage interest risk, increased compared with 2018, albeit to a lesser extent.

The impacts noted above have partly reversed since 31 March 2019, as forward interest rates and yields have increased, however, as yields were falling in the period leading up to 31 March 2019, the Group advantageously entered forward starting interest rate hedges for the K7 (2020-25) period, in line with the Group's interest rate management policy. Through this period around 50% of South West Water's floating rate net debt has been hedged for K7.

Energy hedging

Pennon has adopted a Group portfolio management approach to energy hedging, and has the ability to hedge its market position for periods up to five years ahead, further helping to protect revenues.

Forward hedges have been put in place in the liquid market with the Group c.95% for 2019/20, c.55% for 2020/21 and c.20% for 2021/22 hedged for its energy (generation net of internal usage of electricity). In addition, the Group has a natural hedging opportunity which represents one-third of Viridor's energy generation, as South West Water is a net user of electricity.

The energy portfolio management team continues to actively manage the Group net energy generation position in liquid markets.

Insurance

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

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

- Self-insurance – Group companies pay a moderate excess 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 that have good credit ratings.

Conclusion

Pennon Group had another year of strong performance. The Group goes forward with a sound balance sheet, sustainable finances and dividend well aligned to strategic objectives.

Susan Davy
Chief Financial Officer

Pennon Group plc

Risk report

Risk management and internal control framework

Our core business activities across the water and waste sectors inherently expose the Group to a variety of risks and opportunities which could materially impact our ability to achieve our strategic priorities. The Pennon Board and Pennon Executive are committed to the effective management of both risks and opportunities to ensure the long-term success of the Group.

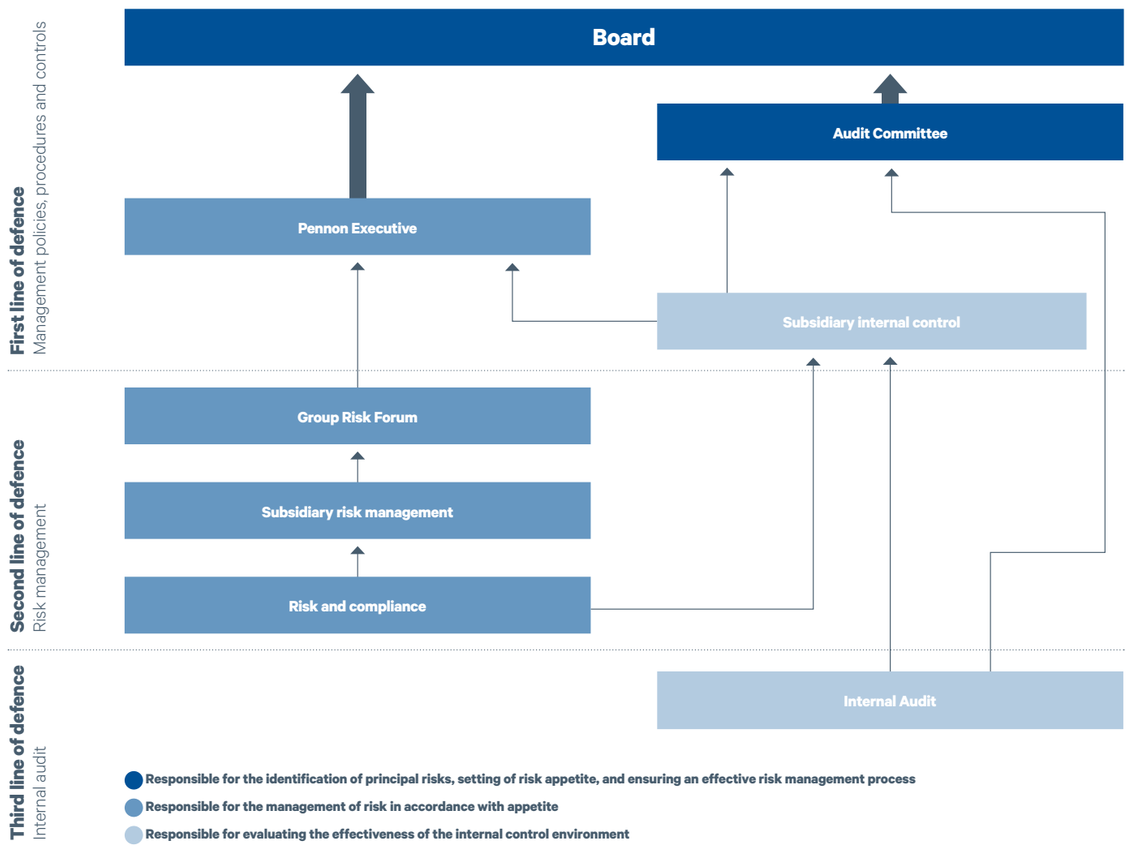
Pennon operates a mature Group-wide risk management framework (see diagram below) which is embedded into our culture and ways of working at all levels of the business. This framework forms a key part of our governance structures to ensure that there is robust review, challenge and assurance over the management of our key risks and opportunities.

Our risk management framework encompasses both a 'top down' and 'bottom up' approach. This allows risks and opportunities to be cascaded and escalated effectively, while enabling a common understanding of the risks and opportunities that the Group is exposed to and their potential impact on the achievement of our strategic priorities. The consideration and evaluation of environmental, social and governance (ESG) risks are integrated into the Group's risk management framework, with the delivery of actions and performance monitored through the ESG framework. Further detail on the ESG framework is provided on page 10.

A consistent methodology is applied in the identification, evaluation and management of the Group's risks, which considers both the likelihood of the risk occurring over a long-term period, formally from a Group perspective, a five-year period, and the potential impact assessed across a range of categories including financial, safety, environmental and customer service. All principal and business level risks are captured within risk registers and are subject to regular review and challenge.

The Group manages its risk exposure, in line with the desired risk appetite and tolerance levels, through the operation of a robust internal control and assurance framework which is aligned to the 'three lines of defence' model. The subsidiary executive boards, Pennon Executive and the Pennon Board obtain comfort over the effectiveness of the internal control environment through visibility of the outputs from a variety of internal and external assurance providers, including an independent Group Internal Audit function.

Risk management framework



The key elements of the Group's risk management process include:

		Key risk management responsibilities	Key assurance activities
First line of defence	Board	• Sets the Group's strategic objectives • Establishes the Group's risk appetite • Determines the Group's principal risks • Ensures an effective internal control framework.	• Quarterly reviews of the Group's principal risks against the determined risk appetite.
	Audit Committee	• Reviews the effectiveness of the Group's risk management framework • Reviews the adequacy of the internal control framework.	• Perform quarterly deep dive reviews on principal risks • Approves the Group Internal Audit plan • Receive reports on the outcomes of key assurance activities.
	Pennon Executive	• Day-to-day management of the Group's principal and operational risks • Establishes the relevant Group-wide risk management processes and procedures • Maintaining the internal control framework.	• Perform a thorough appraisal of the Group's risk profile quarterly • Monitoring of the Group's performance against KPIs and financial performance • Establishes and reviews policies, procedures and delegated authorities.
Second line of defence	Group Risk Forum	• Provides review and challenge over subsidiary/functional principal risks and mitigation strategies • Alignment of the top down and bottom up risk management process • Horizon scanning on emerging risks and opportunities.	• Quarterly review of Group and subsidiary principal risks on a quarterly basis • Deep dive reviews of specific risks. Topics include; cyber security, renationalisation, health & safety, and financial markets and liquidity.
	Individuals subsidiaries/functions	• The identification and assessment of subsidiary level risks • Implementation and execution of appropriate risk mitigation strategies, aligned with the agreed risk appetite • Monitor compliance with internal control framework.	• Review of subsidiary/functional principal risks on a quarterly basis by executive management teams • Risk and Compliance functions undertake compliance activities over ISO standards and other key business processes • Self-certification of compliance with internal control framework.
Third line of defence	Group Internal Audit	• Provide independent, risk-based assurance on the effectiveness of the internal control framework • Coordination of independent assurance activities.	• Regular reporting to Audit Committee and Pennon Executive on the effectiveness of internal controls and the outcomes from other third line assurance activity.

Risk report
continued

Continuous improvements to risk management and internal control

The Group seeks to continually improve its approach to risk management and internal control. During the year there have been a number of developments which have further enhanced these processes, including:

- The Group's risk management strategy has been refreshed, updated and approved by the Board during the year
- There is greater coordination and alignment between assurance activities across the Group with integrated assurance reporting presented to the Board
- Significant progress has been made in rolling out the HomeSafe initiative across the Group, which has delivered reduced injury frequency rates
- A comprehensive health & safety second line assurance programme has been delivered by the Group Health Safety Security and Assurance function
- There has been further standardisation of operational and financial processes and controls as part of the corporate shared services structure
- A review has commenced to identify opportunities to further improve the Group's resilience arrangements.

Ofwat's principles for holding companies – Board leadership, transparency and governance

Ofwat requires that holding companies manage their risks in such a way that the regulated company is protected from risk elsewhere in the Group. The Group's principal risks and uncertainties include those Group-level risks which could materially impact on South West Water.

Pennon's risk management and internal control frameworks ensure that it does not take any action that would cause South West Water to breach its licence obligations. Further, the Group's governance and management structures mean that there is full understanding and consideration of South West Water's duties and obligations under its licence, as well as an appropriate level of information sharing and disclosure to give South West Water assurance that it is not exposed as a result of activities elsewhere within the Group.

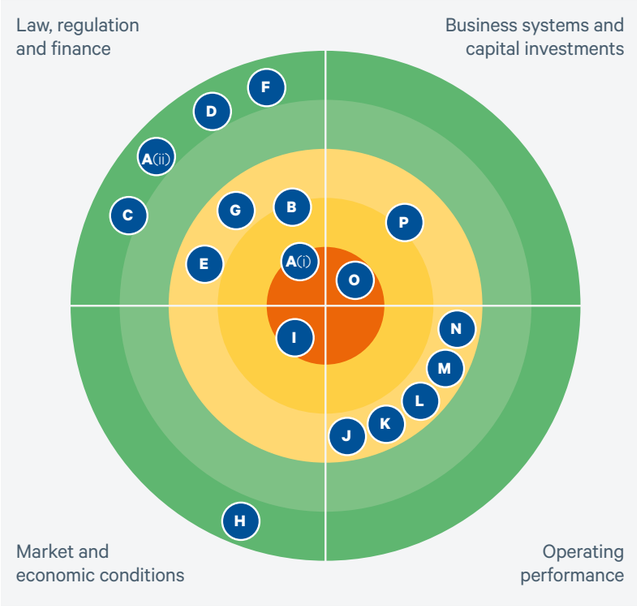
Risk appetite

The UK Corporate Governance Code requires the Group to determine its risk appetite with respect to the level of risk exposure considered appropriate in achieving the Group's strategic priorities. Striking an appropriate balance between risk and reward is key to the success of the Group's strategy.

The Board has established its risk appetite for each risk category and also for each principal risk. This allows the business to pursue value enhancing opportunities, while maintaining an overall level of risk exposure that the Board considers to be appropriate. The Board's evaluation of the effectiveness of internal control is also considered in the context of the stated risk appetite. The risk appetite for each risk category is detailed below:

Risk category	Risk appetite statement
Law, regulation and finance	The Board is committed to fully complying with, and being seen to be complying with, all relevant laws, regulations and obligations and has no appetite for non-compliance in this area. This includes (but is not limited to) health & safety, where the Board places the highest level of importance on the welfare of our staff, the public and those who work for or on behalf of Pennon. The Group also operates a prudent approach to our financing strategy to ensure our long-term financing commitments are met. The Board acknowledges, however, that the Group operates in a complex environment influenced by Government policy and regulatory reform. Consequently, there is a greater acceptance of risk in these areas and the Group seeks to mitigate any potential downside and leverage opportunities that may arise from Government policy and regulatory change.
Market and economic conditions	The Board recognise that our water and waste activities are exposed to changes in macroeconomic and external market conditions, both domestically and internationally. The Group seeks to take well-judged and informed decisions to mitigate these risks where possible, but accepts that a level of residual risk may remain beyond the Board's control.
Operating performance	The Board has a low appetite for significant operational failure of our water or waste assets and seeks to reduce both the likelihood and impact through long-term planning and careful management of our operational assets. There is greater appetite for well-informed risk taking to develop further markets, subject to this not detrimentally impacting on the level of service that we provide to our existing customer base.
Business systems and capital investment	While capital investment activities contain a degree of inherent risk, all decisions are taken on an informed basis with risks weighted against potential appropriate returns on a case-by-case basis. The Group seeks to minimise technology and security risk to the lowest possible level without detrimentally impacting its operations.

Overview of Pennon's principal risk profile



Strategic priorities

1 Leadership in UK water and waste infrastructure

2 Leadership in cost base efficiency

3 Driving sustainable growth

Long-term priorities affected

Risk level

High · Medium · Low

Increasing · Stable · Decreasing

(i) The low, medium and high risk level is our estimate of the net risk to the Group after mitigation. It is important to note that risk is difficult to estimate with accuracy and therefore may be more or less than indicated.

(ii) Current assessment of direction of travel of risk level.

Category	Ref	Strategic priorities	Risk description	Net risk level	Trend
Law and regulation and finance	A	1, 2	Changes in Government policy: (i) Renationalisation	High	Stable
			(ii) Use of single-use plastics	Low	Stable
	B	1, 2	Regulatory reform	Medium	Stable
	C	1, 2	Compliance with laws and regulations	Low	Increasing
	D	1, 3	Maintaining sufficient finance and funding to meet ongoing commitments	Low	Stable
	E	1, 2, 3	Non-compliance or occurrence of avoidable health & safety incident	Medium	Stable
	F	2	Tax compliance and contribution	Low	Increasing
	G	2	Failure to pay all pension obligations as they fall due & increased costs to the Group should the defined benefit pension scheme deficit increase	Medium	Increasing
Market and economic conditions	H	1, 2	Non-recovery of customer debt	Low	Increasing
	I	3	Macro-economic risks impacting commodity and power prices	High	Stable
Operating performance	J	1	Poor operating performance due to extreme weather or climate change	Medium	Stable
	K	1, 3	Poor service and/or increased competition leading to loss of customers	Medium	Stable
	L	1, 3	Business interruption or significant operational failures/incidents	Medium	Increasing
	M	1, 2, 3	Difficulty in recruitment, retention and development of skills	Medium	Stable
	N	1, 2, 3	Non-delivery of regulatory outcomes and performance commitments	Medium	Increasing
Business systems and capital investments	O	1, 3	Failure or increased cost of capital projects/exposure to contract failures	High	Increasing
	P	1	Failure of IT systems, management and protection including cyber risks	Medium	Increasing

Risk report
continued

Principal risks and uncertainties

The Group's business model exposes it to a variety of external and internal risks influenced by the possible impact of macro political, economic and environmental factors; notably the continued uncertainly arising from Britain's exit from the European Union (EU) and the potential renationalisation of the water industry. While the current Government are supportive of the existing regulatory model, in the event of a change of government, it remains the policy of the opposition to renationalise the water industry and Labour has provided further detail of their proposed approach during the year. In the event of this scenario occurring there could be an impact to the Group's business model and consequently this remains a significant risk to the Group.

While the ability of the Group to influence these macro level risks is limited, they continue to be regularly monitored and the potential implications are considered as part of the ongoing risk assessment process. The Group performs a range of scenario planning and analysis exercises to understand the risk exposure of one or a number of these events occurring. The Group's principal risks have remained consistent with the 2018 annual report with the exception of one additional principal risk:

Risk	Net risk	Direction of travel
Non-delivery of regulatory outcomes and performance commitments' This risk reflects the significance of the ODI regime in the regulatory model. South West Water has the opportunity for reward but is also exposed to risk if performance commitments are not achieved.		

Britain's exit from the European Union

During the year the Group has continued to evaluate and monitor the potential risks and opportunities arising from Britain's decision to exit the EU. Cross functional working groups have been established and mitigation plans have been implemented focusing on those activities that are likely to be most impacted in the event of Britain leaving the EU without a withdrawal agreement. The Pennon Executive and the Board have received regular updates throughout the year on the Group's preparations for a no-deal scenario.

The Group continues to reflect the impact associated with Britain leaving the EU within the relevant principal risks. While no single issue is considered to expose the Group to material risk, it is recognised that the combination of multiple issues or events concurrently could result in some disruption in the period immediately after leaving the EU in the event of a no-deal scenario. Plans have been established which seek to minimise the potential impact on the Group and its operations.

The following issues have been identified as potentially having a significant impact on the Group's principal risks:

- **Availability of chemicals** (linked to principal risk: Business interruption or significant operational failures/incidents). Detailed analysis has been completed on chemicals received from European-based suppliers and on South West Water and Viridor stock levels to ensure they continue to be maximised. Additionally, operational plans have been developed to ensure continued asset availability and that Government and Local Resilience Forum requirements are met. South West Water has also been heavily engaged with Water UK in developing a national response. This has involved discussions with the UK Government, regulators and other key stakeholders, developing a 'critical chemicals' action plan jointly with the Chemicals Industry Association and due diligence being undertaken on critical chemical suppliers.
- **Exporting of recyclate material** (linked to principal risk: Macro level risks impacting on commodity and power prices). While we continue to export recyclate to Europe, contingency plans have been established so that, in the event of a no-deal scenario, the majority of recyclate can be diverted to non-European markets. We have engaged extensively with our haulage and shipping partners to understand their preparations and trialled shipments to EU and non-EU countries from alternative UK ports. For the limited volume of recyclate material which will continue to be exported to Europe in the event of a no-deal scenario, revised documentation requirements have been reviewed and internal processes amended where appropriate.
- **Inability to access the same level of funding from the European Investment Bank** (linked to principal risk: Maintaining sufficient finance and funding): Prior to the financial year end funding lines have been put in place which has resulted in cash and committed facilities to fund Viridor's committed growth projects and South West Water's capital programme into K7 (2020-25). Furthermore, we have engaged with a variety of UK and European banks who have reaffirmed their appetite for UK infrastructure lending.
- **The ability to attract and employ individuals with the necessary skills and experience** (linked to principal risk: Difficulty in the recruitment, retention and development of skills): While the current position of the UK Government in the event of a no-deal scenario is that EU nationals already in the country will be able to apply for settled status, the Group has been proactive in reinforcing this to all affected staff. Furthermore, Viridor has moved 180 employees from agency roles into permanent employment. The Group has also sought assurances from temporary employment agencies as to their plans to ensure sufficient availability of temporary resource in the event of a no-deal scenario.

The Directors confirm that during 2018/19 they have carried out a robust assessment of risks facing the Group, including assessing the impacts on its business model, future performance, solvency and liquidity.

These principal risks have been considered in preparing the viability statement on page 69.

Law, regulation and finance

Principal risk	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
A: Changes in Government policy	**Long-term priorities affected:** **1, 2** Changes in Government policy may fundamentally impact our ability to deliver the Group's strategic priorities impacting shareholder value.	(i) While the present Government is supportive of the existing regulatory model, the renationalisation of the water industry continues to be a central policy of the Labour Party and remains a possibility in the event of a change of Government. We continue to engage with all political parties, customers and wider stakeholders, both directly and via Water UK, demonstrating the value received from our operational performance and continued investment in the network infrastructure. South West Water's 2020-25 business plan also detailed how we would empower customers further and deliver benefits for our stakeholders over the next regulatory period. (ii) Viridor remains well placed to leverage the opportunities arising from the key outcomes within the Government's Resources and Waste Strategy, as reflected by investment in an additional plastic processing facility. Further clarity is required, however, with respect to key aspects of the initiatives within the Resources and Waste Strategy as timescales remain uncertain.			We recognise that Government policy evolves. The Group seeks to minimise potential risk and maximise opportunities through regular engagement, communication and robust scenario planning.
B: Regulatory reform	**Long-term priorities affected:** **1, 2** Reform of the regulatory framework may result in changes to the Group's priorities and the service we provide to our customers. It may have a significant impact on our performance which can impact shareholder value.	There remains a continued focus from Ofwat on the governance of companies in the water sector; in particular the introduction of a 'social contract' between water companies and their stakeholders. We have been an active voice in the sector during the year on this topic. This concept was at the heart of South West Water's 2020-25 business plan, entitled 'New Deal', which received fast-track status from Ofwat. The Draft Determination was received from Ofwat in April 2019. This included our commitment to provide customers with a shareholding and a greater say in how South West Water is run. Additionally, as a listed company we continue to uphold the highest standards of corporate governance and transparency, including compliance with the UK Corporate Governance Code and Ofwat's Principles for Holding Companies.			We accept that regulatory reform occurs and seek to leverage opportunities where possible and minimise the negative impact of regulatory reform by targeting changes which are NPV neutral over the longer term to protect customer affordability and shareholder value.
C: Compliance with laws and regulations	**Long-term priorities affected:** **1, 2** The Group is required to comply with a range of regulated and non-regulated laws and regulations across our water and waste businesses. Non-compliance with one or a number of these may result in financial penalties, a negative impact on our ability to operate effectively and reputational damage.	The Group operates a robust and mature regulatory framework which seeks to ensure compliance with Ofwat, Environment Agency and other relevant requirements. The Group also continues to provide a rolling programme of training and guidance to our staff, contractors and partners. This included data protection training following the implementation of the General Data Protection Regulation. During the year we have also refreshed our Code of Conduct and launched a specific Supply Chain Code of Conduct, further reinforcing the standards expected of our staff and our partners. The Group's Speak Up whistleblowing process allows any concerns to be raised confidentially and robust processes are in place for investigating these. Additionally during the year Pennon became a member of the Slave Free Alliance, demonstrating the Group's commitment to eradicating modern slavery.			The Group has the highest standards of compliance and has no appetite for legal or regulatory breaches.

Strategic impact

1 Leadership in UK water and waste

2 Leadership in cost base efficiency

3 Driving sustainable growth

Risk level

High · Medium · Low

Increasing · Stable · Decreasing

Risk report
continued

Law, regulation and finance

Principal risk	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
D: Maintaining sufficient finance and funding, within our debt covenants, to meet ongoing commitments	**Long-term priorities affected:** **1, 3** Failure to maintain funding requirements could lead to additional finance costs and put our growth agenda at risk. Breach of covenants could result in the requirement to repay certain debt.	The Group has mature treasury, funding and cash flow arrangements in place and the impact of political, economic, and regulatory risks on the Group's financing commitments and cashflow is regularly reviewed by Pennon Executive and the Board. The Group has £1.2 billion of cash and committed facilities. During the year the Group has signed new facilities of £830 million of which £600 million is linked to the sustainable nature of our business. This provides funding for Viridor's committed capital projects and funds the South West Water into K7. The strength of our position provides the Group with added resilience in the event of short-term volatility of a potential Brexit no-deal scenario. Further detail is provided on page 62.	Green	↔	The Group operates a prudent approach to our financing strategy in order to ensure our funding requirements are fully met.
E: Non-compliance or occurrence of an avoidable health & safety incident	**Long-term priorities affected:** **1, 2, 3** A breach of health & safety law could lead to financial penalties, significant legal costs and damage to the Group's reputation.	The effective management of health & safety risks continues to be a priority for the Board and Pennon Executive, as demonstrated by the 2025 HomeSafe strategy. Experienced health & safety professionals are embedded within the Group providing advice, guidance and support to operational staff. During the year the Group progressed the full roll out of HomeSafe for Viridor and South West Water which encompassed both face-to-face and e-learning training. This was supported by a comprehensive assurance programme to ensure the key requirements of HomeSafe, legal compliance and our standards are being correctly followed with outcomes reported to the Pennon Health & Safety Committee. The benefits of the HomeSafe programme are already being seen with lost time injury frequency rates falling 32.2% during the year.	Yellow	↔	The Group has no appetite for health & safety related incidents and has the highest standards of compliance within the Group, contractors, partners and other third parties.
F: Tax compliance and contribution	**Long-term priorities affected:** **2** Non-compliance may result in financial penalties, legal costs and reputational damage. Furthermore, the perception that Pennon's overall tax contribution is inadequate could have a detrimental impact on the reputation of the Group.	The Group have an experienced and professionally qualified in-house tax team, supported, where necessary, by external specialists. The Pennon tax strategy has been refreshed and published, following customer consultation. During the year Pennon became the first water and waste management utility to secure the Fair Tax Mark; an independent accreditation scheme, which recognises organisations that demonstrate they are paying the right amount of corporation tax at the right time. Processes and controls have been reviewed during the year to ensure we are able to continue to meet HMRC requirements.	Green	↑	The Group ensures full compliance with HMRC requirements and will not enter into artificial tax arrangements or take an aggressive stance in the interpretation of tax legislation.

Strategic impact

1 Leadership in UK water and waste

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3 Driving sustainable growth

Risk level

High · Medium · Low · ↑ Increasing · ↔ Stable · ↓ Decreasing

Law, regulation and finance continued

Principal risk	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
G: Failure to pay all pension obligations as they fall due and increased costs to the Group should the deferred pension scheme deficit increase	**Long-term priorities affected:** **2** The Group could be called upon to increase funding to reduce the deficit, impacting our cost base.	The Group has an experienced in-house pensions team who also engage professional advisors to manage the pension scheme's investment strategy, ensuring the scheme can pay its obligations as they fall due. During the past year there has been a significant decrease in bond yields resulting from uncertainty over Brexit, which could result in an increased deficit position following the revaluation of the defined benefit pension scheme.	Yellow	↑	The Group will ensure that all obligations are met in full but seeks to manage this without unnecessary increased costs to the Group.

Market and economic conditions

Principal risk	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
H: Non-recovery of customer debt	**Long-term priorities affected:** **1, 2** Potential impact on revenue as a result of reduced customer debt collection, particularly with regard to vulnerable customers and affordability.	South West Water has mature and embedded debt collection strategies in place for the recovery of domestic customer debt which has delivered improved collection rates and decreased bad debt exposure during the past three years. There has been no significant increase in bills for 2019/20 and real-term decreases form part of the business plan for 2020-25. The potential economic impact of Brexit on our customers remains a risk. We work proactively with our customers who are struggling to pay and have a range of affordability schemes and social tariffs to support them including Restart, WaterCare and Freshstart. Within the non-household market there has been continued focus on the collection of older debt which has proved effective. Due to high proportion of public sector contracts, Viridor's debt collection risk is lower, however, customer debt is regularly reviewed and proactively managed.	Green	↑	While seeking to minimise non-recoverable debt, we recognise customer affordability challenges and the inability to disconnect customers results in a residual risk of uncollectable debt remaining.
I: Macroeconomic risks impacting commodity and power prices	**Long-term priorities affected:** **3** Challenges such as continued local authority austerity, reduced global demand for our recycled commodities and decreases in power prices have a direct impact on our revenues generated by our recycling and energy businesses.	Viridor remains well positioned across the waste hierarchy with long-term contracts supporting the ERF business. While recyclate markets have improved during the year, continuing to meet the quality requirements within China and other markets remains a key area of focus in addition to sourcing other potential markets. Extensive planning in the event of a Brexit no deal scenario has also been undertaken and is detailed further on page 62. We continue to invest in our assets and we work closely in partnership with our local authority customers in the delivery of our services and maximising the quality of the input recyclate material. Additionally, a significant proportion of our input contracts have price adjustments based on price fluctuations during the year. Energy risk management is undertaken at a Group level and acts as a natural hedge between South West Water and Viridor, offsetting any drop in power prices. Forward hedges have been put in place with the Group c. 95% hedged for 2019/20, c.55% for 2020/21 and c.20% for 2021/22 hedged..	Orange	↔	The Group seeks to take well-judged and informed decisions while ensuring plans are in place to mitigate the potential impact of macroeconomic risks.

Risk report
continued

Operating performance

Principal risk	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
J: Poor operating performance due to extreme weather or climate change	**Long-term priorities affected:** **1** Failure of our assets to cope with extreme weather conditions may lead to an inability to meet our customers' needs, environmental damage, additional costs and reputational damage.	The increased frequency and impact of extreme weather exposes our assets to risk, while there continues to be a reduced appetite for reduced performance arising from such incidents from the regulator and our stakeholders. The Group seeks to mitigate this risk through investment via a planned capital investment programme, emergency resources and contingency planning. As part of the risk management process the Group also performs horizon scanning on the longer-term impacts of climate change on its operations. Key lessons learnt from the freeze-thaw event in March 2018 were incorporated into our 2018/19 winter preparedness planning. Extensive modelling and forecasting is also performed to evaluate South West Water's water resources, both in actively managing resources in periods of dry weather but also managing long-term water resources as demonstrated through South West Water's 25 year Water Resources Management Plan. Viridor has in place regional adverse weather management strategies aimed at reducing disruption to site operations and transport logistics.	Medium	↔	The Group seeks to reduce both the impact and likelihood through long-term planning and forecasting to ensure that sufficient measures are in place to mitigate the impact of extreme weather and climate change on our operations.
K: Poor customer service/ increased competition leading to loss of customer base	**Long-term priorities affected:** **1, 3** Poor customer service has a direct impact on South West Water's delivery of the PR14 business plan and the ability of both Viridor and Pennon Water Services to retain and grow market share.	There has been a continued focus on customer experience and the customer journey across the Group during the year. Enhanced capability within our call centre, investment in training and expanded channels to interact with our customers resulted in South West Water's best ever SIM customer service score with a ranking of second out of all water and sewerage companies in England and Wales. South West Water is also accredited to the Institute of Customer Service's ServiceMark accreditation. Planning is also underway to evaluate South West Water's performance under the new C-MeX guidance, which will replace SIM from 2020. Customer service and experience has been a continued focus for Viridor with a score of 7.1 out of ten on Trustpilot. Customer service within Pennon Water Services is also monitored through Trustpilot where a score of 8.5 out of ten has been achieved.	Medium	↔	The Group continually seeks to increase customer satisfaction and maximise customer retention while taking well informed risk to develop further markets and offerings.

Strategic impact

1 Leadership in UK water and waste

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3 Driving sustainable growth

Risk level

High · Medium · Low · ↑ Increasing · ↔ Stable · ↓ Decreasing

Operating performance continued

Principal risk	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
L: Business Interruption or significant operational failures/ incidents	**Long-term priorities affected:** **1, 3** Operational failure in our water business could mean that we are unable to supply clean water to our customers or provide safe wastewater processes. This has a direct impact on the successful delivery of the PR14 business plan. Additionally business interruption caused by defects, outage or fire could impact the availability and optimisation of our ERF and recycling facilities.	The Group maintains detailed contingency plans and incident management procedures which are regularly reviewed and assets are managed through a programme of sophisticated planned and preventive maintenance and effective management of stores. Extensive Group-wide Brexit no-deal planning has also been undertaken with further detail outlined on page 62. Continued investment alongside South West Water's pollution reduction strategy has resulted in a reduction of serious pollution incidents to two during the year. This was among the lowest number of such incidents in the industry. There has also been a continued reduction in minor pollution incidents (Category 3). Careful management and effective optimisation of the ERF fleet has again resulted in availability exceeding 90% across our operational portfolio (including joint ventures).	Medium	↑	The Group operates a low tolerance for significant operational failure and seeks to mitigate these risks where possible.
M: Difficulty in the recruitment, retention and development of appropriate skills required to deliver the Group's strategy	**Long-term priorities affected:** **1, 2, 3** Failure to have a workforce of skilled and motivated individuals will detrimentally impact all of our strategic priorities. We need the right people in the right places to innovate, share best practice, deliver synergies and move the Group forward.	The Group's HR Strategy continues to be embedded across the organisation and a range of initiatives have been delivered during the year to attract, retain and develop our employees. Employee Voice Forums and engagement provides opportunities for employees to regularly discuss business priorities and challenges with business leaders. Mitigating actions have also been taken to reduce the potential impact of a Brexit no-deal scenario on our workforce. Further detail is included on page 62. Succession plans remain in place for senior and other key positions. In order to ensure the Group can compete for the top talent in the market place during the year 30 graduates joined Viridor and 226 apprenticeships started across the Group supporting new starters and existing employees in their career development. The impact of these initiatives is measured through the results of the most recent Great Places to Work Best Workplaces™ Survey which showed an improved Trust Index score of 62% and Engagement score of 68%.	Medium	↔	While turnover of staff does occur we ensure the appropriate skills and experience is in place with succession plans providing adequate resilience.
N: Non-delivery of Regulatory Outcomes and performance commitments	**Long-term priorities affected:** **1, 2, 3** South West Water's Regulatory Outcomes and performance commitments cover key strategic focus areas. Non-delivery against these could result in financial penalties being applied as well as reputational damage to the Group.	The regulatory framework has been in place since 1 April 2015 and South West Water has delivered cumulative net ODI rewards of £11.3 million. South West Water is forecast to meet all its ODI commitments by 2020. This risk reflects the significance of the ODI regime in the regulatory model. South West Water has the opportunity for reward but is also exposed to risk if performance commitments are not achieved. Following the South West Water 2020-25 business plan being awarded fast-track status, we are already working on plans to deliver a step change in operational performance as well as meeting our 2020 commitments.	Medium	↑	The Group is committed to achieving all of our performance commitments over the length of each regulatory period. Where performance in an individual year falls below expectation we implement action plans and targeted interventions to ensure performance returns to committed levels.

Risk report
continued

Business systems and capital investment

Principal risk	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
O: Failure or increased cost of capital projects/ exposure to contract failures	**Long-term priorities affected:** **1, 3** Inability to successfully deliver on our capital programme may result in increased costs and delays and detrimentally impacts our ability to provide top class customer service and achieve our growth agenda.	All capital projects are subject to a robust business case process which includes challenge and risk modelling over key assumptions. Projects are delivered using skilled project management resource complimented by senior oversight and leadership. As a result of the financial challenges experienced by large contractors in the construction sector, there is a reduced appetite for large water and waste construction projects, resulting in a general lack of commercial tension. Regular monitoring is performed on the financial health of key contractors and supply chain partners. Glasgow, Beddington and Dunbar ERFs all began processing waste during the year while the commissioning commenced on Mayflower water treatment works. The construction of Avonmouth ERF is progressing well with completion on track for 2020/21. Resulting from remediation work at the Glasgow ERF, Viridor is contractually entitled to recover the gross contractual receivable of £72 million from the original principal contractor Interserve Construction Limited. We will take all necessary legal and procedural steps to achieve this. Liquidated damages associated with Beddington and Dunbar ERFs have been fully offset against milestone payments. The redevelopment of Heathrow Airport continues to be closely monitored, with the Lakeside ERF joint venture located on the site of the proposed third runway. Lakeside ERF would have to be removed in the event this redevelopment occurs and we would expect to be fully compensated for the rebuild of the facility on a like-for-like basis. An alternative site has been identified with detailed site studies and environmental assessments currently being undertaken.	High	Increasing	The Group's investment activities are taken on an informed basis with risks weighed against appropriate returns.
P: Failure of information technology systems, management and protection including cyber risks	**Long-term priorities affected:** **1** Failure of our information technology systems, due to inadequate internal processes or external cyber threats could result in the business being unable to operate effectively and the corruption or loss of data. This would have a detrimental impact on our customers and result in financial penalties and reputational damage for the Group.	The Group operates a mature and embedded governance framework over the 'business as usual' IT environment and major project implementations aligned to ISO 27001 standards. Disaster recovery plans are in place for corporate and operational technology and these are regularly reviewed and tested. Cyber threats continue to increase in volume and sophistication. These risks are mitigated by a strong information security framework aligned to guidance issued by the National Cyber Security Centre (NCSC). A gap analysis of South West Water's drinking water operational technology cyber security controls has been undertaken against the requirements of the Network and Information Systems (NIS) directive utilising external expertise. The outcomes of this exercise have informed future actions where opportunities for further improvement exist.	Medium	Increasing	We seek to minimise the risk of informational technology failure and cyber security threats to the lowest level without detrimentally impacting on business operations.

Strategic impact

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Risk level

High | Medium | Low | Increasing | Stable | Decreasing

Viability statement

The Board has assessed the Group's financial viability and confirms that it has a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over a five-year period, the period considered to be appropriate by the Board in connection with the UK Corporate Governance Code. The five-year period appropriately recognises the mix of business in the Group, noting in particular the ability to look forward with some certainty in the business and regulatory environment in which the Group operates, notably for South West Water.
The assessment has been made with reference to the Group's current position and prospects, its longer-term strategy, the Board's risk appetite and the Group's principal risks and how these are managed, as detailed on pages 63 to 68 of the risk report. The Group's principal operating subsidiaries of South West Water and Viridor are long-term businesses characterised by multi-year investment programmes, with associated revenue streams. The risk of renationalisation is included as a principal risk, this viability assessment assumes, should this occur, it would be conducted in an orderly manner in line with market conventions; noting that this would be dependent on the specific approach adopted by a government to implement a renationalisation policy .

The Group's strategic business plan and associated principal risks are a foundation of the scenario testing. This assessment has considered the potential impact of these and other risks arising on the business model, future performance, solvency and liquidity over the period in question. In making their assessment, the Directors reviewed the principal risks and considered which risks might threaten the Group's viability. Over the course of the year the Audit Committee has considered a deep-dive review of the following principal risks to enable a thorough assessment of the impact of these risks on ongoing viability.

Principal risk	Matters considered by the Audit Committee
Capital projects	Review of the performance of large capital projects
Operational challenges	Ability of South West Water to maintain network resilience in extreme scenarios
Business resilience	A review of business continuity and planning
Commodity risk	Consider the risks and mitigation measures used to manage recycling commodity risk

In stress testing the Group's business plan it was determined that none of the individual principal risks would in isolation, or in aggregate, compromise the Group's viability. In performing this stress testing all risks have been monetised with reference to risk weighting, factoring in the likelihood of occurrence and financial impact.

A further more extreme adverse scenario, excluding the likelihood of occurrence, confirmed the Group remained viable. In addition, further factors were considered to reverse engineer a scenario that could possibly compromise the Group's viability, these included:

- All the principal risks occurring in all of the five years
- Lower RPI projections in each of the five years
- Significant one-off costs
- A deterioration in the credit quality of amounts owed to the Group.

The four factors above, have been monetised as absolute financial costs with the principal risks being risk weighted on likelihood of occurrence.

The Board considered the monetary impact of these factors on the Group's viability over a five-year period, concluding the reversed engineered scenario remote. The five-year period was chosen given the longer-term nature of the Group's businesses and reflects the long term visibility of future cash flows in South West Water, as a regulated utility business, and the infrastructure backed cash flows of Viridor, which operates in commercial markets.

In making the assessment, the Directors have taken account of the Group's robust capital solvency position, its ability to raise new finance and a key potential mitigating action of restricting any non-contractual payments.

In assessing the prospects of the Group, the Directors note that, as the Group operates in a regulatory industry which potentially can be subject to non-market influences, such assessment is subject to uncertainty, the level of which depends on the proximity of the time horizon. Accordingly the future outcomes cannot be guaranteed or predicted with certainty.

As set out in the Audit Committee's report on page 85, the Directors reviewed and discussed the process undertaken by management, and also reviewed the results of the stress testing performed.

Additionally South West Water Limited considered further scenarios concerning South West Water Limited's viability. This additional assessment considered South West Water's regulatory financial ring fence through the following scenarios that are recommended to be tested by Ofwat:

- Totex underperformance (15% of totex)
- ODI penalty (3% of RoRE) in one year
- Inflation sensitivities (+/-3%)
- Increase in the level of bad debt (20%)
- New debt financed at 2% above forward projections
- Financial penalty – equivalent to 3% of turnover
- Any relevant inter-company financing scenarios.

These scenarios were considered in isolation and in the following combination:

- 10% totex underperformance in each of the five years
- ODI penalty of 1.5% in each of the five years
- A one-off financial penalty of 1% of revenue.

These scenarios in isolation and the combination noted above did not compromise the viability of South West Water over their assessment period to 2030. South West Water uses a longer viability period noting a greater visibility of future cash flows, being a regulated business.

Forward-looking statements

This strategic report, consisting of pages 1 to 71, 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 strategic report, 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 all relevant factors, including those set out in this section on principal risks and uncertainties.

Customer ownership

Sharing our success and enhancing our relationship with water customers

As part of South West Water's current business plan (2015-20) we introduced WaterShare – a unique, innovative scheme that enables the financial benefits of successful company performance to be shared with customers in a more open and timely way.

An independent WaterShare panel, which meets three times a year, scrutinises our performance, and reviews and challenges recommendations on how any benefits should be shared. Performance is reported to customers through the WaterShare scorecard and framework, which is overseen by the panel.

Any financial benefits resulting from regulatory outperformance are discussed with customers through focus groups and regular surveys are carried out. Options discussed with customers every year include:

- Reinvestment in improving services for customers;
- Reduction in bills; and
- Deferral of benefits for the future.

We anticipate a WaterShare value of c.£20-25 million to be shared with customers in 2020.

For South West Water's 2020-25 business plan, we reviewed the established WaterShare approach to ensure we would build on our relationship with customers and further embed the sharing of regulatory outperformance.

We undertook research to better understand how customers would like to receive financial benefits.

Options included bill reductions (immediate and deferred), monetary rebates, reinvestment in services and the choice of being given an enduring 'financial stake' in the business.

While 77% of customers do not own shares or have a financial stake in any company, 79% believe share ownership would be a positive step as:

- Customers' interests would be more aligned with investors – customers would receive a share of the Company profits in the form of dividends on the Company's ordinary shares as and when shareholders do, in addition to owning a capital stake in the Company
- Customers would have a vote and an opportunity to share their views through general meetings.

We concluded that, despite the lack of familiarity with share ownership, there is perceived value in it. Our research showed that many customers are aware of schemes that are available for employees and believe these are positive.

Our pledge in the South West Water 2020-25 business plan is to offer customers the choice, alongside bill reductions, rebates and reinvestment, of taking a financial stake in the business via an equity share of Pennon.

Subject to confirmatory votes at the 2019 and 2020 Annual General Meetings, from 2020, eligible household customers will have the proposed option of receiving their rebate in the form of Pennon shares. **These would be purchased in the market, avoiding any dilution of existing shareholdings, with the purchase to be funded by the benefits of outperformance that South West Water has already committed to return to customers via the WaterShare sharing mechanism.**

This approach has been endorsed through the regulatory review by Ofwat, with South West Water's plan fast tracked.

As shareholders, participating customers would then:

- Receive a share of company profits, in the form of dividends, just as shareholders do when dividends are paid;
- Be able to vote and have their say at the company AGM; and
- Receive annual reports and financial statements.

In addition, all customers will be invited to attend a customer annual general meeting and quarterly public customer meetings chaired by the independent WaterShare+ panel.

Our customers already have a say in our business through the extensive engagement we have with them every day. As new shareholders, we believe this will be enhanced by awarding them a tangible stake in our business.

The strategic report consisting of pages 1 to 71 was approved by the Board on 29 May 2019.

By order of the Board

Simon Pugsley
Group General Counsel and Company Secretary

29 May 2019

> "Our customers already have a say in our business through the extensive engagement we have with them every day. We believe our relationship with them will be enhanced by giving them a tangible stake."

We continue to raise an increasing proportion of our funding through our leading Sustainable Finance Framework and to demonstrate good governance via improved disclosures and transparency in our business.

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Good governance enabling investment, innovation and sustainable growth

Mayflower is a green asset

Pennon's Sustainable Financing Framework aims to integrate commitments to environmental and social objectives into funding activities. Mayflower water treatment works is an eligible green asset and is the first of its kind to use innovative ceramic membrane filtration using fewer chemicals and less energy than traditional processes to treat raw water. With a range of financing facilities entered into during 2018/19, Pennon has shown it is at the forefront of green finance in the UK. This is through the UK's first green long funding finance leases and loans linked to both ESG and KPI targets, which will affect the margins paid on these sustainable loans.

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Sustainability focus area

See sustainability strategy on page 11

Chairman's letter to shareholders

> Strong governance is central to our successful management of the Group for the benefit of all our stakeholders.

Sir John Parker
Chairman

Board visit
Demonstrating the Board's commitment to see its facilities in action, part of the March Board meeting included a visit to Viridor's energy recovery facility in Beddington, Sutton.

The facility provides the South London Waste Partnership and local businesses with a safe and cost-effective alternative to landfill and will process around 275,000 tonnes of non-hazardous residual waste a year.

Wider environmental benefits include the landfill diversion of up to 95% of waste delivered to the facility and the generation of up to 26MW of electricity, which will power the facility itself and supply over 22MW to the national grid. It also provides energy direct to a local business and could provide heat for local users.

Dear Shareholder

I am pleased to introduce the corporate governance report for 2019 on behalf of the Board. This is the principal method of reporting to our shareholders on the Board's governance policies and the practical application of the principles of good corporate governance.

Strong governance is central to our successful management of the Group and it provides the framework for the effective delivery of our strategy, the creation of shareholder value and the ongoing development of our sustainable business. As Chairman of Pennon, I remain committed to ensuring that we continue to operate to the highest standards of corporate governance.

An added complication to our governance structure is our ownership of South West Water, a regulated water and wastewater business. In order to meet the requirements of Ofwat, South West Water maintains its own independent board of directors and continues to operate in the manner of a publicly listed company in its own right.

Our current board and committee framework allows us to streamline our decision-making process. The South West Water board, which includes certain Pennon Non-Executive Directors, as well as three South West Water only non-executive directors, convenes on the same day as each Pennon Board meeting and considers South West Water strategy, performance and regulatory planning. In its meetings the Pennon Board concentrates on strategic forward-looking matters for all parts of the Group, including South West Water.

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 each of the Directors and the Board as a whole to perform effectively to promote the success of the Company for the benefit of its stakeholders.

It is my view that the Board is highly effective with a good understanding of the Group's opportunities for growth as well as the threats facing the business. This view is supported by the results of this year's Board and Committee performance evaluations. Further details are provided on page 82.

Stakeholder engagement

The Board understands the part the Group can play in bringing resources to life and creating a more sustainable UK. We are committed to carrying out our business in a responsible way and remain focused on improving the provision of water and waste management services for the benefit of all our stakeholders.

We actively engage with all our stakeholders, including customers, our communities, our people and our suppliers, as well as with our investors, and maintain appropriate and regular dialogue with those stakeholders to ensure that the rationale for our strategy and our performance objectives reflects their expectations. It also allows stakeholders to provide feedback on the matters they consider to be important and any issues which require addressing. Further detail on our stakeholder engagement is contained on pages 20 to 23, as well as on our website.

Our shareholders are just one of our key stakeholder groups for which we continue to manage a comprehensive engagement programme. During the year some 83 meetings and conference calls were held. Pennon attended six city conferences and sales force briefings and hosted nine road shows and investor events in the USA and mainland Europe. This engagement covered both current and prospective shareholders, the majority of which are institutional, with the remainder being a selection of large private client investment managers.

The Chief Financial Officer continues to report to the Board regularly on major shareholders' views about the Group, and every six months the Company's corporate brokers present to the Board on equity market developments and shareholder perceptions. This ensures that the Board is fully briefed on the views and aspirations of shareholders.

It is always pleasing to be part of a well-attended Annual General Meeting (AGM) and I welcome questions on any business issues affecting the Group. At our forthcoming AGM on 25 July, all of our Directors intend to be present together with a number of other senior executives of our businesses and will be available to meet shareholders and take their questions and further explain developments at Pennon.

Compliance with the UK Corporate Governance Code and other requirements

I am pleased to report that throughout the year the Company complied with the provisions and applied the main principles set out in the UK Corporate Governance Code (the UK Code) with no exceptions to report. Further details are contained within this report. The UK Code is published on the Financial Reporting Council (FRC) website, www.frc.org.uk. In accordance with the FRC's requirements, we have reported against the April 2016 version of the UK Code. We are mindful of the more recent 2018 version of the UK Code and will report more fully in our 2020 annual report.

In addition, as the holding company of South West Water Limited, I am pleased to report that the Company has complied with Ofwat's Principles for Holding Companies, in respect of Board leadership, transparency and governance.

My introduction to this corporate governance report and the following sections are made in compliance with the UK Code, Financial Conduct Authority (FCA) Listing Rule 9.8.6 and FCA Disclosure and Transparency Rules 7.1 and 7.2 and covers 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, our confirmation of the Company as a going concern and Directors' responsibility statements. Finally, in accordance with reporting requirements, on page 109 the Board is able to confirm to shareholders that the annual report & accounts taken as a whole is fair, balanced and understandable and provides the information necessary to assess the Company's performance, business model and strategy.

Sir John Parker
Chairman

Pennon Group plc
29 May 2019

Board of Directors

Sir John Parker
Chairman

GBE, FREng, DSc (Eng), ScD (Hon), DSc (Hon), DUniv (Hon), FRINA

Sir John was appointed to the Board as Deputy Chairman on 1 April 2015 and became Chairman on 1 August 2015. He is also chairman of the Nomination Committee.

Skills and experience
Sir John is a highly experienced and independent chairman and brings a wealth of leadership experience across a range of industries. He is widely recognised for his policy work on the value of diversity in the boardroom, having chaired the Government's review on Ethnic Diversity on UK Boards in 2017. Prior to that, he was a member of the Davies Committee – Women on Boards.

He has chaired five FTSE 100 companies and was previously the chairman of Anglo American plc and National Grid plc, senior non-executive director and chair of the Court of the Bank of England, senior non-executive director of the Cabinet Office Board, deputy chairman of DP World, joint chair of Mondi and chair of BVT and P&O plc. He was also president of the Royal Academy of Engineering from 2011 to 2014 and is a Visiting Fellow of the University of Oxford.

External appointments
Sir John is the chairman of construction and engineering company Laing O'Rourke. He is also a non-executive director of Carnival Corporation and is a senior adviser to Spencer Stuart.

Christopher Loughlin
Chief Executive Officer

BSc Hons, MICE, CEng, MBA

Chris was appointed to the Board on 1 August 2006 upon joining Pennon as Chief Executive of South West Water. He became the Group Chief Executive Officer on 1 January 2016. Chris is chairman of the Pennon Executive and a member of the Sustainability Committee.

Skills and experience
Chris has extensive experience of the regulated business environment and the management of major engineering and infrastructure services. He started his career as a chartered engineer working in both the consulting and contracting sectors and, after holding a number of senior positions with British Nuclear Fuels plc, joined its board as an executive director. Prior to joining Pennon, he was chief operating officer with Lloyds Register and before that, executive chairman of Magnox Electric plc. He was also a senior diplomat in the British Embassy, Tokyo.

Chris has a comprehensive understanding of the water industry. He was previously a board member (and, for a period, president) of the Institute of Water, and between April 2008 and March 2012 was chairman of Water UK.

An enthusiastic advocate of local business, Chris was previously the vice-chairman of the Cornwall Local Enterprise Partnership.

Since his appointment as Group Chief Executive Officer, Chris has set Pennon on a path of closer collaboration in pursuit of delivery of its strategy, with the constituent parts of the Group now working together to identify synergies, reduce costs and exploit opportunities for growth.

External appointments
Chris is currently chairman of British Water, a director of Water UK, and a director and trustee of Reall.

Susan Davy
Chief Financial Officer

BSc Hons, ACA

Susan joined the Board on 1 February 2015. She is a member of the Sustainability Committee and the Pennon Executive.

Skills and experience
Susan is a graduate qualified chartered accountant with 20 years' experience in the utility sector. Prior to her current appointment, Susan was Finance Director at South West Water between 2007 and 2015, during which time she was responsible for the company's Business Plan to 2020. She has also held a number of other senior finance roles in the water sector, including as Head of Regulation and Head of Finance (Wastewater) at Yorkshire Water.

Susan's knowledge of the industry coupled with her financial and regulatory expertise has supported the development of Pennon's strategy and her input has been invaluable to the Board in its deliberations. Susan is highly respected in the City and has been instrumental in building Pennon's reputation.

External appointments
Susan is a non-executive director and chairman of the audit committee of Restore plc and is also chair of the CBI South West council and a member of the A4S (Accounting for Sustainability) CFO leadership network.

Board Committee members

- Pennon Executive
- Audit Committee
- Sustainability Committee
- Nomination Committee
- Remuneration Committee
- Chair of Committee

Gill Rider
Senior Independent Director (Non-Executive)

CB, PhD, CCIPD

Gill was appointed to the Board on 1 September 2012. She is chairman of the Remuneration Committee and a member of the Audit, Nomination and Sustainability Committees.

Skills and experience
Gill has a wealth of experience in leadership, governance and remuneration across a broad range of sectors, including professional services, education and government.

Formerly, she was head of the Civil Service Capability Group in the Cabinet Office, reporting to the Cabinet Secretary and prior to that held a number of senior positions with Accenture LLP, culminating in the post of chief leadership officer for the global firm. She was previously president of the Chartered Institute of Personnel and Development and a non-executive director of De La Rue plc and chair of the council of the University of Southampton.

At Accenture she chaired the global corporate responsibility and foundation giving programme and was instrumental in building sustainability objectives into Accenture's worldwide human capital strategies.

As chair of the Remuneration Committee Gill is helping to steer Pennon's approach on executive remuneration, ensuring that it is aligned with and supports the Group's strategy.

External appointments
Gill currently holds non-executive directorships with Charles Taylor plc, where she is senior independent director and Intertek Group plc. She is chairman of both their remuneration committees.

Neil Cooper
Independent Non-Executive Director

BSc Hons, FCMA

Neil was appointed to the Board on 1 September 2014. He is chairman of the Audit Committee and a member of the Remuneration and Nomination Committees.

Skills and experience
Neil brings to the Board extensive experience in a wide variety of corporate and financial matters. He is currently the chief financial officer of Currencies Direct, a foreign exchange broker and international payment provider. Previously, he was group finance director of Barratt Developments plc and, before that, group finance director of William Hill plc and Bovis Homes plc. He also held senior finance positions at Whitbread plc, worked for PricewaterhouseCoopers as a management consultant and held a number of roles with Reckitt & Colman plc.

As chairman of the Audit Committee, Neil has been influential in directing Pennon's approach on a number of significant matters, including internal control, governance and financial reporting.

External appointments
Executive director, Currencies Direct.

Iain Evans
Independent Non-Executive Director

CBE, BSc Hons, FCA, MBA

Iain was appointed to the Board on 1 September 2018. He is chairman of the Sustainability Committee and a member of the Audit, Nomination and Remuneration Committees.

Skills and experience
Iain has 40 years of extensive global experience in advising companies and governments on issues of complex corporate strategy. In 1983 he co-founded L.E.K. Consulting in London and built it into one of the world's largest and most respected corporate strategy consulting firms with a global footprint active in a wide range of industries. Iain was appointed as a non-executive director of Welsh Water plc in 1989 and served on the board for nearly ten years, including five as chairman.

As chairman of the Sustainability Committee, Iain is leading Pennon's development of a sustainability programme that underpins the delivery of Pennon's strategy.

External appointments
Iain acts as an independent corporate strategy consultant.

Claire Ighodaro
Independent Non-Executive Director Designate (Claire joins on 1 September 2019)

CBE, BSc Hons, FCMA, DUniv (Hon)

Skills and experience
Claire has held a number of senior roles and directorships of UK and International organisations and has extensive board experience of serving on audit and governance committees. In May 2019, she stepped down from Bank of America's Merrill Lynch International Board having served the maximum term. Claire is a past president of CIMA and was the first woman to lead this organisation. She spent most of her executive career with BT plc and has also held non-executive directorships across a diverse portfolio including audit committee chair of Lloyd's of London, The Open University and various UK public bodies including UK Trade & Investment and the British Council. She was awarded a CBE in 2008 for services to business. A board level mentor, with Savile Group, from 2009-14, she has also helped executives transitioning into non-executive roles.

External appointments
Currently non-executive chairman of Axa XL UK entities and non-executive director of Flood Re, where she is audit committee chair.

The Board and its governance framework

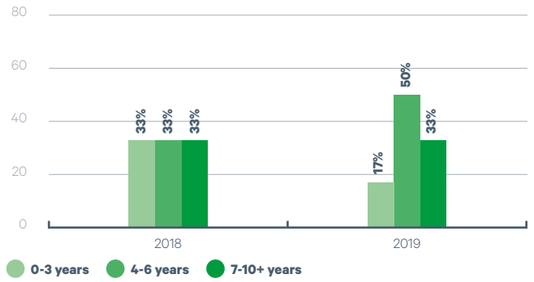
The Board acts as the main governing body for the purpose of oversight for the Group with additional supervision of the regulated business of South West Water being provided by South West Water's own board.

Our approach to governance is an integral part of our culture, guiding how we do business and create value for our stakeholders.

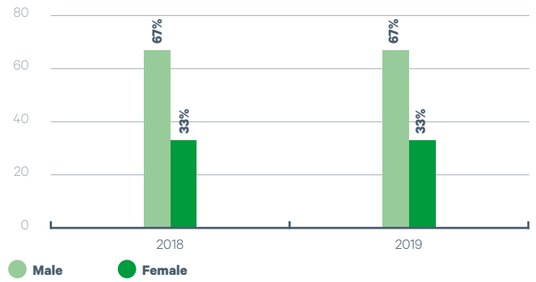
See pages 6 and 7 for further information

Pennon Board composition, independence and experience

Tenure as at 31 March



Diversity as at 31 March



The Board continues to maintain its focus on increasing female representation on the Board and at the year end it was 33.3%.

Stakeholder value
We deliver sustainable value for our stakeholders by providing high-quality environmental infrastructure and customer services.

Strategy
Our strategy is to lead in the UK's water and waste sectors, invest for sustainable growth and drive value through efficiency.

Performance
Our financial and operational performance is driven by our strategic sustainability objectives.

Robust and transparent governance
We are committed to operating to the highest standards of corporate governance.

Effective risk management
We have a mature integrated risk management framework which is embedded into existing governance structures and ways of working.

Strong internal controls
We keep the effectiveness of our internal control environment under regular review and seek continually to improve our approach.

Vision and values
Our vision – bringing resources to life – and its supporting values of trusted, collaborative, responsible and progressive, will help drive our strategic priorities over the long term.

Culture
We are developing a culture that can be lived throughout the Group with integrity and transparency, ensuring Pennon is trusted and valued by all its stakeholders.

All of the Non-Executive Directors are considered by the Board to be independent. None of the relationships or circumstances set out in provision B.1.1 of the UK Corporate Governance Code (the UK Code) applied to the Non-Executive Directors listed on the following page. Martin Angle stepped down from the Board in December 2018 and he was succeeded by Iain Evans who joined the Board in September 2018, to allow a period of overlap and provide a degree of continuity.

Gill Rider has served in excess of six years and the Board agreed that her term be extended for a further three years, subject to annual re-election at each AGM. The Board remains satisfied that, based on her participation at meetings and her contribution outside of the boardroom, Gill Rider continues to demonstrate independence of character and judgement in the performance of her role.

Sir John Parker met the independence criteria set out in provision B.1.1 of the UK Code on his appointment as Chairman and there have been no significant additions to his overall external commitments since his appointment.

All Directors are subject to re-election each year.

All the Non-Executive Directors are 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 76 and 77 and the experience chart above demonstrate collectively a broad range of business, financial and other relevant experience.

The Board and its governance framework
continued

Directors' roles

Neil Cooper is chairman of the Audit Committee and in accordance with the UK Code and FCA Disclosure and Transparency Rule 7.1.1 he has recent and relevant financial and accounting experience (as set out in his biography on page 77.

There is a clear separation of responsibilities between the Chairman and the Chief Executive Officer, divided between managing the Board and the business, while they of course maintain a close working relationship.

All the Directors are equally accountable for the proper stewardship of the Group's affairs but they do have specific roles, which include those set out below:

Position	Director	Role
Chairman	Sir John Parker	• Leading the Board and setting its agenda • Promoting the highest standards of integrity and probity and ensuring good and effective governance • Managing Board composition, performance and succession planning • Providing advice, support and guidance to the Chief Executive Officer • Representing the Group and being available to shareholders • Discussing separately with the Non-Executive Directors performance and strategic issues.
Chief Executive Officer	Chris Loughlin	• Managing the Group and providing executive leadership • Developing and proposing Group strategy • Leading the operation of the Group in accordance with the decisions of the Board • Coordinating with the Chairman on important and strategic issues of the Group and providing input to the Board's agenda • Contributing to succession planning and implementing the organisational structure • Leading on acquisitions, disposals, business development and exploiting Group synergies • Managing shareholder relations.
Senior Independent Director	Gill Rider	• Assisting the Chairman with shareholder communications and being available as an additional point of contact for shareholders • Being available to other Non-Executive Directors if they have any concerns that are not satisfactorily resolved by the Chairman • Leading the annual evaluation of performance of the Chairman with the other Non-Executive Directors.
Chief Financial Officer	Susan Davy	• Supporting the Chief Executive Officer in providing executive leadership and developing Group strategy • Reporting to the Board on performance and developments across the business • Implementing decisions of the Board • Managing specific business responsibilities • Managing investor relations including financing and treasury activities.
Non-Executive Directors	Neil Cooper Iain Evans Gill Rider	• Critically reviewing the strategies proposed for the Group • Critically examining the operational and financial performance of the Group • Evaluating proposals from management and constructively challenging management's recommendations • Contributing to corporate accountability through being active members of the Committees of the Board.

Board meetings and attendance

The Directors and their attendance at the eight scheduled meetings of the Board during 2018/19 are shown below:

Position	Member	Appointment date	Attendance
Chairman	Sir John Parker(1)	April 2015	6/8
Non-Executive Directors	Gill Rider	September 2012	8/8
	Neil Cooper	September 2014	8/8
	Iain Evans(2)	September 2018	3/4
	Martin Angle(3)	December 2008	6/6
Executive Directors	Chris Loughlin	August 2006	8/8
	Susan Davy	February 2015	8/8

(1) Sir John Parker missed two meetings of the Board during the year due to medical treatment. Gill Rider chaired those meetings in his absence.
(2) Appointed on 1 September 2018.
(3) Stepped down on 31 December 2018.

Iain Evans was appointed to the Board on 1 September 2018. Martin Angle stepped down from the Board on 31 December 2018. All other members of the Board served for the full year.

During the year under review, the Board and the Executive Management team undertook reviews of the Board and Committee structures. This review concluded that the Board would be better served by reorganising the current committee structure and by having a more concentrated meeting timetable for the Board and its Committees. As a consequence, the Executive teams of South West Water, Viridor and Pennon meet in advance of each meeting of the Board in order to ensure clear ownership and management of the operations of the business prior to the formal Board and Committee meetings.

In addition, from 2019 onwards, it was agreed that there would be six meetings of the Board, including four two-day meetings when both the Board and its Committees meet. There continue to be a number of additional ad hoc Board and Committee meetings as required.

Managing the Group and its subsidiaries

The Board's responsibilities include overall leadership of the Group, setting the Group's values, policies and standards, approving Pennon's strategy and objectives and providing oversight of the Group's operations and its performance. The Board makes decisions in relation to the Group's business in accordance with its schedule of matters reserved. The South West Water board continues to operate as a separate independent board in accordance with its own schedule of matters reserved thus ensuring compliance with Ofwat's principles on board leadership, transparency and governance. In addition, the independent non-executive directors of South West Water are also invited to attend Pennon Board and Committee meetings in order to gain a greater overview of the wider business.

While certain matters may be delegated to the Board Committees and to the Executive Directors, as appropriate, the matters reserved to the Board include:

- All acquisitions and disposals
- Major items of capital expenditure
- Authority levels for other expenditure
- Risk management process and monitoring of risks
- Approval of the strategic plan and annual operating budgets
- Group policies, procedures and delegations
- Appointments to the Board and its Committees.

The Board also endorses certain decisions taken by the South West Water board, including major capital projects and investments, long-term objectives and commercial strategy, the five-year regulatory plan, annual budgets and certain decisions relating to financing. This approach is compatible with Ofwat's principles for holding companies in respect of Board leadership, transparency and governance.

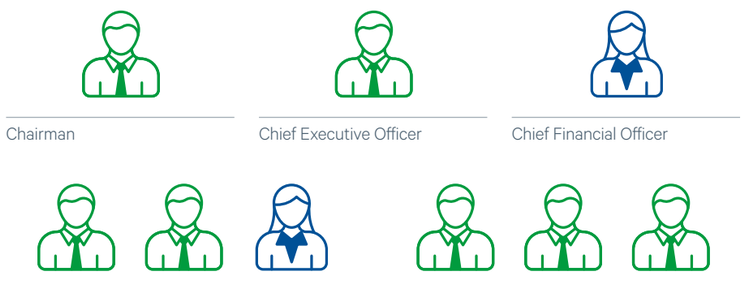
Operation of the Board

The Board operates by receiving written reports circulated in advance of the meetings from the Executive Directors and the Group General Counsel and Company Secretary on matters within their respective business areas. The Board also receives presentations on key areas of the business and undertakes site visits to meet employees and gain a better understanding of the operation of business initiatives. The Managing Directors of both South West Water and Viridor, along with the General Counsel and Company Secretary, attend each of the meetings of the Board in order to present on their respective areas of responsibility, in person.

Under the guidance of the Chairman, all matters placed before the Board are discussed openly. Presentations and advice are received frequently from other senior executives within the Group and from external advisers to facilitate the decision-making of the Board. In the year under review, the Board has considered a wide range of matters in order to meet its obligations and estimates that 20% of its time has been taken up in discussions around strategy, 40% in operations of the Group, including that of both main operating subsidiaries, 30% on financial aspects of the Group and 10% on legal and risk matters.

In decision making, the Board always considers the impact they might have on all stakeholder groups when considering what is in the best interests of shareholders as a whole.

Pennon Board composition



Pennon Executive management

The role of the Pennon Executive is to define and drive the business priorities that will achieve delivery of the strategy. It is responsible for ensuring, to the extent of the authority delegated by the Board, the proper and prudent management of Group resources to create and maximise shareholder value while protecting the interests of the wider stakeholder group. Chaired by the Chief Executive Officer, the Pennon Executive meets regularly, to receive reports from all of the other management committees and to review and refine recommendations to be presented to the Board.

Members of the Pennon Executive	
Chris Loughlin*	Chief Executive Officer
Susan Davy	Chief Financial Officer
Phil Piddington	Managing Director, Viridor
Simon Pugsley	Group General Counsel and Company Secretary
Sarah Heald	Director of Corporate Affairs & Investor Relations
Adele Barker	Group Director of Human Resources
Steve Holmes	Health, Safety, Security and Assurance Director
Ed Mitchell	Group Director of Environment & Sustainability, and Director of Wastewater Services, South West Water
Paul Ringham	Commercial Director, Viridor

* Chris Loughlin is also temporarily fulfilling the role of Managing Director, South West Water.

Board support and training

Directors have access to the advice and services of the Company Secretary, and the Board has an established procedure whereby Directors, in order to fulfil their duties, may seek independent professional advice at the Company's expense. The Company Secretary is responsible for ensuring that the Board operates in accordance with the governance framework and that there are good information flows between the Directors, the Board and its Committees.

The Board and its governance framework
continued

Newly appointed Directors receive a formal, tailored induction, which includes, inter alia, an explanation of the Group structure, regulatory and legal issues, the Group governance framework and policies, the Group's approach to risk management and its principal risks (financial and non-financial, including environmental, social and governance (ESG) risks), duties and obligations (including protocols around conflicts of interest and dealing in shares), and the current activities of the Board and its Committees. Newly appointed Directors are also invited to visit different operating facilities across the Group and to meet with staff in order to better understand key processes and systems.

The training needs of Directors are reviewed as part of the Board's performance evaluation process each year. Training will also include attendance at external courses organised by professional advisers and also internal presentations from senior management.

Performance evaluation

The Board undertakes a formal and rigorous review of its performance and that of its Committees and Directors each year. Having carried out an externally facilitated evaluation in 2017, this year the evaluation was again carried out by means of an internally facilitated online questionnaire. The questions were designed to assess the effectiveness of the Board and its Committees, considering a wide range of themes including strategy, culture and values, the Group's obligations to its shareholders and other stakeholders, overseeing the use of the Group's resources, managing the risks inherent in the strategy, plans and the operating environment, and reviewing the general operations of the Board and its Committees. The performance and effectiveness of the Chairman and Board members were also considered.

The results of the review were discussed at a meeting of the Board and at meetings of each of its Committees. These concluded that the Board, its Committees and its individual Directors had demonstrated a high degree of effectiveness and that there was a good understanding of opportunities for growth and the threats facing the business. The review also confirmed that the Board fully understood its role in setting Pennon's values and standards to ensure that its obligations to its stakeholders are met. The Board's commitment to promoting a strong health & safety culture across the Group was noted. Areas meriting ongoing focus included succession planning, diversity and the ongoing training and development needs of directors. It is expected that, in 2020, an external evaluation exercise will be undertaken using an external consultancy with no other connection to the Company and this will be reported on in next year's annual report.

Board Committees' terms of reference

In accordance with Group policies, a range of key matters are delegated to the Board's Committees as set out on pages 83 to 91 of this governance report.

The terms of reference of each of the Board's Committees are set out on the Company's website **www.pennon-group.co.uk** and are also available from the Group Company Secretary upon request. The terms of reference, as well as the Board's schedule of matters reserved, were reviewed during the year to ensure that they remained appropriate and relevant.

Dealing with Directors' conflicts of interest

In accordance with the directors' interest provision of the Companies Act 2006 and the Company's Articles of Association, the Board has in place a procedure for the consideration and authorisation of Directors' conflicts or possible conflicts with the Company's interests. The Board considers that this has operated effectively during the year.

Risk management and the Group's system 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 2018/19 and up to the date of the approval of this annual report and accounts.

The Group's system of internal control is consistent with the FRC's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' (FRC Internal Control Guidance).

The Board confirms that it applies procedures in accordance with the UK Code and the FRC's Internal Control Guidance, which brings together elements of best practice for risk management and internal control by companies. The Board's risk framework described on pages 58 to 60 in the strategic report provides for the identification of key risks, including ESG risks, in relation to the achievement of the business objectives of the Group, monitoring of such risks and ongoing and annual evaluation of the overall process. ESG risks identified and assessed by the Board cover areas such as health & safety, climate change, changes to government policy on waste and recycling, and tax compliance. Details of the key risks affecting the Group are set out in the strategic report on pages 61 to 68.

KPIs are in place to enable the Board to measure the Company's ESG performance (pages 30, 31 and 36 to 49) and a number of these are linked to remuneration incentives (pages 93 and 96).

As part of the review of the effectiveness of the system of risk management and internal control under the Group risk management policy, 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.

The Group's processes and policies serve to ensure that a culture of effective control and risk management is embedded throughout the Group and that the Group is in a position to react appropriately to new risks as they arise.

Code of Conduct and policies

The Group's Code of Conduct and related policies set out Pennon's commitment to promoting and maintaining the highest level of ethical standards. Areas covered include our impact on the environment and our communities, our workplace and our business conduct.

The Group's policy on anti-bribery and anti-corruption clearly prohibits any employees from offering or accepting bribes, facilitation payments and kickbacks and requires that due diligence checks be carried out before engaging a third party (including a corruption risk assessment that covered potential business partners of the third party and the nature of the proposed work and transaction). The policy also sets out the employment consequences for breach of the policy and potential legal sanctions under bribery laws. The policy places an obligation on employees to report any breach of the policy or any suspicions of fraud or other irregularities. The Group's whistleblowing policy (Speak Up) encourages employees to raise concerns and explains how this should be done.

Allegations of misconduct and irregularity are thoroughly investigated and follow-up action in respect of the Group's control environment is taken when appropriate. In the normal course of business, investigations into irregularities may be ongoing as of the date of the approval of the financial statements.

Our Code of Conduct and our policies are available on our website.

Find out more online at
www.pennon-group.co.uk/sustainability

Board Committees' reports

Audit Committee report

"The role of the Audit Committee is to ensure that robust systems are in place for financial reporting, internal control and risk management."

Neil Cooper
Audit Committee Chairman

Audit Committee composition and meetings

Position	Director	Date of appointment to Audit Committee	Attendance
Committee chairman	Neil Cooper		4/4
Committee members	Gill Rider	September 2012	4/4
	Iain Evans[1]	September 2018	3/3
	Martin Angle[2]	December 2008	3/3

(1) Appointed to the Committee on 1 September 2018.
(2) Stepped down from the Board on 31 December 2018.

Dear Shareholder

I am pleased to introduce the Audit Committee's report.

Committee members – and the Board as a whole – share a common view of the importance of the Audit Committee as a foundation stone in the governance armoury of the Company and I welcome the opportunity to outline our key activities during the year.

The principal responsibilities of the Committee continue to be focused on three key areas:

- Ensuring the appropriateness of the Group's financial reporting; an activity that includes the testing of accounting judgements made in preparing financial reporting and the assessment of whether the presentation of the Group's activities is fair, balanced and understandable
- Reviewing and challenging the ongoing effectiveness of the internal control environment
- The scope and adequacy of risk management processes across the Group. This includes monitoring the Group's risk appetite as well as acting as a forum for carrying out more detailed reviews of higher risk areas of the operation.

These responsibilities are discharged throughout the year in accordance with the calendar of business of the Committee, which is designed to allow sufficient time for their consideration while also permitting time to be spent on related key financial matters. Monitoring and reviewing the effectiveness of the external auditor and the internal audit function is a further important ongoing element of the Committee's assurance activities.

The Group's executive risk management forum continues to assess risk appetite and monitor key risks and their mitigation, with the Committee subsequently receiving detailed 'deep dive' presentations from senior management on areas impacting our principal risks. During the year, these covered a wide range of topics including performance on South West Water's capital projects, South West Water network resilience, Viridor capital projects, impacts of a no-deal Brexit, business resilience and business continuity, a review of Pennon Water Services billing and collection process and recycling commodity risk. More detail on our risk management processes, principal risks and their associated mitigation can be found on pages 58 to 68.

Together with this risk orientated activity, we continue to look at the Group's viability over a period of five years, which appropriately recognises the mix of business in the Group, noting in particular the ability to look forward with some certainty in the business and regulatory environment in which the Group operates, notably for South West Water. South West Water Limited uses a longer assessment period to 2030, noting a greater visibility of future cash flows, being a regulated business. Our viability statement is reported on page 69.

As part of the half-year and year-end reporting review process, we reviewed and challenged the key financial reporting judgements of management as set out on page 85. Significant matters considered by the Committee both during the year and in relation to the year-end financial statements are laid out in this report.

Finally, during the year the Group established a new directorate of Risk and Assurance, encompassing Group risk reporting and internal audit. The consolidation of these activities fully aligns our internal audit approach with the Group's ongoing risk monitoring and mitigation.

Neil Cooper
Audit Committee Chairman

Audit Committee report
continued

Iain Evans was appointed to the Committee on 1 September 2018, following his appointment to the Board, succeeding Martin Angle who stepped down from the Board and its Committees on 31 December 2018. The Committee would like to thank Martin for his strong contribution to Committee activities during his tenure.

Other regular attendees to Committee meetings during the year included: the Chief Executive Officer; the Chief Financial Officer; the Managing Directors of South West Water and Viridor; the Group General Counsel and Company Secretary; the Finance Directors of South West Water and Viridor; the director of Treasury, Tax and Group Finance; the director of Risk and Assurance; and the external auditor.

In addition, the Board Chairman has an open invitation to attend the Committee meetings. In the last year his attendance included those meetings at which the Committee reviewed the half-year and full-year financial results of the Group.

In accordance with the UK Code, the Board is satisfied that Neil Cooper and Iain Evans have recent and relevant financial experience and also, in accordance with FCA Rule 7.1.1R of the FCA's Disclosure Guidance and Transparency Rules, have competence in accounting or auditing. Details of each Director's significant current and prior appointments are set out on pages 76 and 77.

All of the Committee members are also members of the Remuneration Committee, which allows them to provide input into both Committees on any Group performance matters and on the management of any risk factors relevant to remuneration matters.

Significant matters considered by the Committee

The calendar of business of the Committee sets in place a framework for ensuring that it manages its affairs efficiently and effectively throughout the year and is able to concentrate on the key matters that affect the Group.

The most significant matters that the Committee considered and made decisions on during the year and, where appropriate, since the year end, are set out below and opposite.

Financial reporting	• Monitored the integrity of the financial statements of the Group and the half-year and full-year results announcements relating to the Group's financial performance, including reviewing and discussing significant financial reporting judgements contained in the statements • After a detailed review in accordance with its established process, advised the Board that the presentation of the annual report & accounts is fair, balanced and understandable in accordance with reporting requirements and recommended their approval for publication • Internal control and compliance • Review of internal audit reports on core systems and processes across the Group, for example, assurance work on data submissions for Ofwat as part of PR19 and subsidiary financial controls.
External auditor	• Considered auditor's report on its audit of the annual results focusing on key findings • Assessed external auditor effectiveness in respect of the previous year's external audit process • Recommended to the Board reappointment of the external auditor for approval at the Annual General Meeting with the Committee being authorised to agree the external auditor's remuneration • Considered and approved the audit plan and audit fee proposal for the external auditor • Considered the auditor's report on control themes and observations for the year ended 2018, which did not identify any significant deficiencies • Commenced the consideration of the appointment of a new senior statutory auditor following the mandatory five-year rotation of the existing senior statutory auditor on conclusion of the 2018/19 audit. • Considered the likely financial year in which the Group will next tender for its external audit provider
Risk management	• Reviewed the Group's risk management framework and compliance with that framework during the year and after the year end up until the publication of the Company's annual report • Reviewed the assessment of the risks by the Executive Directors and considered risk appetite • Reviewed the Group risk register and considered appropriate areas of focus and prioritisation for the audit work programme for the year which is now aligned to the Group's financial year • Management of information security across the Group in mitigating key IT risks • Received as part of the risk management review the annual report on any whistleblowing • Carried out regular deep dives at Committee meetings on principal risk areas.
Governance	• Discussed the results of the performance evaluation of the Committee • Reviewed new annual report disclosure requirements, including the audit report • Considered and approved Group accounting policies, including the impact of new accounting standards, used in the preparation of the financial statements • Confirmed compliance with the UK Code • Regularly held meetings with the external auditor and the Group Director of Risk and Assurance without members of management being present.

In respect of the monitoring of the integrity of the financial statements, which is a key responsibility of the Committee identified in the UK Code, the significant areas of judgement considered in relation to the financial statements for the year ended 31 March 2019 are set out in the following table, together with details of how each matter was addressed by the Committee. At the Committee's meetings throughout the year the Committee and the external auditor have discussed the significant matters arising in respect of financial reporting during the year, together with the areas of particular audit focus, as reported on in the independent auditor's report on pages 112 to 117. In addition to the significant matters set out in the table below, the Committee considered a range of other matters. These included:

- Implementation and measurement considerations for IFRS 16 'Leases' which was adopted on 1 April 2019
- Presentational matters including contingent liabilities and assets and the non-underlying disclosures; and
- Ensuring a fair presentation of statutory and non-statutory performance and financial measures.

During the year, the Committee's areas of focus have been:

Area of focus	How the matter was addressed by the Committee
Revenue recognition	Given the nature of the Group's revenue, the areas of judgement for South West Water continue to be in respect of revenue recognition relating to income from measured water services and estimates of timing of receipt of unmeasured revenue, accounting for revenue. For Viridor, the focus was from long-term service concession arrangements under IFRIC 12, in particular for Glasgow Recycling and Renewable Energy Centre, where forecast construction spend has increased, and calculation of accrued income on waste management contracts and energy sales. The Committee relied on South West Water's detailed assessment of water into supply and its track record of assessing an appropriate level of accrual at previous year ends as compared to invoiced revenue and Viridor's internal processes for analysing complex long-term contracts. The Committee also closely considered the work in respect of these areas at year end by the external auditor as well as reviewing disclosures around revenue recognition accounting policies. In addition, the Committee focused particularly on the implementation of IFRS 15 'Revenue' from 1 April 2018, with new judgements required in relation to the classification of revenue for the disaggregation note to the financial statements. The Committee reviewed and discussed management's paper which had been prepared in conjunction with expert advice and, after modest changes following that discussion, was satisfied the new disclosures were appropriate.
Non-current asset impairment review and environmental provisions	Recognising that the value of certain non-current assets and long-term environmental provisions within Viridor can be sensitive to changes in assumptions over future discount rates and cash flow projections which require judgement, the Committee pays careful attention to asset impairment and provisions. The Committee noted the substantial headroom in the mandatory review of goodwill for impairment and management's review of evidence of indicators for potential impairment of non-current assets concluded that these areas were less sensitive to changes in these assumptions. Following a detailed review of the analysis undertaken, and consideration of management assumptions in relation to the value of environmental provisions, the Committee was satisfied that a robust and consistent approach had been followed and that management's assertion that the carrying value of these liabilities remained reasonable, and therefore the Committee was able to approve the disclosures in the financial statements. This key area was also closely reviewed as part of the year-end audit by the external auditor.
South West Water bad and doubtful debts	Regular updates on progress against debt collection targets and other contractual payments due are received by the Board. Performance is monitored regularly against both South West Water's historical collection record and the track record of other companies in the sector. At the year end the external auditor reported on the work it had performed, which, together with the detailed analysis reported, enabled the Committee to conclude that management's assessment of the year-end position was reasonable. The Committee noted that the detailed approach applied by management was consistent with the requirements of IFRS 9, effective 1 April 2018, which requires the consideration of expected credit loss.
Glasgow Recycling and Renewable Energy Centre (GRREC) – outstanding contractual claims against Interserve	In November 2016 the lead construction contract for the GRREC was terminated due to delays and underperformance. Additional costs required to complete the project have been incurred and form part of a claim being brought against the principal contractor, Interserve Construction Limited. At half year and year end, the Committee has reviewed information on the background, quantum and likelihood of the claims recognised in accounting terms as an amount owing to the Group, considering both legal and financial analysis from management and expert third party opinions. In addition the Committee considered management's assessment of the likely recoverability of the amount in regard to the financial condition of Interserve. The Committee noted management's assessment of Interserve's credit worthiness having regard to publicly available information including latest annual filed accounts and the administrator's statement of proposal. The Committee is satisfied that the asset recognition criteria for this amount has been met and that appropriate disclosures have been made, while recognising that this is both judgemental and fast moving.
Going concern basis for the preparation of the financial statements and viability statement	A report from the Chief Financial Officer on the financial performance of the Group including forward-looking estimates of covenant compliance and funding levels under different scenarios, is provided to the Board on a periodic basis. Rolling five-year strategy projections and the resultant headroom relative to borrowings are also regularly reviewed by the Board, including scenarios to enable the Committee to better understand the potential range of outcomes. At the end of each six-month period the Chief Financial Officer prepares for consideration by the Committee a report focusing on the Group's liquidity over the 12-month period from the date of signing of either the annual report or half-year results. The Committee also reviewed a report from the Chief Financial Officer on the Group's financial viability over an appropriate period, which the Board considers to be five years, in connection with the UK Corporate Governance Code requirement for a viability statement to be given by the Board. South West Water Limited uses a longer assessment period to 2030, noting a greater visibility of future cash flows, being a regulated business. Consideration of these reports and constructive challenge on the findings of the reports, including the scenario testing carried out by management, has enabled the Committee to form its assessment and satisfy itself that it remains appropriate for the Group to continue to adopt the going concern basis of accounting in the preparation of the financial statements and in addition advise the Board on providing the viability statement set out on page 69.

Effectiveness of the external audit process

Receiving high-quality and effective audit services is of paramount importance to the Committee. We continue to monitor carefully the effectiveness of our external auditor as well as its independence, bearing in mind that it is recognised there is a need to use our external auditor's firm for certain non-audit services. We have full regard to the FRC's Ethical Standard and ensure that our procedures and safeguards meet these standards.

The current external auditor, Ernst & Young LLP (EY), was appointed following a comprehensive audit tender process and approval by shareholders at the Company's 2014 AGM. Their reappointment was approved at the 2018 Annual General Meeting. Debbie O'Hanlon is the

Audit Committee report
continued

audit partner and has been in that role for the five years since EY's appointment, and consequently will be rotating off from the Pennon audit. EY have put forward potential replacements who have met with Committee members and management and have shadowed Debbie through her final year on the Pennon audit to ensure a smooth transition going into next year's audit. The Committee would like to thank Debbie for her valuable input to the Committee over the past five years in what was a transition period from the Company's previous auditors to EY.

The external auditor produced a detailed audit planning report in preparation for the year-end financial statements, which has assisted the auditor in delivering the timely audit of the Group's annual report & financial statements and which was shared with, and discussed by, the Committee in advance.

The effectiveness review of the external auditor is undertaken as part of the Committee's annual performance evaluation. Further details of the performance evaluation are provided on page 82. No issues were raised during that review and the Committee concluded that the auditor was effective during the year.

The Committee considered that it is appropriate that the external auditor be reappointed and has made this recommendation to the Board. The Committee chairman has also met privately with the external auditor to discuss key matters.

Auditor independence

The Committee carefully reviews on an ongoing basis the relationship with the external auditor to ensure that the auditor's independence and objectivity is fully safeguarded.

The external auditor reported on their independence during the year and again since the year end, confirming to the Committee that they have complied with the FRC's Ethical Standard and, based on their assessment, that they were independent of the Group.

Provision of non-audit services

In line with the requirements of the EU Audit Directive and Regulation which came into force on 17 June 2016, the Committee continues to have a robust policy for the engagement of the external auditor's firm for non-audit work. The Committee receives a regular report covering the auditor's fees including details of non-audit fees incurred.

Recurrent fees typically relate to agreed procedures in relation to annual regulatory reporting obligations to Ofwat; work which is most efficiently and effectively performed by the statutory auditor. The policy is for non-audit fees not to exceed 70% of the audit fee for statutory work and for the Committee chairman to approve all non-audit work performed by the statutory auditor. The Committee carefully reviews non-audit work proposed for the statutory auditor, taking into consideration whether it was necessary for the auditor's firm to carry out such work and would only grant approval for the firm's appointment if it was satisfied that the auditor's independence and objectivity would be fully safeguarded. If there were another accounting firm that could provide the required cost-effective level of experience and expertise in respect of the non-audit services, then such firm would be chosen in preference to the external auditor.

The level of non-audit fees payable to the external auditor for the past year is 22% of the audit fee, which is well within the Group's 70% non-audit fee limit.

The Chief Financial Officer regularly reports to the Committee on the extent of services provided to the Company by the external auditor and the level of fees paid. The fees paid to the external auditor's firm for non-audit services and for audit services are set out in note 7 to the financial statements on page 138.

Internal audit

The internal audit activities of the Group are a key part of the internal control and risk management framework of the Group. At Group level there is a long-standing and effective centralised internal audit service which makes a significant contribution to the ability of the Committee to deliver its responsibilities.

During the year the Group established a new directorate of Risk and Assurance, encompassing Group risk reporting and internal audit. The consolidation of these activities fully aligns our internal audit approach with the Group's ongoing risk monitoring and mitigation. The 2019/20 Group internal audit plan was approved in March 2019. It takes account of the principal risks, the activities to be undertaken by the external auditor, and the Group's annual and ongoing risk management reviews. This approach seeks to ensure that there is a programme of internal and external audit reviews focused on identified key risk areas throughout the Group.

The Director of Risk and Assurance reported regularly through the year to the Committee on audit reviews undertaken and their findings, and there were regular discussions, correspondence and private meetings between the director of risk and assurance and the Committee chairman.

An external assessment of the internal audit function was last performed by KPMG LLP in 2016 and concluded that the Company's internal audit function conforms to IIA standards issued by the Institute of Internal Auditors but identified some areas for improvement including the alignment of the internal audit annual programme with the financial year and refreshed reporting content. These have been actioned.

Fair, balanced and understandable assessment

To enable the Committee to advise the Board in making its statement that it considered that the Company's annual report & accounts is fair, balanced and understandable (FBU) on page 109, the Committee has applied a detailed FBU review framework that takes account of the Group's well-documented verification process undertaken in conjunction with the preparation of the annual report & accounts. This is in addition to the formal process carried out by the external auditor to enable the preparation of the independent auditor's report, which is set out on pages 112 to 117.

In preparing and finalising the 2019 annual report & accounts, the Committee considered a report on the actions taken by management in accordance with the FBU process and an FBU assessment undertaken by the Pennon Executive. This assisted the Committee in carrying out its own assessment and being able to advise the Board that it considered that the annual report & accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

Statement of compliance with CMA order

Having undertaken a competitive audit tender process in 2014, the Company is in compliance with the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Following the rotation of the senior statutory auditor, the committee considers a full tender for the Group's external audit services, subject to its annual reviews, likely in the year ending March 2024. This allows for any potential new audit firm to take up the role for the year ending March 2025. The Committee believes this approach is in the best interest of shareholders, as over this period the Group will benefit from an efficient and effective audit, whilst receiving fresh challenge from a new senior statutory auditor.

Sustainability Committee report

"Our refreshed Sustainability Strategy ensures alignment and integration with Pennon's business, people and health and safety strategies."

Iain Evans
Sustainability Committee Chairman

Sustainability Committee composition and meetings

Position	Director	Date of appointment to Sustainability Committee	Attendance
Committee chairman	Iain Evans[1]	September 2018	3/3
Committee members	Gill Rider	September 2012	4/4
	Susan Davy	March 2018	4/4
	Chris Loughlin	November 2006	4/4
	Martin Angle[2]	December 2008	3/3

(1) Appointed on 1 September 2018 and as Committee chairman on 1 January 2019.
(2) Stepped down from the Board on 31 December 2018.

Dear Shareholder

I am pleased to report on the Sustainability Committee's activities during the year, and would particularly like to thank my predecessor, Gill Rider, for her work in the role, including her Chairmanship up until November 2018. I am delighted we have retained Gill's experience and expertise on the Committee.

Our refreshed Sustainability strategy ensures alignment and integration with Pennon's business, people and health & safety strategies. With clear objectives, targets and implementation plans identified throughout the organisation, we are confident that we will be able to ensure that our services bring resources to life, responsibly, for customers and communities now and in the long term.

The role of the Sustainability Committee is to oversee the delivery of Pennon's strategic sustainability objectives and to ensure robust scrutiny of key aspects of environmental, social and governance (ESG) performance. This year we have reviewed and approved refreshed strategic objectives, within an ESG framework, to add value and resilience to our business. These are set out on page 11.

In the development of our new strategy we tested thoroughly the materiality of our areas of focus and consulted a cross-section of our key stakeholders. We have also set new Group-wide three-year sustainability targets aligned with the new strategy as an effective way of monitoring performance against our objectives in the focus areas most materially relevant to the business and our stakeholders. Progress and performance will be clearly reported on going forward.

We have also assessed and aligned our objectives and targets against the most relevant of the United Nations Sustainable Development Goals (SDGs) and will increasingly monitor our performance using the SDGs.

A strong performance against these SDGs and our own sustainability objectives, ensures high standards of corporate responsibility for the benefit of all our stakeholders – our customers and communities, our people, suppliers and regulators, and our investors.

This annual report provides an integrated assessment to show how a responsible approach to sustainability helps us to balance the immediate and longer-term needs of society with the delivery of sustained commercial success.

Iain Evans
Sustainability Committee Chairman

Sustainability Committee report
continued

Iain Evans was appointed to the Committee on 1 September 2018, following his appointment to the Board. Iain took over as Chairman from Gill Rider in January 2019.

Martin Angle stepped down from the Board and its Committees on 31 December 2018. All other members served the full year.

The Sustainability Committee assesses performance against a range of approved targets for the Group's subsidiaries, set as part of their business planning processes. Progress is reported to the Committee throughout the year.

In addition, the South West Water Sustainability Committee provides assessment and oversight of South West Water's performance against sustainability targets that are core to the successful delivery of its K6 Business Plan 2015-20. This is consistent with Ofwat's requirement for independent governance of the regulated business.

The Committee ensures challenging targets are set and approved. As at 31 March 2019, Pennon has achieved 10 out of its 12 targets for the year, South West Water had achieved seven of its 12 and Viridor had completed nine out of 12 of its targets. Full details of the sustainability performance for South West Water and Viridor in 2018/19 are given in their respective reports.

During the year the Committee continued to work closely within the best practice framework developed by Business in the Community (BITC), a leading business-led charity promoting responsible business. Pennon was pleased to be a pioneer company in trialing BITC's new Responsible Business Tracker during 2018 and will use the results to further inform its own community benefit programmes contributing to social capital gain.

The Sustainability Committee aims to ensure a transparent approach to conducting business in a responsible manner, within a business focused on delivering robust financial performance and sustainable value for shareholders and stakeholders.

The Committee reviews and approves appropriate strategies, policies, management processes, initiatives, disclosures, targets and performance of the Pennon Group companies in the areas of occupational health, safety, wellbeing and security, environment and compliance, workplace policies, responsible and ethical business practice, supply chain, customer service and engagement, community benefit, and the role and value of the Group in society.

During 2018/19, the Committee has considered a wide range of matters in the course of fulfilling its duties in accordance with its terms of reference:

- The Group's health & safety performance and the effectiveness of health & safety policies and procedures, including the continued roll-out of the HomeSafe programme
- Environmental strategy and performance
- Performance in respect of customer service, satisfaction and engagement
- The Group's approach to community relations, community benefit and investment
- Performance against the Group's workplace policy, within its People strategy, including the results of the latest Group-wide employee engagement survey
- Sustainable supply chain procurement and practices, including a new Suppliers' Code of Practice
- Sustainability reporting and disclosures for 2018 and the associated verifier's reports and recommendations
- Progress against the sustainability targets for 2018/19 and sustainability targets for 2020-23.
- Materiality and refreshed sustainability strategy.

Reporting and verification
In reporting on sustainability, the Company has sought to comply with the Investment Association Guidelines on Responsible Investment Disclosure.

Pennon's sustainability performance and reporting has been audited by DNV GL, an independent management consultancy specialising in technical assurance in the utility sector. Pennon considers that DNV GL's method of verification – which includes testing the assumptions, definitions, methods and procedures that are followed in the development of data and the auditing thereof to ensure accuracy and consistency – complements the best practice insight gained through the Group's continued membership of Business in the Community. Certain disclosures within this annual report that relate to the sustainability performance of South West Water and Bournemouth Water have been verified by DNV GL against the output of an independent audit of regulatory data conducted by Jacobs.

Benchmarking
Pennon is a constituent within the FTSE4Good Index and a number of other leading external ESG assessments. FTSE4Good is an equity index series that is designed to facilitate investment in companies that meet globally recognised corporate responsibility standards. Companies in the FTSE4Good Index Series have met stringent environmental, social and governance criteria, and are positioned to capitalise on the benefits of responsible business practice.

Pennon sustainability report
Pennon's sustainability reporting is integrated throughout the strategic report and specifically in the following sections:

- Business model, page 6
- Strategic priorities, page 8
- Sustainability at our core, page 10
- Chairman's statement, page 14
- Our stakeholders, page 20
- Chief Executive Officer's review, page 26
- Key performance indicators, page 30
- People, page 32
- Our operations, pages 36 to 49

Viridor and South West Water sustainability reports
The sustainability report for Viridor will be published in August 2019 and South West Water's company annual performance report and regulatory reporting, to be published in July 2019, will incorporate its sustainability reporting. Both documents will be available to view at **www.pennon-group.co.uk/sustainability** and on the subsidiaries' websites.

Nomination Committee report

"We are committed to taking action to encourage the growth of a diverse workforce where individuals from different backgrounds can fulfil their potential."

Sir John Parker
Nomination Committee Chairman

Nomination Committee composition and meetings

Position	Director	Date of appointment to Pennon Nomination Committee	Attendance
Committee chairman	Sir John Parker	April 2015	2/3
Committee members	Gill Rider	September 2012	3/3
	Neil Cooper	September 2014	3/3
	Iain Evans(1)	September 2018	2/2
	Martin Angle(2)	December 2008	2/2

(1) Appointed on 1 September 2018.
(2) Stepped down from the Board on 31 December 2018.

The Nomination Committee met three times during the year to fulfil the duties set out in its terms of reference.

Matters considered by the Committee during the year included:
- The annual review of the Group policy on Diversity, Respect and Inclusion and the Group's progress on diversity
- A review of succession planning for Non-Executive Directors resulting in the following changes:
  - The extension of Sir John Parker's appointment as Chairman of Pennon Group plc from 1 August 2018 into his second term
  - The extension of Gill Rider's appointment as a Non-Executive Director of Pennon Group plc from 1 September 2018 into her third term. Gill was also appointed to the role of Remuneration Committee Chairman from 1 January 2019
  - The recruitment and appointment of Iain Evans as a Non-Executive Director of Pennon Group plc from 1 September 2018, replacing Martin Angle who stepped down from the Board on 31 December 2018. Iain was also appointed as a member of each of the Board Committees as well as to the role of Chairman of the Sustainability Committee with effect from 1 January 2019
  - The recruitment of Claire Ighodaro, to take effect from 1 September 2019
  - A review of the time spent by Non-Executive Directors in fulfilling their duties
- A review of the Group's succession plans, leadership of the Group and the Group's approach to succession planning
- A review of the Group's gender pay disclosure for 2018 and ongoing action plan.

It is the practice of the Committee, led by the Chairman, to appoint an external search consultancy to assist in Board appointments to ensure that an extensive and robust search can be made for suitable candidates. During the year we engaged with Heidrick & Struggles to assist in the recruitment of our Non-Executive Director, Iain Evans and assist the Company in the recruitment of certain senior employees. Heidrick & Struggles has no other connection with the Company.

We also engaged with the Inzito Partnership to assist in the recruitment of Claire Ighodaro. Inzito has no other connection with the Company.

Sir John Parker unfortunately missed the May 2018 meeting due to medical treatment. Gill Rider chaired the May Committee meeting in Sir John's absence. Iain Evans was appointed to the Committee on 1 September 2018, following his appointment to the Board and Martin Angle stepped down from the Board and its Committees on 31 December 2018. All other members served for the full year.

Other regular attendees to Committee meetings during the year included the Chief Executive Officer, the Group General Counsel and Company Secretary and the Group Director of Human Resources.

Nomination Committee report
continued

Board diversity policy

The Committee is required by the Board to review and monitor compliance with the Board's diversity policy and report on the targets, achievement against those targets and overall compliance in the annual report each year.

The Board's diversity policy confirms that the Board is committed to:

- The search for Board candidates being conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of gender and ethnic diversity on the Board
- Satisfying itself that plans are in place for orderly succession of appointments to the Board and to senior management to maintain an appropriate balance of skills and experience within the Group and on the Board and to ensure progressive refreshing of the Board. The Committee is mindful of the direction of travel of the 2018 UK Corporate Governance Code and the Board will endeavour to achieve and maintain:
  - A minimum of 33% female representation on the Board
  - A minimum of 33% female representation on the Group's senior management team.

The Committee is pleased to report that as at 31 March 2019 33% of the Board's Directors were women, as disclosed on pages 76 and 77.

Action is being taken to improve diversity across the workforce, which will assist in increasing female representation at senior management level as described on page 32. In support of this aim, both our Chairman and our Chief Executive Officer are members of the 30% Club, a UK campaign that supports the goal of women holding 30% of board seats and promotes initiatives to expand the female talent pipeline at all levels.

Our position in the Hampton Alexander review is 85 out of the 250 companies in the FTSE 250. This is down from 40 last year primarily driven by a transitional change in the composition of our Board when the analysis was undertaken. In September 2018, Iain Evans was appointed to the Board and Martin Angle stepped down from the Board and its Committees on 31 December.

Our position will change again in September 2019, with the appointment to the Board of Claire Ighodaro. We remain committed to the targets as proposed by Hampton Alexander of 33% representation of women on the Board and on the Executive Committee.

The Committee and the Board will continue to monitor and promote diversity across the Group with the aim of ensuring a diverse pipeline for succession to board and senior management positions in accordance with our Diversity, Respect and Inclusion Policy, which encourages the growth of a diverse workforce where individuals from different backgrounds can fulfil their potential.

Our 2018 employee survey told us that 88% of our employees believe that people within Pennon Group are treated fairly regardless of race or ethnic origin and we were pleased to see our graduate intake in 2018/19 having a gender split of 66% male/34% female with 50% of the whole intake being from diverse ethnic backgrounds. While we recognise this as good progress, we plan to further increase our focus on ethnic diversity in the coming year. We continue to strive to ensure people with disabilities are given all the encouragement and support necessary and that Pennon is seen as a welcoming and inclusive place to work in all respects.

Information regarding the gender breakdown of the workforce is provided on page 33.

Sir John Parker
Nomination Committee Chairman

Remuneration Committee report

"Ensuring that Executive remuneration is aligned with and supports the Group's strategy, reflects our values and meets best practice governance standards is an important responsibility for the Committee."

Gill Rider
Remuneration Committee Chairman

The Committee met four times during the year to fulfil the duties set out in its terms of reference. In particular, the Committee is responsible for:

- Ensuring remuneration is aligned with and supports the Group's strategy, reflects our values as a Group and optimises performance
- Maintaining and, in every third year, reviewing the remuneration policy and considering any changes necessary to ensure it remains appropriate and fulfils its purpose of attracting and retaining high-calibre people who are able to contribute to the success of the Group
- 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 executives of the Group
- Reviewing workforce remuneration and related policies for the purpose of aligning incentives and reward with culture, taking these into account when setting the remuneration policy for Executive Directors and providing the Board with feedback.

Remuneration Committee composition and meetings

Position	Director	Date of appointment to Remuneration Committee	Attendance
Committee chairman	Gill Rider(1)	September 2012	4/4
Committee members	Neil Cooper	September 2014	4/4
	Iain Evans(2)	September 2018	3/3
	Martin Angle(3)	December 2008	3/3

(1) Appointed as Committee chairman on 1 January 2019.
(2) Appointed on 1 September 2018.
(3) Stepped down from the Board on 31 December 2018.

The Committee's activities during the financial year

The Committee engaged in the following activities during the year:

- Undertaking a comprehensive retendering process for the appointment of remuneration consultants, resulting in the reappointment of Deloitte, with a refreshed advisory team
- Reviewing and implementing the required changes to remuneration practices following the July 2018 publication of the UK Corporate Governance Code
- Ensuring executive pay in South West Water is aligned to Ofwat's principles and responding to their request to ensure we set the appropriate stretch in targets to meet customer delivery requirements as part of achieving fast-track status
- Reviewing the wider workforce remuneration using the Pennon Pay Dashboard, to help inform executive pay decisions and ensuring cultural alignment
- Completing the annual executive salary review and the annual review of the Chairman's fee
- Reviewing drafts of the Directors' annual remuneration report and recommending it to the Board for approval for inclusion in the 2019 annual report
- Determining performance targets in respect of the Annual Incentive Bonus Plan for 2018/19
- Determining bonuses and deferred bonus awards pursuant to the Company's Annual Incentive Bonus Plan in respect of the year 2017/18
- Approving the long-term incentive plan (LTIP) awards for the year
- Approving the release of the 2015 deferred bonus share awards
- Reviewing the outcome of the 2015 Performance and Co-Investment Plan awards
- Reviewing the results of the Committee's performance evaluation and considering any appropriate changes.

The Committee's focus for 2019/20

- Ensure that targets are stretching but also fair and achievable, so that they act to retain, motivate and incentivise the executive to deliver the Group's strategic goals and to create long-term value for shareholders
- Monitor on an ongoing basis the alignment of executive pay and benefits with the strategic direction of the Group to ensure these support the long-term success of the Company and promote its values
- Review workforce remuneration and related policies for the purpose of aligning incentives and reward with culture, taking these into account when setting the remuneration policy for Executive Directors and providing the Board with feedback
- Reviewing and redrafting the remuneration policy in line with the three-year cycle for approval at the AGM in 2020.

Iain Evans was appointed to the Committee on 1 September 2018, following his appointment to the Board, and Martin Angle stepped down from the Board and its Committees on 31 December 2018.

In accordance with the Code, all of the Committee members are independent Non-Executive Directors. The Chairman of the Board attends from time to time but is not a member of the Committee. The Chief Executive Officer also attends meetings when invited except for such part of a meeting when matters concerning his own remuneration are to be discussed.

The Committee is advised by Deloitte, an independent remuneration consultant, to ensure remuneration is determined impartially. The Committee is also supported by the Group Director of Human Resources and the Group General Counsel and Company Secretary.

Gill Rider
Remuneration Committee Chairman

Directors' remuneration report

DIRECTORS' REMUNERATION REPORT

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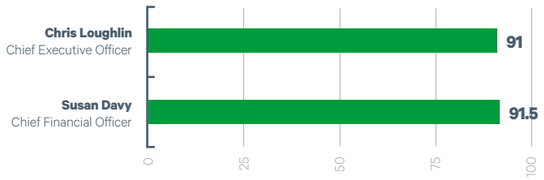
2018/19 – performance highlights and outcomes

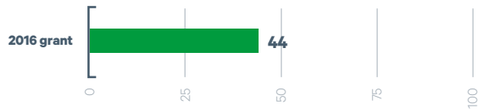
Group performance

- Underlying profit before tax up 8.3%
- 2018/19 dividend per share up 6.4% to 41.06p per share
- EBITDA growth of 19.1% at Viridor supported by ERF performance
- South West Water business plan awarded fast-track status, the only water company to achieve this for two successive price reviews

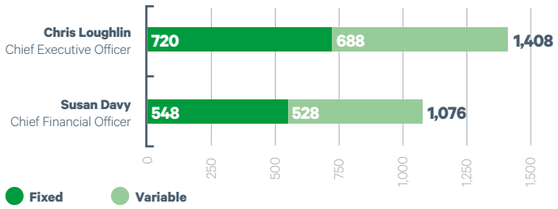
Annual bonus 2018/19 outturn (% of maximum)



Performance and Co-Investment Plan outturn (estimated vesting) (% of maximum)



2018/19 single figure outcome (£'000)



Link between strategy and remuneration

1 Leadership in UK water and waste infrastructure

Lead in the water and waste sectors by capitalising on Group strengths, capabilities, best practice and synergies and achieving the right balance between risk and reward.

2 Leadership in cost base efficiency

Focused on driving down overheads and operating in the most efficient way to minimise costs.

3 Driving sustainable growth

Actively seek opportunities to invest for growth, whether through investment to increase our asset portfolio, initiatives to expand our customer base or partnerships with other organisations.

Group KPIs	Link to strategy			Link to variable remuneration	
	1	2	3	Annual bonus	LTIP
Long-term					
Earnings per share	✓	✓	✓		✓
Dividend per share	✓	✓	✓		✓
Return on capital employed (RoCE)		✓	✓		✓
Annual					
Profit before tax (PBT)	✓	✓	✓	✓	
Return on regulated equity (RoRE)	✓	✓	✓	✓	
ODI net rewards	✓		✓	✓*	
ERF availability	✓		✓	✓*	
Sustainable business					
Customer satisfaction with overall service	✓		✓	✓*	
Employee engagement	✓		✓	✓*	
Health & safety	✓		✓	✓*	
Carbon emissions	✓		✓	✓*	

* Reflected in bonus operational and individual metrics.

Link to customers

Pay linked to underlying performance **Performance pay – appropriately aligned with customer interests** **Bonus and long-term incentives – substantial link to stretching performance delivery for customers**	• Significant portion of executive remuneration linked to performance of the business • Annual bonus includes customer and operational measures linked to metrics assessed by the water industry regulator, customers, communities and wider stakeholders • Stretching targets – motivate management to deliver sustainable performance • Safeguard mechanisms in place to ensure outcomes reflect underlying performance
Transparency **Clear disclosure of reasons for changes to policy** **Explanation of how changes take into account customer interests**	• Principles followed for 2017 policy review : – Ensure a transparent, simple and equitable approach to pay – Incentivise the delivery of sustainable long-term value to shareholders – Support the underlying strategic priorities of operating safely, with an engaged workforce and focus on customer service • Next policy review in 2020 – maintain commitment to transparent pay structures and clear disclosure of any changes.

Annual statement from the Chairman of the Remuneration Committee

Dear Shareholder

Introduction

I am pleased to present the Directors' remuneration report for the year ending 31 March 2019. This is my first report to you as chairman of the Remuneration Committee, having succeeded Martin Angle who stepped down from the Board in December 2018. On behalf of the Committee, I would like to thank Martin for his significant contribution.

In recent years, Pennon has received strong support from our shareholders for our approach to pay. Our current Remuneration Policy was approved in 2017 with close to 98% support. At last year's Annual General Meeting (AGM), over 99% of votes were in favour of our Directors' remuneration report. In light of this strong endorsement, we are not proposing to make any major changes to our pay arrangements this year.

A significant proportion of remuneration for the Executive Directors is delivered as variable pay that rewards for the achievement of sustainable strong performance. As illustrated on page 93, the metrics used for the bonus and long-term incentives are directly aligned with Pennon's strategy. The incentives reward for performance against financial, operating and customer-based metrics that are important to our shareholders, our customers, the water industry regulator and wider stakeholders.

Performance in 2018/19

This has been another year of strong performance in which Pennon has reaffirmed its status as a leading provider of diverse environmental services.

Key achievements in the year included:

- Underlying profit before tax increased by 8.3% to £280 million
- The South West Water 2020-25 business plan received a fast track green light from Ofwat, the water industry regulator – the only company to have achieved fast-track status for two consecutive price reviews
- Strong performance in the water business, demonstrating service resilience through extreme weather conditions. Our focus on customers was demonstrated by delivery of our lowest ever supply interruptions and a record customer service score. South West Water is now ranked second in the industry for quality and service
- Delivery of sector leading cumulative return on regulated equity (RoRE) at 11.8%
- EBITDA growth of 19.1% at Viridor supported by the build out and performance of our ERFs
- 2018/19 dividend per share up 6.4% to 41.06p.

These outcomes place the Company in a strong position to continue to enjoy financial resilience driven by reliable operating cash flow, a strong liquidity and balance sheet position, and a diversified mix of low-cost and flexible funding.

Incentive outcomes

The bonus outturns for the Executive Directors for 2018/19 reflect the Company's strong achievements against financial, operational, customer and individual targets set at the start of the year. For 2018/19, the Chief Executive Officer and Chief Financial Officer earned bonuses of c.90% of salary. The Committee considered the formulaic outcome and concluded that the bonus was a fair reflection of the strong performance achieved in the year. Further details of bonus targets, measures and performance are set out on pages 98 and 99.

For the 2018/19 bonus, Executives were also asked to evidence how they demonstrated our new Company values (trusted, collaborative, responsible, progressive), in delivering individual objectives. This is in order to ensure that our values become part of the leadership culture, with the intention of introducing this performance element to further levels of the organisation.

Half of the bonus earned is deferred into shares which affirms Executives' commitment to creating a long-term, sustainable business.

Legacy awards granted under the Performance and Co-investment Plan in 2016 will be eligible for vesting in 2019. This award was based on relative TSR performance against sector peers and the wider FTSE 250 (excluding investment trusts). Although the performance assessment for this award will only be concluded after the finalisation of this report, our current expectation is that there will be partial vesting, currently estimated at c.44% for this award, due to outperformance against sector peers.

Pay for wider workforce

The Remuneration Committee spends considerable time on matters relating to remuneration in the wider organisation.

Details of pay trends for the wider employee base provide important context when making decisions regarding remuneration for the Executive Directors as well as ensuring that consistent approaches are being adopted across the organisation. In this year's remuneration report we have provided expanded disclosure on the Committee's activities in this area.

Although the structure of pay varies at different levels in the organisation, the Company applies a consistent set of guiding principles.

Future remuneration

As noted above, no major changes to executive pay are being proposed for the coming year. Key decisions include:

- Salaries for Executive Directors were increased by 2%, which is slightly lower than the pay increase awarded to the wider employee population
- Maximum incentive opportunities will remain unchanged
- We are maintaining the same form and balance of performance measures from last year as these continue to be closely aligned with our strategy and the interests of our various stakeholders
- The Remuneration Committee will continue to consider how Executives demonstrate our values when delivering individual objectives.

In this year's report, we have provided detail as to how we comply with the remuneration provisions of the new UK Corporate Governance Code which takes effect for 2019/20. Pennon is well placed for the adoption of these provisions.

Under the normal three-year renewal cycle, our Remuneration Policy will be presented to shareholders for approval at the 2020 AGM. During the year we will therefore be undertaking a review of our current arrangements in light of our strategic priorities, as well as evolving market and best practice. As part of this review we intend to consider our approach to pensions and post-employment shareholding guidelines in response to the new Code.

We are keen to maintain a dialogue with our investors on pay matters and we intend to consult with shareholders regarding our proposals, ahead of the 2020 AGM.

The Remuneration Committee has sought to take a measured and responsible approach to executive pay, with a close focus on the strategic priorities of the business and the interests of wider stakeholders. We hope that this approach is clear in our remuneration report. The Committee appreciated the strong endorsement of last year's Directors' remuneration report and we hope we can continue to rely on shareholders' support.

Gill Rider
Remuneration Committee Chairman

Annual report on remuneration
at a glance

Summary of Directors' remuneration policy and implementation in 2019/20

The current Directors' remuneration policy was approved by shareholders at the Company's AGM held on 6 July 2017, is displayed in its entirety on the Company's website at **www.pennon-group.co.uk/about-us/governance-and-remuneration** and is available upon request from the Group Company Secretary. A summary of the policy is set out below alongside detail on how we intend to implement the policy in 2019/20.

Element	Operation	Implementation in 2019/20
Base salary		
Set at a competitive level to attract and retain high calibre people to meet the Company's strategic objectives in an increasingly complex business environment.	Salaries are generally reviewed annually and any changes are normally effective from 1 April each year. In normal circumstances, salary increases will not be materially different to general employee pay increases.	Salaries for 2019/20 were increased by 2%, which was lower than increases for all employees: Chris Loughlin – £538,550 Susan Davy – £411,800
Benefits		
Benefits provided are consistent with the market and level of seniority to aid retention of key skills to assist in meeting strategic objectives.	Benefits currently include the provision of a company vehicle, fuel, health insurance and life assurance. Other benefits may be provided if the Committee considers it appropriate.	No changes.
Annual bonus		
Incentivises the achievement of key performance objectives aligned to the strategy of the Company.	The maximum bonus potential for each Director is 100% of base salary. A portion of any bonus is deferred into shares in the Company which are normally released after three years. Normally 50% is deferred. Malus and clawback provisions apply.	No changes. Maximum opportunity of 100% of salary, with deferral of 50% of any bonus into shares for three years.
Long-term incentive plan (LTIP)		
Provides alignment to the achievement of the Company's strategic objectives and the delivery of sustainable long-term value to shareholders.	Annual grant of conditional shares (or equivalent). Share awards vest subject to the achievement of specific performance conditions measured over a performance period of no less than three years. In addition, a two year holding period will apply in respect of any shares which vest at the end of the three-year performance period. The maximum annual award is 150% of base salary. An underpin applies which allows the Committee to reduce or withhold vesting if the Committee is not satisfied with the underlying operational and economic performance of the Company. Malus and clawback provisions apply.	No changes. Maximum award of 150% of salary.
Shareholding requirements		
Create alignment between executives and shareholders and promote long-term stewardship.	200% of salary for both the Chief Executive Officer and Chief Financial Officer.	No change.
Pension		
Provides funding for retirement and aids retention of key skills to assist in meeting the Company's strategic objectives.	The maximum annual pension contribution or cash allowance is 20% of salary. For Executive Directors who commenced employment prior to April 2013, the maximum annual pension contribution or cash allowance is 30% of salary.	No changes. Current benefit levels as agreed in prior years are: 30% for Chris Loughlin and 25% for Susan Davy. As part of the updated UK Corporate Governance Code, the Remuneration Committee will be expecting to reduce the pension benefits for any future Board appointment to reflect pensions across the wider employee population.
All employee share plans		
Align the interests of all employees with Company share performance.	Executive Directors may participate in HMRC approved all-employee plans on the same basis as employees. The maximum is as prescribed under the relevant HMRC legislation governing the plans.	No changes.
Non-Executive Director fee policy		
Set at a market level to attract Non-Executive Directors who have appropriate experience and skills to assist in determining the Group's strategy.	Non-Executive Directors normally receive a basic fee and an additional fee for any specific Board responsibility such as membership or chairmanship of a Committee or occupying the role of Senior Independent Director. Expenses incurred in the performance of non-executive duties for the Company may be reimbursed or paid for directly by the Company (including any tax due on the expenses). The Chairman's benefits include the provision of a driver and vehicle, when appropriate for the efficient carrying out of his duties.	2019/20 fee policy is set out below (2% increase): Chairman – £275,700 Basic NED fee – £49,100 Senior Independent Director fee – £7,280 Chairman of the Audit Committee – £14,785 Chairman of the Remuneration Committee / Sustainability Committee – £10,560 Committee fee – £5,280.

Annual report on remuneration

Implementation of the remuneration policy for 2019/20 – further details on performance metrics

Annual bonus

For 2019/20, the annual bonus will be based on the following performance measures:

Group financial measures (60%)	50% PBT 10% RoRE
Customer and operational measures (20%)	These measures will be quantitative and measurable, and are key to meeting the needs of our customers, our regulator and wider stakeholders. **Water metrics will include:** Customer service score Bathing water failures Leakage Wastewater pollution incidents Interruptions to supply Asset reliability **Waste metrics will include:** ERF availability and efficiency metrics Power output Landfill and recycling volumes traded Recyclate revenue
Individual objectives (20%)	Individual objectives include goals relating to: • Safety • Employee engagement • Execution of business plan • Development of strategy. Executives will be asked to evidence how they demonstrated our values (trusted, collaborative, responsible, progressive), in delivering individual objectives. This is in order to ensure that the values become a part of the leadership culture, with the intention of introducing this performance element to further levels of the organisation.

The detail of the annual bonus targets for 2019/20 are closely aligned to the strategy and are therefore considered to be commercially sensitive. However, the Company intends to provide retrospective disclosure of targets in next year's remuneration report.

Long-term incentive plan

For 2019/20, performance measures will continue to be EPS growth, a sustainable dividend measure and RoCE, with targets set as in the table below. The LTIP award will be subject to an underpin relating to overall Group performance including consideration of environmental, social and governance factors and safety performance, as well as financial performance.

	Threshold (25% of element)	Maximum (100% of element)
EPS growth (40%)	6% p.a.	10% p.a.
Sustainable dividends (40%)	2.6x	3.6x
RoCE* (20%)	8%	10%
	Straight-line vesting between the threshold and maximum	

* RoCE is defined as: (underlying operating profit + joint venture profit after tax + interest receivable) divided by capital employed (debt + equity invested including hybrid).

The sustainable dividends is based on EBITDA dividend cover. This element is subject to two underpins:

- Achievement of a gateway dividend growth target of RPI+4% p.a.; and
- The Board must also be satisfied with the level of EPS dividend cover. EBITDA dividend cover will be based on adjusted EBITDA calculated as (underlying EBITDA + share of joint venture dividends & interest receivable + IFRIC 12 interest receivable).

For the purpose of the calculation, dividend cover would be based on the policy of 4% p.a. above RPI.

Discretion

In line with the 2018 Corporate Governance Code, the Remuneration Committee has ensured that they will maintain the ability to override the formulaic outcomes for future awards under the annual bonus and LTIP where the outcomes are not considered by the Committee to be appropriate (e.g. unreflective of underlying performance). The Committee will disclose the use of any such discretion.

Remuneration approach for wider employees

Consistent with best practice, the Remuneration Committee spends considerable time on matters relating to remuneration arrangements in the wider organisation. Details of pay trends for the wider employee base provide important context when making decisions regarding remuneration for the Executive Directors as well as ensuring that consistent approaches are being adopted across the organisation.

Although the structure of pay varies at different levels in the organisation, the Company applies a consistent set of guiding principles. The structure of Pennon's approach to remuneration in the wider organisation is summarised in the table below:

Base salary	Salaries reflect the scope and responsibility of the role, as well as the skill and experience of the individual. The percentage change in salary for the Chief Executive Officer in 2019 was 2%, compared with general increases of between 2% and 2.4% across the Group.
Pension and benefits	All employees of the Group are entitled to pension provision, including life assurance. Certain benefits are generally available only to more senior employees at management level and above. The Group also encourages share ownership among its employees by operating HM Revenue & Customs approved Sharesave scheme and Share Incentive Plan. All employees are eligible to participate in share plans, and there is a strong emphasis of employee buy-in and ownership.
Variable remuneration	All employees in Pennon Group plc and South West Water are entitled to participate in annual bonus arrangements. In Viridor and Pennon Water Services, all senior and middle management employees as well as many employees in operations functions are entitled to participate in annual bonus arrangements or performance incentives. The maximum bonus levels are based on seniority and level of responsibility. Long-term incentive share awards are only available to senior executives and Executive Directors.

In response to the 2018 Corporate Governance Code, the Committee have also reviewed the level of information provided on pay matters in the wider organisation. Key activity in this regard included:

Pennon pay dashboard	• We have established a pay dashboard to help support the Committee in reviewing workforce remuneration and related policies • The dashboard provided an overview of pay arrangements across the business and provides key statistics on pay in different areas of the business • The dashboard covers information on workforce demographics, gender pay, pay ratios, pension and benefits and incentive outcomes in different areas of the business • The Committee intends to keep the content of the dashboard under review to ensure that it continues to provide suitable information for the Committee.
Gender Pay Gap	• From April 2018 Pennon has published Gender Pay Gap data for the business • As a Group that operates in traditionally non-diverse sectors, we are well aware of the impact our own practices may have in relation to gender, as well as the broader issue of race and ethnicity. • While we firmly believe there is still much to be done, our already established programme of measures means that Group-wide we have an average Gender Pay Gap of 2.7%, below the latest published UK average.

Employee engagement

Across Pennon we endorse the principle of strengthening opportunities for employees to engage in two-way dialogue at all levels.

We have welcomed the insight provided from the annual employee survey and the feedback from the Employee Voice and Employee Engagement Forums. We have increased the frequency of Big Chat events during the year which provides employees the opportunity to dial-in to a Group-wide call with the Pennon Executive to hear updates on key projects and participate in open question and answer sessions. This feedback is essential as we continue to work with employees to make performance improvements across the Group and motivate and engage our employees. One of the key priority areas for discussion during the last year has been on reward and remuneration and we were pleased to see a 2% increase in our Trust Index score from 2017.

Annual report on remuneration
continued

Single total figure of remuneration tables (audited information)

	Base salary/fees (£000)		Benefits[i] (including Sharesave) (£000)		Annual bonus (cash and deferred shares) (£000)		Long-term incentive plan (£000)		Pension[iii] (£000)		Total remuneration (£000)	
	2018/19	2017/18	**2018/19**	2017/18	**2018/19**	2017/18	**2018/19**[ii]	2017/18	**2018/19**	2017/18	**2018/19**	2017/18
Executive Directors												
Chris Loughlin	**528**	518	**34**	30	**480**	450	**208**	–	**158**	155	**1,408**	1,153
Susan Davy	**404**	396	**29**	28	**369**	346	**159**	–	**115**	113	**1,076**	883
Non-Executive Directors												
Sir John Parker	**270**	270	**–**	–	**–**	–	**–**	–	**–**	–	**270**	270
Gill Rider	**77**	74	**–**	–	**–**	–	**–**	–	**–**	–	**77**	74
Martin Angle[iv]	**52**	67	**–**	–	**–**	–	**–**	–	**–**	–	**52**	67
Neil Cooper	**69**	66	**–**	–	**–**	–	**–**	–	**–**	–	**69**	66
Iain Evans[v]	**40**	–	**–**	–	**–**	–	**–**	–	**–**	–	**40**	–

(i) Benefits comprise a car allowance and medical insurance.
(ii) Based on an estimated 44% vesting as referred to on page 99.
(iii) See page 100 for further information on pensions.
(iv) Martin Angle stepped down from the Board on 31 December 2018.
(v) Iain Evans was appointed to the Board on 1 September 2018.

Notes to the single figure table

Annual bonus outturn for 2018/19

The bonuses for Executive Directors were based on a combination of financial, operational and personal objectives. The performance targets set and the performance achieved in respect of the annual bonus for 2018/19 for both Executive Directors is set out below.

In line with the Committee's policy, 50% of any bonus is payable in shares, the release of which is deferred for a three-year restricted period.

Group financial measures – 60% weighting

Measure	Threshold	Target	Maximum	Actual outturn	Bonus outturn
Underlying profit before tax (50% weighting)	£262.1m	£267.4m	£280.8m	£280.2m	49%
RoRE (10% weighting)	8%	9%	11%	11.8%	10%

Customer and operational measures – 20% weighting

Measures	Target	Actual outturn	Target achieved	Bonus outturn
Water metrics				
Service incentive mechanism (SIM)	85/87	88/88	Yes	
Bathing water quality	<5 beaches failing	0	Yes	
Leakage	81	84	No	
Wastewater pollution incidents:				7%
Category 1-2	2	2	No	
Category 3-4	180	248		
Average duration of interruptions to supply	0.214 hours per property	0.161 hours per property	Yes	
Water and wastewater asset reliability	Stable	Stable	Yes	
Waste metrics				
ERF availability	91%	91%	Yes	
Delivery against recycling action plan		Action plan delivered	Yes	7%
Growth in customer base		Not achieved	No	

Individual objectives – 20% weighting

Objectives	Achievements
CEO and CFO – joint objectives	
Lead and develop an innovative PR19 business plan to maximise the potential of a positive outcome for South West Water, its customers and other stakeholders and work with government to achieve the same, gaining Board approval and submitting a high quality bid to Ofwat	• Delivery of high-quality submission • PR19 business plan for South West Water achieved fast-track status – only water company to receive this status for two consecutive price reviews • Clear evidence of Innovation in development of Water/Share+ • Industry leading cost base efficiency.
Continue to embed HomeSafe across the entire Group and drive further improvement in health & safety performance	• Successful roll-out of e-learning throughout the organisation • Headline LTIFR reduced by 32.2% to 1.37 • Reduction in serious incidents and near-miss events • Visible leadership across the organisation – site visits and training sessions.
Build on the trust and engagement of our 5,000 employees to support the delivery of our strategy	• 2% improvement in Group's Trust Index • Successful implementation of various internal initiatives to improve engagement and leadership across the organisation.
Undertake a strategic review of our recycling businesses in light of the Government's waste strategy, developing and gaining Board approval for an appropriate strategy for Viridor	• Strategy for Viridor established and agreed • Strategic focus on derisked infrastructure model • Implementation underway.
CEO only	
Continue to refine and extend the reach of the organisation's succession and talent management processes	• Refinement of talent management processes • Development of succession plans for senior roles • New wider-reaching Graduate recruitment programme developed, alongside MBA programme in partnership with Exeter University and Cranfield School of Management. • Continuation of apprenticeship programme – 384 new apprenticeships offered in last two years.
CFO only	
Delivery of a sustainable financing strategy and the embedding of new financial systems and processes	• Sustainable finance strategy developed and implemented • Fair Tax Mark – first water company to be awarded • Support for the ongoing position with Interserve • Successful enterprise audits taken place – underlining the step change in system approach. Good progress with heritage projects refocused to look at landfill solutions and gatehouse.

Summary of bonus outcome

		Bonus outturn	
	Weighting	Chief Executive Officer	Chief Financial Officer
Group financial measures	60%	59%	
Customer and operational measures	20%	14%	
Individual objectives	20%	18%	18.5%
Total outturn	**100%**	**91%**	**91.5%**

Long-term incentive plan – Performance and Co-investment Plan outturn for 2018/19

The awards in the single figure table relate to share awards granted on 1 July 2016, which are due to vest on 1 July 2019. These awards were granted under the legacy incentive plan which operated prior to 2017.

The 2016 share awards were subject to the satisfaction of TSR-based performance conditions. These conditions were set at the time that the awards were granted. The calculation for this award requires averaging TSR performance over the first three months of the performance period and comparing it to the average over the three months following the end of the performance period (1 April 2019 to 30 June 2019). In light of this timeframe, the outturn described in this report is based on an estimate based on TSR up to 20 May 2019. The final vesting outcome will be confirmed in next year's remuneration report.

	Threshold (30% of maximum vests)	Maximum (100% of maximum vests)	Forecasted achievement	Forecasted vesting
Comparator index (50% of award)	Equal to index	15% above the index	Outperformance of index: 12.4%	44%
FTSE 250 (excluding investment trusts) (50% of award)	Above 50th percentile	At or above 75th percentile	Below median	0%
Total				**44%**

Straight-line vesting between points.
For below threshold performance for either performance condition, 0% vests in respect of that performance condition.
Comparator index comprises: National Grid Plc, Séché Environnement, Severn Trent, Shanks Group, Suez Environnement, United Utilities and Veolia Environnement.

The calculation of TSR performance was undertaken by Deloitte LLP for the Committee. Vesting of an award is also subject to the underpin described in the remuneration policy, which the Committee has determined to the date of this report would be satisfied, if any award was to vest.

If awards were to vest, they would be subject to a two-year holding period during which clawback may be applied where the Committee considers it appropriate in certain circumstances. The holding period ends on 30 June 2021.

Annual report on remuneration
continued

Retirement benefits and entitlements (audited information)

Both Executive Directors were appointed prior to April 2013 and participate in legacy pension arrangements. Details of the Directors' pension entitlements and pension-related benefits during the year are as follows:

	Value of defined benefit pension[i] (£000)	Company contributions to defined contribution arrangements (£000)	Cash allowances in lieu of pension (£000)	Total value for the year (£000)	Normal retirement age and date (for pension purposes)	Accrued pension at 31 March 2019[ii] (£000)
Chris Loughlin	–	–	158	158	67 (20 August 2019)	–
Susan Davy	29	–	86	115	65 (17 May 2034)	23[ii]

(i) The value of the defined benefit pension accrued over the period comprises the total pension input amount (which has been calculated in line with regulatory requirements) less the pension contributions paid by the Director.

(ii) Accrued pension is based on service to the year end and final pensionable salary at that date.

Chris Loughlin is not a member of any of the Pennon Group's pension schemes and receives a sum in lieu of pension entitlement equivalent to 30% of salary.

Susan Davy receives an overall pension benefit from the Company equivalent to 25% of her salary which in 2018/19 comprised an employer's contribution of £11,256 and a cash sum of £86,470. She is a member of Pennon Group's defined benefit pension arrangements and is entitled to normal retirement pension payable from age 65 of broadly 1/80th of pensionable remuneration for each year of pensionable service completed.

The employer's contribution to the pension for Susan Davy is deducted from the overall pension allowance.

Pensions in payment are guaranteed to increase at a rate of 5% p.a. or RPI if lower for service accrued in the period up to 30 June 2014 and at a rate of 2.5% p.a. or CPI if lower for service accrued in the period after this date. If a Director dies within five years of retiring, a lump sum equal to the balance of five years' pension payments is paid plus a spouse's pension of one half of the member's pension. Pensions may also be payable to dependants and children.

No additional benefits will become receivable by a Director in the event that the Director retires early.

Outside appointments

Executive Directors may accept one board appointment in another company. Board approval must be sought before accepting an appointment. Fees may be retained by the Director. In January 2019, Susan Davy joined the board of Restore Plc as a non-executive director and retained earnings of £11,250. No other outside company appointments are held by the Executive Directors other than with industry bodies or governmental or quasi-governmental agencies.

Directors' service contracts and letters of appointment

The dates of Directors' service contracts and letters of appointment and details of the unexpired term are shown below.

Executive Directors	Date of service contract	Notice period
Chris Loughlin*	1 January 2016	12 months
Susan Davy*	1 February 2015	12 months

* Each of the Executive Directors' service contracts is subject to 12 months' notice on either side. The contract has a normal retirement age of 67, except where otherwise agreed by both the executive and the Company.

Non-Executive Directors	Date of initial letter of appointment	Expiry date of appointment
Sir John Parker	19 March 2015	31 March 2021
Neil Cooper	17 July 2014	31 August 2020
Gill Rider	22 June 2012	31 August 2021
Iain Evans	1 September 2018	31 August 2021

The policy is for Non-Executive Directors' letters of appointment to contain three-month notice period from either side and for the Chairman's letter of appointment to contain a 12-month notice period from either side.

All Non-Executive Directors are subject to annual re-election and letters of appointment are for an initial three-year term. During the year the Nomination Committee recommended that Gill Rider's appointment be extended for a further three-year term, having considered both her ongoing independence and her contribution to the Board

Copies of Executive Directors' service contracts and Non-Executive Directors' letters of appointment are available for inspection at the Company's registered office.

Non-Executive Director fees and benefits

The Non-Executive Directors' fees were increased by the Board for 2018/19 by 2%. The Chairman declined to accept an increase for 2018/19.

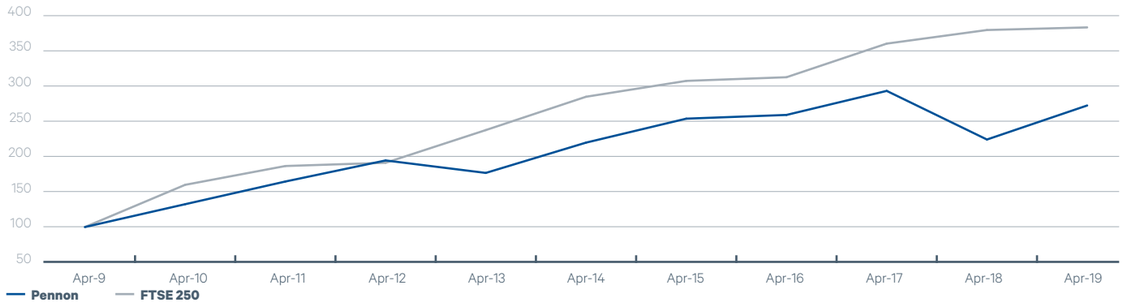
The Chairman's benefits comprise provision of a driver and vehicle, when appropriate for the efficient conduct of his duties. He is entitled to expenses on the same basis as for the other Non-Executive Directors.

Additional contextual information

Historical TSR

The graph below shows the value, over the ten-year period ended on 31 March 2019, of £100 invested in Pennon Group on 1 April 2009 compared with the value of £100 invested in the FTSE 250 Index. The FTSE 250 index is a broad equity market index of which the Company is a constituent.

Total shareholder return – Since April 2009



Historic chief executive officer remuneration

As the Company did not have a Chief Executive Officer until 1 January 2016, the table below provides historic single figure information in the form of the average remuneration of the Executive Directors for years up to and including 2014/15. Their remuneration was considered to be the most appropriate to use as they were the most senior executives in the Company.

From 2015/16 onwards, the Chief Executive Officer's remuneration for the year is shown.

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16[i]	2016/17	2017/18	2018/19
Average Executive Director single figure of remuneration (£000)	916	1,091	1,221	894	962	762	–	–	–	–
Chief Executive Officer single figure of remuneration (£000)	–	–	–	–	–	–	1,119	1,318	1,153	1,408
Annual bonus payout (% of maximum)	91.79	94.69	72.87	47.00	67.56	68.20	83.98	84.05	87.00	91.00
LTIP vesting (% of maximum)[iii]	67.30	50.00	79.30	50.00	30.20	0.00	37.90	20.40	0.00	44.00[iii]

(i) Group Chief Executive Officer for the year, including remuneration received between 1 April 2015 and 31 December 2015 when in position as Chief Executive of South West Water.

(ii) The long-term incentive plan (LTIP) vesting percentage excludes accrued dividends which are added on vesting.

(iii) The LTIP vesting percentage is an estimate as at 20 May 2019.

Comparison of Chief Executive Officer remuneration to employee remuneration

The table below shows the percentage change between 2017/18 and 2018/19 in base salary, benefits and annual bonus for the Chief Executive Officer, and all employees.

	Percentage change in salary	Percentage change in benefits	Percentage change in annual bonus
Chief Executive Officer remuneration	1.9%	13.3%	6.7%
All employees	4.5%	2.2%	5.7%

The percentage increase in average remuneration for employees is calculated using wages and salaries (excluding share-based payments) of £184.3 million (2017/18 £170.6 million), analysed into the three components in the table and the average number of employees of 5,306 (2017/18 5,014) both as detailed in note 13 to the Group financial statements.

Annual report on remuneration
continued

Relative importance of spend on pay

	2018/19 (£ million)	2017/18 (£ million)	Percentage change
Overall expenditure on pay[i]	**205.8**	192.9	6.7
Distributions to ordinary shareholders	**162.0**	149.5	8.4
Distributions to perpetual capital security holders	**8.6**	25.3	(66.0)
Purchase of property, plant and equipment (cash flow)	**356.0**	390.6	(8.9)

(i) Excludes non-underlying items.

The above table illustrates the relative importance of spend on pay compared with distributions to equity holders. The purchase of property, plant and equipment (cash flow) has also been included as this was the most significant outgoing for the Company in the past financial year.

Share awards and shareholding disclosures (audited information)

Share awards granted during 2018/19

The table below sets out details of share awards made in the year to Executive Directors.

Executive Director	Type of interest	Basis of award	Face value £000	Percentage vesting at threshold performance	Performance/restricted period end date
Chris Loughlin	LTIP	150% of salary	792	25% of maximum	1 July 2021
Susan Davy			606		
Chris Loughlin	Deferred bonus	50% of bonus awarded	225	n/a	24 July 2021
Susan Davy			173		

LTIP awards were calculated using the share price of £7.9012 being the average closing price over the five dealing days preceding the date of grant, which was 2 July 2018. LTIP awards are also subject to an additional two-year holding period. Deferred bonus awards were calculated using the average share price at which shares were purchased on the market on 25 July 2018 in order to satisfy the award, which was £7.6136.

Directors' shareholding and interest in shares

The Remuneration Committee believes that the interests of Executive Directors and senior management should be closely aligned with the interests of shareholders.

To support this the Committee operates shareholding guidelines, which from 2017/18 more significantly increased from 100% to 200% of salary for both the Chief Executive Officer and Chief Financial Officer. This may be built up over a period of no more than five years. Once obtained, the shareholding is then expected to be maintained by each Director and is revalued each year in accordance with the then prevailing share price and the Executive Director's salary.

Interests in share awards following departure enable departing Directors to remain aligned with the interests of shareholders for an extended period after leaving the Company. Deferred bonus and LTIP awards subject to a holding period will normally vest (and be released from their holding periods) at the normal time. This means that Directors may retain a significant interest in shares following departure from the Company. The Remuneration Committee intends to further review the Company's arrangements for alignment with shareholders post-cessation of employment as part of the review of the Remuneration Policy that will take place prior to the 2020 AGM.

The beneficial interests of the Executive Directors in the ordinary shares (40.7p each) of the Company as at 31 March 2019 and 31 March 2018 together with their shareholding guideline obligation and interest are shown in the table below:

					Unvested awards		
	Share interests (including connected parties) at 31 March 2019	Share interests (including connected parties) at 31 March 2018	Shareholding guideline	Shareholding guideline met?	Performance shares (subject to performance conditions)	SAYE	Deferred bonus shares
Chris Loughlin	**359,265**	324,935	200%	Yes	252,406	2,196	74,838
Susan Davy	**71,844**	63,658	200%	No	193,016	2,834	55,773

Since 31 March 2019, 7,588 additional ordinary shares in the Company have been acquired by Chris Loughlin as a result of participation in the Company's Dividend Reinvestment Plan (DRIP) and the Company's Share Incentive Plan; and 91 additional ordinary shares in the Company have been acquired by Susan Davy as a result of participation in the Company's Share Incentive Plan. There have been no other changes in the beneficial interests or the non-beneficial interests of the above Directors in the ordinary shares of the Company between 1 April 2019 and 29 May 2019.

Non-Executive Directors' shareholding

The beneficial interests of the Non-Executive Directors, including the beneficial interests of their spouses, civil partners, children and stepchildren, in the ordinary shares (40.7p) of the Company are shown in the table below:

Director	Shares held at 31 March 2019	Shares held at 31 March 2018
Sir John Parker	**27,027**	27,027
Neil Cooper	**–**	–
Iain Evans	**–**	–
Gill Rider	**2,500**	2,500

There have been no changes in the beneficial interests or the non-beneficial interests of the above Directors in the ordinary shares of the Company between 1 April 2019 and 29 May 2019.

There is no formal shareholding guideline for the Non-Executive Directors; however, they are encouraged to purchase shares in the Company.

Shareholder dilution

The Company can satisfy awards under its share plans with new issue shares or shares issued from treasury up to a maximum of 10% of its issued share capital in a rolling 10-year period to employees under its share plans. Within this 10% limit the Company can only issue (as newly issued shares or from treasury) 5% of its issued share capital to satisfy awards under discretionary or executive plans. The percentage of shares awarded within these guidelines and the headroom remaining available as at 29 May 2019 is as set out below:

	Awarded	Headroom	Total
Discretionary schemes	1.53%	3.47%	5%
All schemes	4.01%	5.99%	10%

Details of share awards

(a) 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 (of nominal value of 40.7p each) of the Company shown below, representing the maximum number of shares to which they would become entitled under the plan should the relevant criteria be met in full:

Director and date of award	Conditional awards held at 1 April 2018	Conditional awards made in year	Market price upon award in year	Lapsed in year[i]	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2019	Date of end of period for qualifying conditions to be fulfilled	Expected date of release[ii]
Chris Loughlin								
01/07/15	49,352	–	810.50p	49,352	–	–	–	–
01/07/16	55,434	–	920.00p	–	–	55,434	30/06/19	30/06/21
25/08/17	96,733	–	802.70p	–	–	96,733	24/08/20	24/08/22
02/07/18	–	100,239	790.12p	–	–	100,239	01/07/21	01/07/23
Susan Davy								
01/07/15	40,098	–	810.50p	40,098	–	–	–	–
01/07/16	42,391	–	920.00p	–	–	42,391	30/06/19	30/06/21
25/08/17	73,972	–	802.70p	–	–	73,972	24/08/20	24/08/22
02/07/18	–	76,653	790.12p	–	–	76,653	01/07/21	01/07/23

(i) All of the 2015 share awards lapsed in 2018 as a consequence of not meeting the performance criteria.

(ii) Awards granted from 2015 onwards are subject to a two-year holding period following vesting.

Annual report on remuneration
continued

(b) Annual Incentive Bonus Plan – deferred bonus shares (long-term incentive element)

The following Directors had or 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 have or 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 2018	Conditional awards made in year	Market price of each share upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2019	Date of end of period for qualifying conditions to be fulfilled
Chris Loughlin							
27/07/15	19,124	–	791.00p	19,124(i)	142	–	26/07/18
04/07/16	18,759	–	950.14p	–	–	18,759	03/07/19
30/08/17	26,504	–	808.691p	–	–	26,504	29/08/20
25/07/18	–	29,575	761.36p	–	–	29,575	24/07/21
Susan Davy							
27/07/15	9,809	–	791.00p	9,809(i)	73	–	26/07/18
04/07/16	12,524	–	950.14p	–	–	12,524	03/07/19
30/08/17	20,503	–	808.691p	–	–	20,503	29/08/20
25/07/18	–	22,746	761.36p	–	–	22,746	24/07/21

(i) These shares were released on 3 August 2018 at 740.08p per share.

During the year the Directors received dividends on the above shares in accordance with the conditions of the bonus plan as follows: Chris Loughlin £24,847*; Susan Davy £16,530.

* Chris Loughlin received his dividend in the form of ordinary shares (40.7p each) in the Company as a result of participation in the Company's dividend reinvestment plan. These shares are included in the figure given for the additional ordinary shares (40.7p each) in the Company that he acquired since 31 March 2018 given on page 102.

(c) Sharesave scheme

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

Date of award	Options held at 1 April 2018	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 2019	Options held at 31 March 2019	Exercise period/ maturity date
Chris Loughlin								
03/07/13	2,788	–	2,788	538.00p	739.80p	–	–	–
24/06/15	2,196	–	–	683.00p	–	743.60p	2,196	01/09/20 – 28/02/21
Susan Davy								
24/06/15	2,635	–	2,635	683.00p	698.80p	–	–	–
03/07/18	–	2,834	–	635.00p	–	743.60p	2,834	01/09/21 – 28/02/22

The Remuneration Committee and its advisers

Gill Rider and Neil Cooper were members of the Committee throughout the year. Martin Angle stepped down from the Committee on 31 December 2018. Iain Evans was appointed to the Committee on 1 September 2018.

During the year the Committee received advice or services which materially assisted the Committee in the consideration of remuneration matters from Sir John Parker (Chairman of the Board), Adele Barker (Group Director of Human Resources) and from Deloitte LLP.

During the year Deloitte LLP was reappointed directly by the Committee, with a refreshed advisory team, following a comprehensive retendering process. Deloitte LLP's fees in respect of advice which materially assisted the Committee during 2018/19 were £41,680 (arrived at from an hourly rate basis of charging). During the year, Deloitte LLP also provided tax and risk advisory services to the Group. Deloitte LLP is a member of the Remuneration Consultants Group and as such voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. The Committee is satisfied that the advice it has received from Deloitte LLP has been objective and independent.

Statement of voting at general meeting

The table below sets out the voting by the Company's shareholders on the resolutions to approve the Directors' remuneration report at the 2018 AGM and the remuneration policy at the 2017 AGM, including votes for, against and withheld.

Annual report on remuneration (2018 AGM)	
For % (including votes at the Chairman's discretion)	99.78
Against %	0.22
Withheld number	2,071,068
Remuneration policy (2017 AGM)	
For % (including votes at the Chairman's discretion)	97.92
Against %	2.08
Withheld number	237,155

A vote withheld is not counted in the calculation of the proportion of votes for and against a resolution.

Directors' remuneration report compliance

This Directors' remuneration report has been prepared in accordance with the provisions of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. It also complies with the requirements of the Financial Conduct Authority's Listing Rules and the Disclosure and Transparency Rules. The UK Corporate Governance Code also sets out principles of good governance relating to directors' remuneration, and this report describes how these principles are applied in practice. The Committee confirms that throughout the financial year the Company has complied with these governance rules and best practice provisions. The above regulations also require the external auditor to report to shareholders on the audited information within the annual report on remuneration which is part of the Directors' remuneration report. The external auditor is obliged to state whether, in its opinion, the relevant sections have been prepared in accordance with the Companies Act 2006. The external auditor's opinion is set out on page 112 and the audited sections of the annual report on remuneration are identified in this report.

On behalf of the Board

Gill Rider
Chairman of the Remuneration Committee

29 May 2019

Directors' report – other statutory disclosures

Introduction

This Directors' report is prepared in accordance with the provisions of the Companies Act 2006 and regulations made thereunder. It comprises pages 74 to 91 and 106 to 109 as well as the following matters which the Board considers are of strategic importance and, as permitted by legislation, has chosen to include in the strategic report rather than the Directors' report:

- Risk management systems (pages 58 to 62 of the strategic report)
- Likely future developments of the Company (pages 28 and 29 of the strategic report)
- Certain employee matters (pages 32 to 35 of the strategic report), as well as the disclosures below.

In addition, there are a number of disclosures which are included in the Directors' report by reference, including:

- Financial risk management (note 3 of the notes to the financial statements)
- Financial instruments (pages 50 to 57 of the strategic report and notes 2(o) and 18 of the notes to the financial statements).

Board of Directors

The Directors in office as at the date of this report are named on pages 76 and 77. In addition, Martin Angle, an Independent Non-Executive Director, served during the year until he stepped down from the Board on 31 December 2018.

Financial results and dividend

The Directors recommend a final dividend of 28.22 pence per ordinary share to be paid on 3 September 2019 to shareholders on the register on 26 July 2019, making a total dividend for the year of 41.06 pence, the cost of which will be £173 million, resulting in a transfer to reserves of £ 41 million. The strategic report on pages 50 to 57 analyses the Group's financial results in more detail and sets out other financial information.

Directors' insurance and indemnities

The Directors have the benefit of the indemnity provisions contained in the Company's Articles of Association (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 that comply with the requirements of the Companies Act 2006 and which were in force throughout the year and remain in force.

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.

The Group has policies in place covering health and safety, equal opportunities, diversity and inclusion, ethics and employee relations. In addition, the Board has a diversity policy details of which are set out in the report of the Nomination Committee on page 90. Information regarding the diversity of the workforce is provided on page 32 to 35.

Pennon respects the right to freedom of association and employees are consulted regularly about changes which may affect them either through their trade union-appointed representatives or consultation groups or by means of their elected representatives at the Employee Engagement Forum which operates in South West Water and the Employee Voice Forum which operates in Viridor. These forums, together with regular meetings with particular groups of employees, are used to ensure that employees are kept up to date with the business performance of their employer and the financial and economic factors affecting the performance of the Group. The Group also cascades information monthly to all employees to provide them with important and up-to-date information about key events and to obtain feedback from them. Further information about workforce engagement and employment matters relating to the Group is set out on pages 32 to 35 of the strategic report.

The Group encourages share ownership among its employees by operating an HM Revenue & Customs approved Sharesave scheme and Share Incentive Plan. Following shareholder approval at the 2014 AGM, these were amended to provide for the increased savings limits approved by the Government. At 31 March 2019, around 38% (2018 38%) of the Group's employees were participating in these plans.

Greenhouse gas emissions

Methodology and approach

We have followed the Government's updated Environmental Reporting Guidelines: including streamlined energy and carbon reporting guidance (January 2019). In calculating our emissions, we have used the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard (revised edition) and the 2018 web-based conversion factors provided by the Government's Department for Business, Energy & Industrial Strategy.

Streamlined energy and carbon reporting

The new Streamlined Energy and Carbon Reporting (SECR) regulations require all large UK companies to begin reporting using their 2019/20 data in their 2020 annual reports. To provide greater transparency on our greenhouse gas (GHG) emissions and allow the Group to assess compliance in readiness for 2019/20 we have decided to report our 2018/19 GHG emissions in accordance with SECR Guidance in advance of the regulatory requirement.

Organisational boundary

The emissions listed here cover the Pennon Group of companies, each of which uses the financial control approach, except where Viridor uses an equity share approach where a joint venture exists. This means that emissions from joint venture operations can be accurately attributed to the company in proportion to the percentage of Viridor's holding. The remaining companies in the Group continue to use the financial control approach. This is the conventional method for parent companies and subsidiaries within a group that have the ability to direct financial and operating policies and retain the majority of the organisation's risk and rewards.

Operational scopes

We have measured our Scope 1, 2 and certain Scope 3 emissions where information is available

Market and location based methodology

The Greenhouse Gas Protocol allows for the reporting of both 'market-based' and 'location-based' Scope 2 emissions from imported energy. We supplement our self-generation of renewable/low carbon energy by contracting with third party renewable energy suppliers where appropriate. We ensure this supply is backed by Renewable Energy Guarantees of Origin (REGOs) and retire these REGOs allowing the contracted green tariff supply to qualify as zero carbon 'market-based' emissions. We have chosen to report our market-based emissions separately from the location-based supply and this is set out in our Group GHG emissions table opposite.

Base year

For GHG reporting we always compare current financial against the previous financial year performance. As part of the new Pennon Sustainability Strategy, we are reviewing an appropriate baseline for longer-term targets

Targets

For our water business, as part of our latest business plan, we have set a new medium term GHG emissions target of 130,000 tCO2e by 2025. As part of the new Pennon sustainability strategy, the Group GHG emissions targets including for our waste business are currently under review.

Intensity measurement

We are reporting an intensity measure of Scope 1 and 2 gross emissions in tCO2e per £100,000 revenue.

Self-generated renewable energy export

Pennon Group self-generates more electricity than it uses and most of this power is exported to the grid as renewable/low carbon electricity. This self-generated renewable energy export reduces our overall net emissions since under the GHG Protocol accounting methodology it offsets Scope 2 emissions up to the total amount of electricity purchased and consumed by the organisation. Since our self-generated export is many times our imported volume our Scope 2 emissions are completely removed from our net emissions.

External assurance statement

Our GHG emissions data has been independently assured by DNV GL. Certain aspects that relate to the disclosures of South West Water and Bournemouth Water's emissions have been subject to an independent audit of regulatory data conducted by Jacobs. The assumptions, methods and procedures that are followed in the development of the reported data have been tested and the data audited for accuracy and consistency. DNV GL's statement and the Pennon Sustainability Indicator definitions document can be found on the Pennon website **www.pennon-group.co.uk/sustainability**.

Pennon Group plc greenhouse gas emissions (tCO_2e)

	2018/19 (Market Based)	2018/19 (Location Based)	2017/18
Scope 1	**1,572,996**	**1,572,996**	1,797,147
Scope 2	**100,472**	**101,661**	123,665
Scope 3	**60,547**	**60,547**	65,185
Total gross emissions	**1,734,015**	**1,735,204**	1,985,997
REGO-backed renewable electricity import via private wire	**Included in Scope 2 above**	**(1,190)**	(1,738)
Exported renewable energy reduction (up to total amount of electricity purchased and consumed by organisation)	**(100,472)**	**(100,472)**	(125,403)
Total annual net emissions	**1,633,543**	**1,633,543**	1,858,857
Biogenic emissions outside of scopes	**1,588,882**	**1,588,882**	1,520,021
Intensity measure: tCO_2e (gross Scope 1+2/£100,000 revenue)	**113.2**	**113.2**	137.6

Previous year's intensity measure was based on underlying revenue as opposed to the statutory revenue figure which was slightly different in 2017/18. For consistency with our standard communications on Group revenue, which use the statutory revenue figure, the intensity measure is expressed based on the statutory revenue figure. Previous year's figure (137.9) has been updated in the table using the statutory measure.

Scope 1 (direct emissions) Activities owned or controlled by our organisation that release emissions straight into the atmosphere. For Pennon, key Scope 1 emission sources include combustion related emissions from energy recycling facilities, fugitive emissions from landfill, emissions from stationary plant, fugitive emissions from air conditioning plant and transport related emissions from our own vehicles and fleet.

Scope 2 (indirect emissions) Emissions released into the atmosphere associated with our consumption of purchased electricity, heat, steam and cooling. These Emissions released into the atmosphere associated with our consumption of imported electricity.

Scope 3 (other indirect emissions) Emissions that are a consequence of our actions, which occur at sources which we do not own or control. For Pennon, such Scope 3 emission sources include business travel, Well to Tank emissions and some embodied carbon emissions associated with purchased goods where data is available.

Pennon Group plc greenhouse gas emissions by business

	Waste (Viridor)	Water (South West Water and Bournemouth Water)
Scope 1	1,554,916	18,080
Scope 2	15,915	84,557
Scope 3	22,743	37,804
Total gross emissions (market based)	**1,593,574**	**140,440**

Note: The water business figure provided here includes the impact of emissions from our two hydroelectric power stations which do not form part of our annual reporting to the water regulator Ofwat since these sites are outside of the Ofwat regulated contract.

Change in emissions

Gross GHG emissions for the Group reduced by 12.7%. For Viridor this was primarily as a result of reduced landfill emissions, improved data methods at sites as well as a change in the ownership status of Viridor Manchester sites which takes them out of reporting boundaries.

All Group companies benefited from a continued reduction in the UK's average electricity grid emissions conversion factor, which fell by 20% from 0.38443 to 0.3072 kgCO2e/kWh over the reporting period. This resulted in a reduction in the Group's overall Scope 2 emissions and has helped both SWW and Bournemouth Water to reduce their overall carbon footprint by around 11%.

The intensity metric has decreased from 138 to 113 tCO2e/£100,000 turnover. This reflects both a reduction in overall Scope 1 and 2 emissions, as described above, alongside an increase in turnover compared to 2017/18.

Further information on our GHG emissions can be found in our CDP climate change disclosure available on the CDP website.

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Energy efficiency action taken

Both South West Water and Viridor are accredited to the ISO50001 energy management system standard. A summary of key improvement activities undertaken in 2018/19 is provided below.

South West Water

Pumping represents around 80% of South West Water's energy consumption and so we've continued to invest in energy efficiency projects under our Pump Efficiency Programme. We also funded energy efficiency projects under our PowerDown Programme.

Projects completed during 2018/19 include energy analysis of system performance at Penzance STW which revealed over-sized pumps. Smaller pumps were installed which will deliver expected annual energy savings of £23,000. Elsewhere, pump refurbishment at Ilsham Valley pumping station will save £65,000, while installation of variable speed drives at Pynes Hill WTW will save £13,000.

Directors' report – Other statutory disclosures
continued

Energy
Our water business uses 351GWh of energy while our waste business uses 357GWh of energy. A breakdown of Group energy usage is shown below.

Energy usage (MWh)

	2018/19
Imported grid electricity	355,026
Imported private wire electricity (renewable)	4,202
Self-supplied renewable electricity	11,982
Self-supplied heat	7,524
Natural gas	13,255
Liquid fuels (for stationary applications)	83,925
Energy used by fleet transport, hire cars and private mileage	232,822
Total energy usage	**708,738**
Intensity measure: MWh/£100,000 revenue	47.9

No heat, steam and cooling was purchased by any Group company in 2018/19.

Viridor
To support energy management across the Viridor business, 18 energy champions (one at each major energy using site) achieved BSI energy efficiency training in 2018/19. After the installation at our Sheffield facility in 2018/19, most sites have now upgraded their lighting to LED, reducing the energy requirement for lighting by up to 91%.

Viridor trialled the use of submetering at Rochester plastics recycling facility (PRF), during the year. The increased visibility of the PRF process's energy consumption highlighted inefficiencies facilitating energy savings, while at the same time increasing plant availability. As a result, submetering projects are progressing for other high energy consuming sites (Skelmersdale PRF, Crayford materials recycling facility (MRF), Ford MRF). Further site-based energy surveys were conducted at various sites around the company in 2018/19 to identify energy saving opportunities.

Human rights and anti-slavery
The Group is fully supportive of the principles set out in the UN Declaration of Human Rights, and the Group's Code of Conduct outlines the high standards of employment practice with which everyone in Pennon Group is expected to comply. The Group also supports the International Labour Organization's core conventions for the protection and safety of workforces wherever they may be throughout the Group.

The Group's commitment to ensuring the human rights of its employees are not infringed extends to those of its suppliers. Supplier codes of conduct are in place to ensure that people are treated fairly and with respect and dignity.

In addition, we have in place policies and procedures to assess, monitor and reduce the risk of forced labour and human trafficking occurring in our businesses and supply chains. Risk assessments of any high risk supply partners have been completed by Viridor, South West Water and Bournemouth Water to ensure compliance with the Modern Slavery Act across the Group and our anti-slavery and human trafficking web-based statement for the year is available at **www.pennon-group.co.uk**.

Research and development
Research and development within the Group involving water and waste treatment processes amounted to £0.2 million during the year (2017/18 £0.1 million).

Overseas branches
The Company has no overseas branches.

Pennon Group donations
During 2018/19, the Group provided a total of £197,000 in charitable donations (2017/18 £151,000).

No political donations were made or political expenditure incurred and no contributions were made to a non-EU political party (2017/18 nil).

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 (AGM) in 2018), which was valid as at 31 March 2019 and remains currently valid. No purchases were made during the year. As at 1 April 2018, 8,443 shares were held in treasury, with a nominal value of £3,436 and representing 0.002% of issued share capital. No treasury shares were reissued during the year.

Disclosures required by publicly traded companies
The following disclosures are made pursuant to Part 6 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and Rule 7.2.6.R of the UK Listing Authority's Disclosure and Transparency Rules (DTR).

As at 31 March 2019:

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 33 to the financial statements on page 162. 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, 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;

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 Conduct Authority's Listing Rules or the City Code on Takeovers and Mergers. There are no persons with special rights regarding control of the Company. No shares issued under the employee share schemes have rights with regard to control of the Company that are not exercisable directly by the employees;

c) Details of significant direct or indirect holdings of securities of the Company are set out in the shareholder analysis on page 178. The Company is not aware of any agreements between shareholders which may result in restrictions on the transfer of securities or on voting rights;

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 above. The Directors also have the authority to allot shares up to an aggregate nominal value of:

   (i) £56,944,013 (such amount to be reduced by any shares allotted or rights granted under (ii) below in excess of £56,944,013); and

   (ii) £113,888,026 by way of a rights issue (such amount to be reduced by any shares allotted or rights granted from (i) above), which was approved by shareholders at the 2018 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;

f) There are a number of agreements that take effect, alter or terminate upon a change of control of the Company following a takeover bid, such as bank loan agreements, Eurobond documentation, hybrid capital securities documentation, private placement debt and employees' share plans. This may result in certain funding agreements being altered or repaid early. The impact on employees' share plans is not considered significant; and

g) There are no agreements between the Company and its Directors or employees providing for compensation for loss of office or employment that occurs because of a takeover bid.

There is no information to be disclosed under Listing Rule (LR) 9.8.4R. The Company has no long-term incentive arrangements in place under LR 9.4.2R (2) where the only participant is a Director and the arrangement is established specifically to facilitate, in unusual circumstances, the recruitment or retention of the individual.

Going concern
Having considered the Group's funding position and financial projections, the Directors have a reasonable expectation that the Group has adequate resource 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.

Statement of Directors' responsibilities
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 (EU).

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 EU 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' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the International Accounting Standards 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 76 and 77, confirms that, to the best of his or her knowledge:

i) The financial statements, which have been prepared in accordance with IFRSs 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.

ii) The strategic report (pages 1 to 71) and the Directors' report, include a fair review of the development and performance of the business during the year and the position of the Company and the Group at the year end, together with a description of the principal risks and uncertainties they face.

iii) Following receipt of advice from the Audit Committee, the annual report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the shareholders to assess the Group's position and performance, business model and strategy.

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

Statement as to disclosure of information to the auditor
i) 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 auditor is unaware; and

ii) Each of the Directors has taken all the steps each Director ought to have taken individually as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

The Directors' report consisting of pages 74 to 91 and 106 to 109 was approved by the Board on 29 May 2019.

By order of the Board

Simon A F Pugsley

Group General Counsel and Company Secretary

29 May 2019

We aim to demonstrate environmental leadership via our carbon reduction and energy efficiency programmes, and by embedding our pollution prevention and compliance culture across our business.

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Environmental leadership

Our energy producing facilities are already set up with grid connections so we do all that we can to squeeze as much energy out as possible. That's why we've installed solar panels on many of our facilities and Head Office and created a solar farm at our closed landfill in Wiltshire.

We are also creating energy parks at some of our energy recovery facilities that allow us to generate decentralised energy for consumption locally without the need for the national grid.

We will continue to investigate opportunities to utilise solar energy and other energy generating technologies where it can bring economic and environmental benefit.

Sustainability focus area

See sustainability strategy on page 11

Independent auditor's report to the members of Pennon Group plc

Opinion

In our opinion:

- Pennon Group plc's group financial statements and parent company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2019 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union 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.

We have audited the financial statements of Pennon Group plc which comprise:

Group	Parent company
Consolidated Balance sheet as at 31 March 2019	Balance sheet as at 31 March 2019
Consolidated income statement for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of comprehensive income for the year then ended	Cash flow statement for the year then ended
Consolidated statement of changes in equity for the year then ended	Related notes 1 to 44 to the financial statements, including a summary of significant accounting policies
Consolidated cash flow statement for the year then ended statement	
Related notes 1 to 44 to the financial statements, including a summary of significant accounting policies	

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.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs(UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 58 to 68 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 58 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 109 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 69 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• Revenue recognition across the Group's operations • Valuation of landfill related provisions (Viridor) • Valuation of the provision for doubtful debts (SWW) • Contract claims (Viridor)
Audit scope	• We performed an audit of the complete financial information of three components and audit procedures on specific balances for one component. • The components where we performed full or specific audit procedures accounted for 100% of Profit before taxation before non-underlying items, 100% of Revenue and 95% of Total assets.
Materiality	• Overall group materiality of £14.0 million which represents 5% of Profit before taxation before non-underlying items.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Revenue recognition across the Group's operations (£1,478.2 million, PY comparative £1,396.2 million) **Risk direction** *Refer to the Audit Committee Report (page 83); Accounting policies (page 123); and Note 4 of the Consolidated Financial Statements (page 134)* The Group's material revenue streams relate to the provision of water and sewerage services by South West Water and Pennon Water Services and revenue generated from the renewable energy, recycling and waste management services provided by Viridor. ISAs (UK & Ireland) presume there is a risk of fraud relating to revenue recognition. For the Group, given targets associated with financial performance and pressures to meet market expectations, there is an incentive to overstate revenue. This risk over revenue recognition specifically arises in the following judgemental areas, where there is opportunity to overstate revenue: **South West Water and Pennon Water Services** Income from measured water services requires an estimation of the amount of unbilled charges at the year end. This is calculated using a combination of system generated information, based on previous customer volume usage, together with management judgement as to the likely impact on usage of factors such as recent weather patterns. The accrued income balance at 31 March 2019 is £89.8 million (2018: £70.3 million) for South West Water and £29.1 million (2018: £20.2 million) for Pennon Water Services. **Viridor** Calculations of accrued income on waste management contracts and powergen revenue to be received involve estimation by management. The accrued income balance at 31 March 2019 is £54.7 million (2018: £53.4 million). Accounting for revenue from long term service concession arrangements under IFRIC12 requires revenue to be recognised on construction, during service delivery and as a capital return on the asset. The determination of the margin allocated during the different phases of each service concession involves management judgement. At 31 March 2019 the Group has recognised contract receivables of £188.3. million (2018: £234.1 million) and other intangible assets of £90.6 million (2018: £69.2 million), related to service concession arrangements (refer to Note 16 and 19).	Our procedures include: **South West Water and Pennon Water Services** • We obtained an understanding of the process for the supply of measured services, meter reading and related billing in order to evaluate whether expected adjustments have been made to the accrual or deferral of revenue • We tested key controls linked to system generated information and around the estimation process for measured revenue • We compared the accrued income to bills raised post year end for a sample of customers, and compared management's history of estimating the accrued income balance to bills raised in the subsequent year to assess the accuracy of the accrued income balance • We corroborated the key assumptions and estimates made by management in recognising revenue, by obtaining internal and external data on factors that influence demand from customers, such as weather patterns and leaks in infrastructure networks, together with information on 'water into supply' • For a sample of contracts, we tested whether contract terms and conditions were met, and revenue recognised at the correct time in accordance with IFRS 15 • We performed analytical procedures by comparing revenue balances for the year against expectation and obtaining support for significant variances • We tested a sample of transactions to underlying bills • In performing our journal testing, we paid increased attention to entries impacting revenue, focusing on non-system postings and those raised in the last two weeks of the year. **Viridor** • We compared the key assumptions and estimates made by management in recognising accrued revenue in the current year to those applied in the prior year to identify significant changes • We analysed revenue trends, compared to prior year, and corroborated accrued income balances to third party support, including published rates and tariffs • We obtained customer confirmations for a sample of revenue • For material items, within accrued income, we reperformed the calculation of the income that had been earned on waste management contracts and powergen revenue to confirm the accuracy of the accrued income recorded by management • We tested the application of the IFRIC12 revenue recognised and assessed the allocation of consideration between the construction and operating services provided • We agreed whether the revenue recognition policies adopted comply with IFRS 15 and with the requirements of IFRIC 12. In particular, we tested that the margins used to recognise revenue are appropriate, through testing that costs were allocated to the correct contracts and that revenue recognised, based on those costs, is reasonable and aligned with the individual contract models. We also compared the margins to those generated in prior years and to the latest projections for future years • In performing our journal testing, we paid increased attention to entries impacting revenue, particularly those raised close to the balance sheet date. We performed full and specific scope audit procedures over this risk area for three components, which covered 100% of the risk amount.	**South West Water and Pennon Water Services** We concluded that the estimation process undertaken by management to calculate the measured income accrual reflects latest operational factors in the key assumptions and results in an acceptable income accrual. **Viridor** We concluded that accrued income has been appropriately recognised, and IFRIC 12 appropriately applied.
Valuation of landfill related provisions (Viridor) (£209.6 million, PY comparative £191.9 million) **Risk direction** *Refer to the Audit Committee Report (page 83); Accounting policies (page 123); and Note 4 of the Consolidated Financial Statements (page 133)* Landfill related provisions of £209.6 million (2018: £191.9 million) are disclosed in note 32 and consist of aftercare, restoration and remediation provisions. Calculation of the aftercare provision involves significant judgement in respect of the expected period of aftercare, the level of costs to be incurred and the discount rate to be used. Key areas of estimation for the restoration provision include the expected restoration costs, the void space to be filled and timing of site closure. Judgement over the remedial action required to comply with current environmental legislation, where breaches have been identified, is a key estimate for the remediation provision. We focused on this area given there is a risk that provisions could be misstated due to the complexity of factors to be assessed and assumptions, such as discount rates, applied by management being inappropriate, including the impact of any management bias.	Our procedures include: • We tested the aftercare, restoration and remediation provision models, and verified that the models are arithmetically accurate • We evaluated the forecast costs in the models, agreeing these to supporting evidence such as budgets and supplier cost quotations and current performance, including prices charged by contractors in current year for significant sites • We assessed the material estimates made for evidence of management bias, including agreeing anticipated cost savings to detailed plans and current performance • We benchmarked the discount and inflation rates applied, using our internal valuation experts to assist in our review of whether management's assumptions are within an acceptable range based on comparative market data • We compared the key assumptions used in the calculation of the provisions, including the discount rates, inflation rates, void space and remaining lives of the sites, to available market information • We compared the key assumptions used in the current models to those used in the prior year, and obtained evidence to corroborate that changes were appropriate. This included obtaining evidence to support the impact of future planned technological changes • We performed sensitivity analysis on these key assumptions • We tested the appropriateness of journal entries impacting landfill related provisions, particularly those raised close to the balance sheet date. We performed full scope audit procedures over this risk area at Viridor, which covered 100% of the risk amount.	We concluded that management's real risk free rate of 2.325% applied to the most significant provision (aftercare) is within an acceptable range (1.94% to 2.329%). Our range was calculated using average yields on 30 year index linked UK government bonds and adjusting for quantitative easing and duration premiums. We consider key assumptions supporting the landfill related provisions reflect management's best estimates, informed by latest external and internal data, resulting in an acceptable provision balance.

Independent auditor's report to the members of Pennon Group plc
continued

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Valuation of the provision for doubtful debts (South West Water) (£86.8 million, PY comparative £88.5 million) **Risk direction** *Refer to the Audit Committee Report (page 83); Accounting policies (page 123); and included within the total Group balance per Note 22 of the Consolidated Financial Statements (page 151)* The South West Water provision of £86.8 million (2018: £88.5 million) is calculated using a combination of system generated information on historic debt recovery rates and management's judgement of the future likely recovery rates. Under the new revenue recognition criteria, revenue should be recognised only when it is probable that the company will collect the consideration to which it is entitled in exchange for services that will be transferred to the customer. There is a risk that the assumptions used by management in calculating the bad debt provision may be susceptible to management bias and the valuation of the provision against trade receivables may be misstated. We have therefore focused on this key audit matter.	Our procedures include: • We performed a walkthrough of the process for calculating the bad debt provision and assessed the design effectiveness of key controls • We tested the operating effectiveness of key controls over the integrity of data and the report utilised to generate the ageing and categorisation of debt within South West Water's billing system • We tested historic data on collection rates and evaluated how this data was used in the preparation of the bad debt provision • We obtained an understanding of management's consideration of the new standard (IFRS 9 Financial Instruments) and its impact on the bad debt allowance calculation • We obtained an understanding of management's consideration of the new revenue standard (IFRS 15) and its impact on revenue recognition and the bad debt allowance • We corroborated the assumptions used by management in determining the amounts provided against the different categories and age of debt, by comparing these assumptions to historic collection rates and by considering the impact of changes in the methods adopted operationally by management to collect debt, and in the external environment • We utilised collection information over the past three years, to determine a range of the likely ultimate collection of debts existing at the balance sheet date and compared this to the provision recorded by management, including assessing assumptions for evidence of management bias • We tested the appropriateness of journal entries and adjustments impacting the doubtful debt provision, particularly those raised close to the balance sheet date. We performed full scope audit procedures over this risk area at South West Water, which covered 100% of the risk amount.	We concluded that the doubtful debt provision is within an acceptable range (£84.3 million to £92.6 million) and reflects recent history of collection of outstanding debts.
Contract claims (Viridor) **Risk direction** *Refer to the Audit Committee Report (page 83); Accounting policies (page 123); and Note 4 of the Consolidated Financial Statements (page 134)* Viridor was contracted by Glasgow City Council to construct a Recycling and Renewable Energy Centre in Glasgow. Viridor terminated the contract with the original principal contractor, Interserve Construction Limited (Interserve), in November 2016 and has overseen the remaining construction. The facility completed commissioning and became operational during the financial year. Expenditure to complete construction has exceeded the original target and management has accounted for what it believes its contractual rights are. Contract claims as at 31 March 2019 amounted to £72.0 million (2018: £68.7 million). Management has recognised a provision of £28.7 million (2018: £6.0 million), under IFRS 9, resulting in a net receivable recognised of £43.3 million (2018: £62.7 million). Where contract claims arise, the claims and the related accounting can be complex. We focused on this area given there is risk of challenge of the legal position taken and higher judgement involved in assessing the collectability of amounts recorded.	• We obtained an understanding of the key assumptions and estimates made by management in accounting for material claims, assessing for evidence of management bias and concluding on whether we concur with accounting estimates made by management • We obtained an update, from management and Group legal, to understand the latest position of material claims as at the year end date • We inspected legal advice management has obtained in relation to contract positions, quantum of costs and amounts recoverable • We inquired of management and assessed other evidence, including board minutes, agreement to monies spent and review of contracts, to test the completeness of amounts recorded in relation to contract claims • In respect of the Interserve claim, we inspected external data, including financial reports, market announcements, Administrators' statement of proposals, valuations of Interserve's business units and correspondence between Viridor and Interserve, to assess the recoverability of amounts due and whether the reserve recognised reflects an appropriate level of provision • We read the disclosures made by management in Note 4 'Critical accounting judgements and estimates' in the Annual Report and Accounts, and evaluated the adequacy of these. We performed full scope audit procedures over this risk area in one location, which covered 100% of the risk amount.	We concluded that the accounting position taken by management, including the recoverability of amounts due from Interserve, is appropriate and is based on supporting legal and financial analysis. We concluded that the disclosures on this key judgement, including the possible range of outcomes, in the Annual Report and Accounts are appropriate.

The key audit matters for the current year are consistent with matters included in our prior year auditor's report.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of group-wide controls, changes in the business environment and other factors such as recent Internal audit results when assessing the level of work to be performed at each entity.

In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements, of the six reporting components of the Group, we selected four components covering Pennon Group plc, Viridor, South West Water and Pennon Water Services, which represent the principal business units within the Group.

Of the four components selected, we performed an audit of the complete financial information of three components ("full scope components") which were selected based on their size or risk characteristics. For the remaining one component ("specific scope component"), we performed audit procedures on specific accounts within that component that we considered had the potential for the greatest impact on the significant accounts in the financial statements either because of the size of these accounts or their risk profile.

The reporting components where we performed audit procedures accounted for 100% (2018: 100%) of the Group's Profit before taxation before non-underlying items, 100% (2018: 100%) of the Group's Revenue and 95% (2018: 95%) of the Group's Total assets. For the current year, the full scope components contributed 100% (2018: 100%) of the Group's Profit before taxation before non-underlying items, 88% (2018: 88%) of the Group's Revenue and 95% (2018: 94%) of the Group's Total assets. The specific scope component contributed -0.6% (2018: -0.4%) of the Group's Profit before taxation before non-underlying items, 12% (2018: 12%) of the Group's Revenue and 1% (2018: 1%) of the Group's Total assets. The audit scope of these components may not have included testing of all significant accounts of the component but will have contributed to the coverage of significant accounts tested for the Group.

Of the remaining two components that together represent less than 1% of the Group's profit before taxation before non-underlying items, none are individually greater than 1% of the Group's profit before taxation before non-underlying items. For these components, we performed other procedures, including analytical review procedures, testing of consolidation journals and intercompany eliminations to respond to any potential risks of material misstatement to the Group financial statements

Involvement with component teams

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken at each of the components by us, as the primary audit engagement team, or by component auditors operating under our instruction. There are three key locations where we perform audit procedures for the Group and its components, being Exeter, Taunton and Bournemouth. The Pennon Group plc and South West Water accounting functions are based in Exeter and the audit teams of these components are led by the Senior Statutory Auditor. Separate teams audit full scope component, Viridor, in Taunton, and specific scope component, Pennon Water Services, based in Exeter and Bournemouth. Where the work was performed by component auditors, we determined the appropriate level of involvement to enable us to determine that sufficient audit evidence had been obtained as a basis for our opinion on the Group as a whole.

The primary team interacted regularly with the component teams where appropriate during various stages of the audit, reviewed key audit working papers on risk areas, attended key meetings with local management and were responsible for the scope and direction of the audit process. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £14.0 million (2018: £12.7 million), which is 5% (2018: 5%) of profit before taxation before non-underlying items. We believe that profit before taxation before non-underlying items provides us with an appropriate measure of the underlying performance of the Group. We excluded non-underlying items on the basis that profit before taxation after non-underlying items is not indicative of the underlying performance of the Group. We also note that market and analyst commentary on the performance of the Group uses the same measure. We therefore considered profit before taxation before non-underlying items to be the most relevant performance metric on which to base our materiality calculation.

We determined materiality for the Parent Company to be £7.8 million (2018: £7.3 million), which is 75% (2018: 75%) of Group performance materiality, which is a lower materiality than the amount determined on a stand alone basis.

Starting basis

Reported profit before taxation £260.3 million (2018: £262.9 million)

↓

Adjustments

Non-underlying items – decrease basis by £19.9 million (2018: £4.1 million decrease) (refer to note 6 of the Consolidated Financial Statements)

↓

Materiality

Totals £280.2 million (2018: £258.8 million) profit before taxation before non-underlying items.

Materiality of £14.0 million (5% of profit before taxation before non-underlying items)

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2018: 75%) of our planning materiality, namely £10.5 million (2018: £9.7 million). We have set performance materiality at this percentage based on our assessment of the Group's internal control environment and the extent and nature of audit findings identified in the prior period. This basis is consistent with the prior year.

Independent auditor's report to the members of Pennon Group plc
continued

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £3.2 million to £9.5 million (2018: £2.9 million to £9.0 million).

Reporting threshold
An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.7 million (2018: £0.7 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information
The other information comprises the information included in the annual report set out on pages 1 to 109, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- **Fair, balanced and understandable set out on page 109** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting set out on pages 83 to 86** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code set out on page 109** – the parts of the directors' statement required under the Listing Rules relating to the company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Opinions 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.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements and those reports have been prepared in accordance with applicable legal requirements;
- the information about internal control and risk management systems in relation to financial reporting processes and about share capital structures, given in compliance with rules 7.2.5 and 7.2.6 in the Disclosure Rules and Transparency Rules sourcebook made by the Financial Conduct Authority (the FCA Rules), is consistent with the financial statements and has been prepared in accordance with applicable legal requirements; and
- information about the company's corporate governance code and practices and about its administrative, management and supervisory bodies and their committees complies with rules 7.2.2, 7.2.3 and 7.2.7 of the FCA Rules.

Matters on which we are required to report by exception
In the light of the knowledge and understanding of the Group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in:

- the strategic report or the directors' report; or
- the information about internal control and risk management systems in relation to financial reporting processes and about share capital structures, given in compliance with rules 7.2.5 and 7.2.6 of the FCA Rules

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent 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.

Responsibilities of directors
As explained more fully in the directors' responsibilities statement set out on page 109, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud
The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the group and determined that the most significant are:
  - Companies Act 2006
  - Financial Reporting Council (FRC) and the UK Corporate Governance Code
  - Tax legislation (governed by HM Revenue & Customs)
  - Health and Safety legislation
  - Environment Agency environmental permits
  - Ofwat regulations
  - UK listing rules
- We understood how Pennon Group plc is complying with those frameworks by reading internal policies and codes of conduct and assessing the entity level control environment, including the level of oversight of those charged with governance. We made enquiries of the Group's legal counsel, regulatory team and internal audit of known instances of non-compliance or suspected non-compliance with laws and regulations. We corroborated our enquiries through review of correspondence with regulatory bodies. We designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraph above. As well as enquiry and attendance at meetings, our procedures involved a review of the reporting to the above committees and a review of board meetings and other committee minutes to identify any non-compliance with laws and regulations. Our procedures also involved journal entry testing, with a focus on journals meeting our defined risk criteria based on our understanding of the business.
- We assessed the susceptibility of the Group's financial statements to material misstatement, including how fraud might occur by making enquiries of senior management, including the Chief Executive Officer, Chief Financial Officer, Head of Internal Audit and Audit Committee Chairman. We planned our audit to identify risks of management override, tested higher risk journal entries and performed audit procedures to address the potential for management bias. particularly over areas involving significant estimation and judgement. Further discussion of our approach to address the identified risks of management override are set out in the key audit matters section of our report.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved making enquiries of key management and legal counsel, reviewing key policies, inspecting legal registers and correspondence with regulators and reading key management meeting minutes. We also completed procedures to conclude on the compliance of significant disclosures in the Annual Report and Accounts with the requirements of the relevant accounting standards, UK legislation and the UK Corporate Governance Code.
- We communicated regularly with the component teams and attended key meetings with the component teams, management and legal counsel in order to identify and communicate any instances of non compliance with laws and regulations.
- The Group operates in the water and waste sectors which are highly regulated environments. As such the Senior Statutory Auditor reviewed the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of an expert where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at **https://www.frc.org.uk/auditorsresponsibilities**. This description forms part of our auditor's report.

Other matters we are required to address
- We were appointed by the company at its annual general meeting on 5 July 2018 to audit the financial statements for the year ending 31 March 2019 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 5 years, covering the years ended 31 March 2015 to 31 March 2019.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company and we remain independent of the group and the parent company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee

Use of our report
This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Debbie O'Hanlon
(Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Reading

29 May 2019

Notes:

(1) The maintenance and integrity of the Pennon Group plc web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

(2) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement
For the year ended 31 March 2019

	Notes	Before non-underlying items 2019 £m	Non-underlying items (note 6) 2019 £m	Total 2019 £m	Before non-underlying items 2018 £m	Non-underlying items (note 6) 2018 £m	Total 2018 £m
Revenue	5	**1,478.2**	**–**	**1,478.2**	1,393.0	3.2	1,396.2
Operating costs	7						
Employment costs		**(205.8)**	**(3.0)**	**(208.8)**	(192.9)	–	(192.9)
Raw materials and consumables used		**(109.3)**	**–**	**(109.3)**	(108.7)	–	(108.7)
Other operating expenses		**(616.9)**	**(22.7)**	**(639.6)**	(581.8)	–	(581.8)
Earnings before interest, tax, depreciation and amortisation	5	**546.2**	**(25.7)**	**520.5**	509.6	3.2	512.8
Depreciation and amortisation	7	**(195.2)**	**–**	**(195.2)**	(185.7)	–	(185.7)
Operating profit	5	**351.0**	**(25.7)**	**325.3**	323.9	3.2	327.1
Finance income	8	**23.5**	**–**	**23.5**	24.2	–	24.2
Finance costs	8	**(106.7)**	**5.8**	**(100.9)**	(98.7)	(21.6)	(120.3)
Net finance costs	8	**(83.2)**	**5.8**	**(77.4)**	(74.5)	(21.6)	(96.1)
Share of post-tax profit from joint ventures	20	**12.4**	**–**	**12.4**	9.4	22.5	31.9
Profit before tax	5	**280.2**	**(19.9)**	**260.3**	258.8	4.1	262.9
Taxation (charge)/credit	9	**(42.7)**	**5.0**	**(37.7)**	(44.4)	3.4	(41.0)
Profit for the year		**237.5**	**(14.9)**	**222.6**	214.4	7.5	221.9
Attributable to:							
Ordinary shareholders of the parent		**229.2**	**(14.9)**	**214.3**	193.1	7.5	200.6
Non-controlling interests		**(0.3)**	**–**	**(0.3)**	(0.2)	–	(0.2)
Perpetual capital security holders		**8.6**	**–**	**8.6**	21.5	–	21.5
Earnings per ordinary share (pence per share)	11						
– Basic				**51.1**			48.0
– Diluted				**50.9**			47.8

Consolidated statement of comprehensive income
For the year ended 31 March 2019

	Notes	Before non-underlying items 2019 £m	Non-underlying items (note 6) 2019 £m	Total 2019 £m	Before non-underlying items 2018 £m	Non-underlying items (note 6) 2018 £m	Total 2018 £m
Profit for the year		**237.5**	**(14.9)**	**222.6**	214.4	7.5	221.9
Other comprehensive (loss)/income							
Items that will not be reclassified to profit or loss							
Remeasurement of defined benefit obligations	30	**(17.2)**	**–**	**(17.2)**	24.5	–	24.5
Income tax on items that will not be reclassified	9, 31	**3.2**	**–**	**3.2**	(4.2)	–	(4.2)
Total items that will not be reclassified to profit or loss		**(14.0)**	**–**	**(14.0)**	20.3	–	20.3
Items that may be reclassified subsequently to profit or loss							
Share of other comprehensive income/(loss) from joint ventures	20	**0.5**	**–**	**0.5**	(2.7)	–	(2.7)
Cash flow hedges		**(6.4)**	**–**	**(6.4)**	20.5	–	20.5
Income tax on items that may be reclassified	9, 31	**0.6**	**–**	**0.6**	(3.5)	–	(3.5)
Total items that may be reclassified subsequently to profit or loss		**(5.3)**	**–**	**(5.3)**	14.3	–	14.3
Other comprehensive (loss) /income for the year net of tax	36	**(19.3)**	**–**	**(19.3)**	34.6	–	34.6
Total comprehensive income/(loss) for the year		**218.2**	**(14.9)**	**203.3**	249.0	7.5	256.5
Total comprehensive income attributable to:							
Ordinary shareholders of the parent		**209.9**	**(14.9)**	**195.0**	227.7	7.5	235.2
Non-controlling interests		**(0.3)**	**–**	**(0.3)**	(0.2)	–	(0.2)
Perpetual capital security holders		**8.6**	**–**	**8.6**	21.5	–	21.5

The notes on pages 123 to 173 form part of these financial statements.

Balance sheets
At 31 March 2019

	Notes	Group 2019 £m	Group 2018 £m	Company 2019 £m	Company 2018 £m
Assets					
Non-current assets					
Goodwill	15	**385.0**	385.0	**–**	–
Other intangible assets	16	**92.1**	72.6	**–**	–
Property, plant and equipment	17	**4,509.4**	4,310.6	**0.3**	0.2
Other non-current assets	19	**256.4**	263.5	**1,044.6**	846.0
Deferred tax assets	31	**–**	–	**1.2**	1.6
Derivative financial instruments	23	**70.5**	70.5	**3.7**	4.2
Investments in subsidiary undertakings	20	**–**	–	**1,980.8**	1,980.8
Investments in joint ventures	20	**51.1**	22.8	**–**	–
		5,364.5	5,125.0	**3,030.6**	2,832.8
Current assets					
Inventories	21	**28.8**	24.6	**–**	–
Trade and other receivables	22	**484.8**	416.0	**21.6**	42.7
Derivative financial instruments	23	**11.8**	12.9	**2.8**	6.4
Cash and cash deposits	25	**569.6**	585.3	**284.8**	303.3
		1,095.0	1,038.8	**309.2**	352.4
Liabilities					
Current liabilities					
Borrowings	28	**(150.4)**	(209.8)	**(335.7)**	(433.2)
Financial liabilities at fair value through profit	24	**(3.8)**	(2.6)	**(0.4)**	(0.4)
Derivative financial instruments	23	**(11.1)**	(9.4)	**(0.2)**	(2.7)
Trade and other payables	26	**(298.0)**	(342.0)	**(15.8)**	(57.1)
Current tax liabilities	27	**(19.1)**	(24.4)	**(3.6)**	(23.9)
Provisions	32	**(28.7)**	(38.0)	**–**	–
		(511.1)	(626.2)	**(355.7)**	(517.3)
Net current assets/(liabilities)		**583.9**	412.6	**(46.5)**	(164.9)
Non-current liabilities					
Borrowings	28	**(3,498.7)**	(3,177.0)	**(989.7)**	(711.7)
Other non-current liabilities	29	**(147.9)**	(140.1)	**(8.6)**	(8.7)
Financial liabilities at fair value through profit	24	**(43.1)**	(46.6)	**(1.4)**	(1.7)
Derivative financial instruments	23	**(9.9)**	(8.2)	**(0.7)**	(0.9)
Retirement benefit obligations	30	**(60.8)**	(49.5)	**(3.4)**	(3.3)
Deferred tax liabilities	31	**(305.1)**	(295.6)	**–**	–
Provisions	32	**(203.1)**	(181.5)	**–**	–
		(4,268.6)	(3,898.5)	**(1,003.8)**	(726.3)
Net assets		**1,679.8**	1,639.1	**1,980.3**	1,941.6
Shareholders' equity					
Share capital	33	**171.1**	170.8	**171.1**	170.8
Share premium account	34	**223.6**	218.8	**223.6**	218.8
Capital redemption reserve	35	**144.2**	144.2	**144.2**	144.2
Retained earnings and other reserves	36	**843.0**	807.1	**1,144.7**	1,111.1
Total shareholders' equity		**1,381.9**	1,340.9	**1,683.6**	1,644.9
Non-controlling interests		**1.2**	1.5	**–**	–
Perpetual capital securities	37	**296.7**	296.7	**296.7**	296.7
Total equity		**1,679.8**	1,639.1	**1,980.3**	1,941.6

The profit for the year attributable to ordinary shareholders' equity dealt within the accounts of the parent Company is £194.8 million (2018 £215.1 million).

The notes on pages 123 to 173 form part of these financial statements.

The financial statements on pages 118 to 173 were approved by the Board of Directors and authorised for issue on 29 May 2019 and were signed on its behalf by:

Chris Loughlin, Chief Executive Officer Pennon Group plc

Registered Office: Peninsula House, Rydon Lane, Exeter, Devon, England EX2 7HR. Registered in England Number 2366640.

Statements of changes in equity

For the year ended 31 March 2019

	Share capital (note 33) £m	Share premium account (note 34) £m	Capital redemption reserve (note 35) £m	Retained earnings and other reserves (note 36) £m	Non-controlling interests £m	Perpetual capital securities (note 37) £m	Total equity £m
Group							
At 1 April 2017	168.4	217.4	144.2	684.4	–	294.8	1,509.2
Profit for the year	–	–	–	200.6	(0.2)	21.5	221.9
Other comprehensive income for the year	–	–	–	34.6	–	–	34.6
Total comprehensive income for the year	–	–	–	235.2	(0.2)	21.5	256.5
Transactions with equity shareholders:							
Dividends paid	–	–	–	(149.5)	–	–	(149.5)
Adjustment for shares issued under the Scrip Dividend Alternative	2.1	(2.1)	–	41.7	–	–	41.7
Adjustment in respect of share-based payments (net of tax)	–	–	–	2.2	–	–	2.2
Issuance of perpetual capital securities	–	–	–	–	–	296.7	296.7
Redemption of perpetual capital securities	–	–	–	(5.2)	–	(294.8)	(300.0)
Distributions to perpetual capital security holders	–	–	–	–	–	(25.3)	(25.3)
Current tax relief on distributions to perpetual capital security holders	–	–	–	–	–	3.8	3.8
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	0.1	0.4	–	(1.7)	–	–	(1.2)
Proceeds from shares issued under the Sharesave Scheme	0.2	3.1	–	–	–	–	3.3
Non-controlling interests	–	–	–	–	1.7	–	1.7
Total transactions with equity shareholders	2.4	1.4	–	(112.5)	1.7	(19.6)	(126.6)
At 31 March 2018	170.8	218.8	144.2	807.1	1.5	296.7	1,639.1
Profit for the year	–	–	–	214.3	(0.3)	8.6	222.6
Other comprehensive loss for the year	–	–	–	(19.3)	–	–	(19.3)
Total comprehensive income for the year	–	–	–	195.0	(0.3)	8.6	203.3
Transactions with equity shareholders:							
Dividends paid	–	–	–	(162.0)	–	–	(162.0)
Adjustment in respect of share-based payments (net of tax)	–	–	–	4.4	–	–	4.4
Distributions to perpetual capital security holders	–	–	–	–	–	(8.6)	(8.6)
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	–	–	–	(1.5)	–	–	(1.5)
Proceeds from shares issued under the Sharesave Scheme	0.3	4.8	–	–	–	–	5.1
Total transactions with equity shareholders	0.3	4.8	–	(159.1)	–	(8.6)	(162.6)
At 31 March 2019	**171.1**	**223.6**	**144.2**	**843.0**	**1.2**	**296.7**	**1,679.8**

The notes on pages 123 to 173 form part of these financial statements.

	Share capital (note 33) £m	Share premium account (note 34) £m	Capital redemption reserve (note 35) £m	Retained earnings and other reserves (note 36) £m	Perpetual capital securities (note 37) £m	Total equity £m
Company						
At 1 April 2017	168.4	217.4	144.2	1,005.4	294.8	1,830.2
Profit for the year (note 10)	–	–	–	215.1	21.5	236.6
Other comprehensive income for the year	–	–	–	3.6	–	3.6
Total comprehensive income for the year	–	–	–	218.7	21.5	240.2
Transactions with equity shareholders:						
Dividends paid	–	–	–	(149.5)	–	(149.5)
Adjustment for shares issued under the Scrip Dividend Alternative	2.1	(2.1)	–	41.7	–	41.7
Issuance of perpetual capital securities	–	–	–	–	296.7	296.7
Redemption of perpetual capital securities	–	–	–	(5.2)	(294.8)	(300.0)
Distributions to perpetual capital security holders	–	–	–	–	(25.3)	(25.3)
Current tax relief on distributions to perpetual capital security holders	–	–	–	–	3.8	3.8
Adjustment in respect of share-based payments (net of tax)	–	–	–	0.8	–	0.8
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	0.1	0.4	–	(0.8)	–	(0.3)
Proceeds from shares issued under the Sharesave Scheme	0.2	3.1	–	–	–	3.3
Total transactions with equity shareholders	2.4	1.4	–	(113.0)	(19.6)	(128.8)
At 31 March 2018	170.8	218.8	144.2	1,111.1	296.7	1,941.6
Profit for the year (note 10)	–	–	–	194.8	8.6	203.4
Other comprehensive income for the year	–	–	–	0.2	–	0.2
Total comprehensive income for the year	–	–	–	195.0	8.6	203.6
Transactions with equity shareholders:						
Dividends paid	–	–	–	(162.0)	–	(162.0)
Distributions to perpetual capital security holders	–	–	–	–	(8.6)	(8.6)
Adjustment in respect of share-based payments (net of tax)	–	–	–	1.5	–	1.5
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	–	–	–	(0.9)	–	(0.9)
Proceeds from shares issued under the Sharesave Scheme	0.3	4.8	–	–	–	5.1
Total transactions with equity shareholders	0.3	4.8	–	(161.4)	(8.6)	(164.9)
At 31 March 2019	**171.1**	**223.6**	**144.2**	**1,144.7**	**296.7**	**1,980.3**

The notes on pages 123 to 173 form part of these financial statements.

Cash flow statements
For the year ended 31 March 2019

	Notes	Group 2019 £m	Group 2018 £m	Company 2019 £m	Company 2018 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	38	**399.8**	443.5	**(223.0)**	249.4
Interest paid	38	**(83.9)**	(69.6)	**(36.8)**	(32.5)
Tax (paid)/received		**(29.2)**	(21.7)	**(22.1)**	17.9
Net cash generated/(outflow) from operating activities		**286.7**	352.2	**(281.9)**	234.8
Cash flows from investing activities					
Interest received		**10.3**	8.3	**44.5**	41.2
Dividends received	44	**5.5**	6.5	**196.7**	202.3
Investments in subsidiary undertakings		**–**	–	**–**	(356.6)
Investment in joint venture		**(54.8)**	–	**–**	–
Loan repayments received from joint ventures		**0.5**	33.3	**–**	–
(Deposit)/return of restricted deposits		**(21.6)**	42.3	**–**	–
Purchase of property, plant and equipment		**(356.0)**	(390.6)	**–**	(0.2)
Purchase of intangible assets		**–**	(1.0)	**–**	–
Acquisition of subsidiary undertakings		**–**	(8.4)	**–**	–
Proceeds from sale of property, plant and equipment		**6.3**	10.6	**–**	–
Net cash (used in)/received from investing activities		**(409.8)**	(299.0)	**241.2**	(113.3)
Cash flows from financing activities					
Proceeds from issuance of ordinary shares		**5.1**	3.9	**5.1**	3.9
Proceeds from the issuance of perpetual capital securities		**–**	296.7	**–**	296.7
Redemption of 2013 perpetual capital securities		**–**	(300.0)	**–**	(300.0)
Purchase of ordinary shares by the Pennon Employee Share Trust		**(1.5)**	(1.8)	**–**	–
Proceeds from new borrowing		**384.5**	106.9	**334.5**	–
Repayment of borrowings		**(181.6)**	(116.0)	**(149.6)**	(63.9)
Finance lease sale and lease back		**74.9**	140.1	**–**	–
Finance lease principal repayments		**(27.8)**	(28.6)	**–**	–
Disposal of non-controlling interest		**–**	1.7	**–**	–
Dividends paid		**(162.0)**	(107.8)	**(162.0)**	(107.8)
Perpetual capital securities periodic return	37	**(5.8)**	(19.6)	**(5.8)**	(19.6)
Net cash received from/(used in) financing activities		**85.8**	(24.5)	**22.2**	(190.7)
Net (decrease)/increase in cash and cash equivalents		**(37.3)**	28.7	**(18.5)**	(69.2)
Cash and cash equivalents at beginning of the year	25	**403.0**	374.3	**303.3**	372.5
Cash and cash equivalents at end of the year	25	**365.7**	403.0	**284.8**	303.3

The notes on pages 123 to 173 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 119. Pennon Group's business is operated through two main subsidiaries. South West Water Limited includes the integrated water businesses of South West Water and Bournemouth Water, providing water and wastewater services in Devon, Cornwall and parts of Dorset and Somerset and water only services in parts of Dorset, Hampshire and Wiltshire. Viridor Limited is a recycling and residual waste processing and transformation business. Pennon Group is also the majority shareholder of Pennon Water Services Limited, a company providing water and wastewater retail services to non-household customer accounts across Great Britain.

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 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, transfers of assets from customers and certain financial instruments as described in accounting policy notes (b), (w) and (o) respectively) and in accordance with International Financial Reporting Standards (IFRS) and interpretations of the IFRS Interpretations Committee as adopted by the European Union, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. 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 109.

The new standards or interpretations which were mandatory for the first time in the year beginning 1 April 2018 did not have a material impact on the net assets or results of the Group.

Initial adoption of IFRS 15 'Revenue from Contracts with Customers'
The Group adopted the standard with effect from 1 April 2018 using the full retrospective approach to transition. As the impact of the new standard has not had a material effect on the Group's reported revenues, net assets or any specific financial statement line, there has been no restatement of prior year figures.

The revised accounting policy on revenue following implementation of IFRS 15 is set out below in paragraph (c). The disaggregation of revenue information required by IFRS 15 is given below within note 5 (Segmental information) for the current and prior years.

Initial adoption of IFRS 9 'Financial Instruments'
IFRS 9 replaced IAS 39 with effect from 1 April 2018 bringing together all three aspects of the accounting for financial instruments: classification and measurement, impairment and hedge accounting. The Group applied IFRS 9 prospectively from 1 April 2018. The first time application of this standard in the specific areas is detailed below but has not resulted in any adjustment or reclassification of amounts previously reported.

The classification and measurement requirements of IFRS 9 require that financial assets are classified in the statements of financial position according to their nature, the characteristics of their contractual cash flows and the business model adopted for their management. Following assessment of the Group's business model as of the date of initial application, 1 April 2018, these requirements did not have a significant impact on the Group. The Group continued measuring at fair value all financial assets previously held at fair value under IAS 39.

The impairment aspects of IFRS 9 require the Group to evaluate and recognise expected credit losses (ECLs) on financial assets and to ensure changes in credit risk are assessed at regular intervals, and to make suitable adjustments for ECLs where applicable. The disclosure below within note 4 Critical accounting judgements and estimates on provision for doubtful debts has been expanded to clarify the Group's evaluation approach, which now includes the forward-looking assessment of ECLs and changes in credit risk.

The Group has a policy of hedging currency risk and interest rate risks as detailed in note 3 and previously adopted hedge accounting under IAS 39. The Group adopted hedge accounting in accordance with IFRS 9 from 1 April 2018.

IFRS 16 'Leases'
The adoption of IFRS 16 on 1 April 2019 will affect primarily the accounting for those leases currently classified as operating leases. IFRS 16 no longer distinguishes between an on the balance sheet finance lease and an off the balance sheet operating lease.

The Group has made the following elections on adopting IFRS 16 to apply from 1 April 2019:

- Applying the modified retrospective approach: the cumulative effect of initially applying IFRS 16 has been calculated as a reduction to retained profits at 1 April 2019 of £8.1 million. Under this election no restatement of comparative figures will be made
- Electing to apply the standard to contracts that were previously identified as leases when applying IAS 17
- Using the exemptions available in respect of contracts with a lease term ending within 12 months of 1 April 2019 and in respect of the low value of underlying assets. These exemptions allow accounting similar to that for an operating lease under IAS 17.

Carrying amounts for assets and liabilities under leases accounted for as finance leases prior to adoption of IFRS 16 will not be impacted.

At 31 March 2019 the Group had non-cancellable operating lease commitments of £195.7 million. These predominantly relate to leases of properties occupied by the Group in the course of carrying out its businesses. Applying IFRS 16 at 1 April 2019 results in the Group recognising an asset in use of £107.6 million, a deferred tax asset of £1.6 million, an additional lease liability of £121.2 million and the reversal of prepayments and accruals of £0.5 million and £4.4 million respectively. The overall reduction in net assets of £8.1 million is deducted from retained profits at 1 April 2019 in accordance with the modified retrospective approach.

Notes to the financial statements
continued

2. Principal accounting policies continued

Differences between the values of the disclosed operating lease commitment at 31 March 2019 and the additional lease liability recognised at 1 April 2019 under IFRS 16 result from future cash outflows being discounted under IFRS 16 rather than shown gross, the availability of exemptions available on transition and different rules defining the appropriate length of lease to use between the two methods.

Based on the additional lease liability and associated assets recognised at 1 April 2019 it is estimated that the impact on profit for the year ended 31 March 2020 would be a reduction in profit after tax of £1.0 million, resulting from an increase in EBITDA of £12.7 million, depreciation of £9.9 million, finance costs of £4.0 million and a reduction in corporation tax of £0.2 million.

Other new standards or interpretations in issue but not yet effective are not expected to have a material impact on the Group's net assets or results.

(b) Basis of consolidation

The Group financial statements include the results of Pennon Group plc and its subsidiaries and joint ventures.

The results of subsidiaries and joint ventures 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 is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The results of joint ventures are accounted for on an equity basis.

Intra-group trading, 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

Group revenue is recognised following delivery of performance obligations and an assessment of when control over the product or service is transferred to the customer. Revenue is only recognised when collection of consideration is highly probable.

Revenue is recognised either when the performance obligation in the contract has been performed (point in time recognition) or 'over time' as the performance obligations to the customer are satisfied. For each obligation satisfied over time, the Group applies a revenue recognition method that accurately reflects performance in transferring control of the services to the customer.

Where a contract with a customer includes more than one performance obligation, revenue is allocated to each obligation in proportion to a fair value assessment of the total contract sales value split across the services provided.

At the inception of a contract the total transaction price is estimated, being the fair value to which the Group expects to be entitled under the contract, including any variable consideration. Variable consideration is based on the most likely outcome of the performance obligations.

Revenue excludes value added tax, trade discounts and revenue arising from transactions between Group companies. Revenue includes landfill tax.

Water (domestic and non-household retail)

For most of the services provided to domestic customers, contract terms are implied through statute and regulation in the absence of formal, written contracts. South West Water has a duty under legislation to provide domestic customers with services regardless of payment and is not permitted to disconnect domestic customers for non-payment of bills. Charges are set via the periodic review price-setting process, regulated by Ofwat.

In respect of ongoing, continuous services to customers, such as the provision of drinking water and waste water services, revenue is recognised over time in line with customer usage of those services.

Customers with an unmeasured supply are billed at the start of the year for the full amount of the annual charge but typically take advantage of a choice of payment arrangements to pay by regular instalments.

Customers with a metered supply are sent up to four bills per year, based either on actual meter readings or estimated usage. For these customers, revenue includes an estimation of the amount of unbilled usage at the period end. Payment options for domestic customers include an annual Meter Payment Plan where customers agree to pay a fixed amount per month which is adjusted to reflect actual consumption at the end of the year.

A range of regulated services is offered to property developers and owners who require connection to the water and sewerage networks or need the networks to be extended or altered. Typically, these customers pay an estimate of the charges in advance as a deposit, which is treated as a contract liability and are billed or refunded the difference between the estimate and actual costs on completion of the work.

Where the performance obligation relates solely to a connection to the network, revenue is recognised at the point of connection when the customer is deemed to obtain control.

Where assets are constructed or provided by the Group or assets transferred to the Group, it is considered that there is an explicit or implied performance obligation to provide an ongoing water and/or waste water service, with the result that revenue is recognised over a time no longer than the economic life of assets provided by or transferred to the Group.

Pennon Water Services provides specialist retail water and waste water services to business customers. It raises bills and recognises revenue in accordance with its contracts with customers and in line with the limits established for the non-household periodic price-setting process where applicable.

2. Principal accounting policies continued

Energy sales

The Group receives revenue from the sale of electricity from generating assets. These assets include solar, anaerobic digestion, gas from landfill and energy recovery facilities. Revenue from the sale of electricity from the Group's generating assets is measured based upon metered output delivered at rates specified under contract terms or prevailing market rates. Revenue is recognised at a 'point in time', being the point of distribution. Typically, invoices are raised monthly with standard payment terms.

Waste Management Services

In respect of single services with fixed fees, such as the receipt of gate and collection fees, revenue is recognised at the time the service is provided.

The Group also delivers other waste management services for which revenue is recognised 'over time' in accordance with contracts with customers. The nature of contracts and/or performance obligations includes management fees to operate local authority recycling centres and energy recovery facilities, multi service contracts including collections and gate fees.

Revenue from other services can be fixed (i.e. management fees) or variable (i.e. gate fees).

Gate fee revenue, derived from the Group's operational assets, is recognised as customer waste is deposited and is based on tonnage received.

In respect of waste collection services, revenue is recognised at the point of collection from customer premises.

A majority of waste management customers are invoiced monthly for services provided within the monthly billing period. Payments are typically due on an end of month following invoice basis. Alternative billing and/or payment terms are agreed in exceptional circumstances.

The Group transfers control of such waste management services prior to invoicing. Receipt of payment following invoice is based solely on the passage of time. A trade receivable is recognised until payment is made and/or refund issued.

Where the Group has entered into service concession arrangements it accounts for these contracts in accordance with IFRIC12. Consideration is treated as contract assets or other intangible assets, depending upon the right to receive cash from the asset. Consideration is split between construction of assets, operation of the service and provision of finance recognised as interest receivable.

Revenue in respect of construction services is recognised over time and is based on the fair value of work performed, with reference to the total sales value and the stage of completion of those services, as this best reflects the manner in which control passes to the customer. While construction is in progress the consideration is disclosed as a contract asset within non-current financial assets. On entry into operational service, in accordance with IFRIC 12, the contract asset is reclassified as either costs recoverable from construction activities disclosed within other intangible assets when the concession grantor has not provided a contractual guarantee in respect of the recoverable amount regardless of the service use by customers, and/or within other non-current financial assets when the concession grantor contractually guarantees the payment of amounts determined in the contract or the shortfall, if any, between amounts received from users of the public service and amounts specified or determined in the contract. No payments are received during construction.

In respect of operating services, revenue is recognised over time in line with delivery of operational services in accordance with the contract with the local authority.

Once the operational phase commences the Group has a right to receive consideration for the construction and operational services delivered. Invoicing typically occurs monthly and payments are due by the end of the month following date of invoice.

Recyclate

The Group transforms waste into recyclate ready for resale. Revenue is measured at the agreed transaction price per tonne of recyclate under the contract with the customer. Revenue recognition occurs when control over the recyclate assets has been transferred to the customer.

In respect of UK sales, the Group's performance obligation is satisfied at the point of collection by the customer. This is the point in time when an invoice is issued and revenue is recognised. Payment terms are typically end of month following invoice date. Overseas sales are predominantly agreed under a letter of credit. Goods are despatched at the point the letter of credit is accepted by the customer's bank. Payment is released when the customer confirms satisfactory receipt of the recyclate. This is the point legal title (i.e. control) passes to the customer and revenue is recognised.

Contract assets and liabilities

A trade receivable is recognised when the Group has an unconditional right to receive consideration in exchange for performance obligations already fulfilled. A contract asset is recognised when the Group has fulfilled some of its performance obligations but has not yet obtained an unconditional right to receive consideration, such as in the construction phase of a service concession agreement, as described above. The amounts for contract assets are disclosed within note 19 (Other non-current assets) and note 22 (Trade and other receivables) as appropriate. A contract liability is recognised when consideration is received in advance of the Group performing its performance obligations to customers, including, when appropriate, transfers of assets from customers (per paragraph (w) below). The value of contract liabilities is disclosed within note 26 (Trade and other payables) and note 29 (Other non-current liabilities) as appropriate.

(d) Landfill tax

Landfill tax is recognised in both revenue and operating costs at the point waste is disposed of at a licensed landfill site.

(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 are based primarily on business segments. The water business comprises the regulated water and wastewater services undertaken by South West Water. The waste management business is the recycling and residual waste processing and transformation services provided by Viridor. The non-household retail business comprises the services provided by Pennon Water Services in the non-household water and wastewater retail market which, while regulated, is open to competition. Segmental revenue and results include transactions between businesses. Inter-segmental transactions are eliminated on consolidation.

Notes to the financial statements
continued

2. Principal accounting policies continued

(f) Goodwill

Goodwill arising on consolidation from the acquisition of subsidiary undertakings represents the excess of the purchase consideration over the fair value of net assets acquired, less any subsequent impairment charges.

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. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash generating units or group of cash generating units, that is expected to benefit from the synergies of the combination. Each unit or group of units to which goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal reporting purposes. Goodwill is allocated and monitored at the reportable operating segment level. Further details are contained in accounting policy (j).

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

(g) Other intangible assets

Other intangible assets are recognised in relation to long-term service concessions contracts to the extent that future amounts to be received are not contracted.

Other intangible assets include assets acquired in a business combination and 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 lives, with the expense charged 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 and impairment charges. 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 evenly over their useful economic lives, and are principally:

Dams and impounding reservoirs	200 years
Water mains	40 – 120 years
Sewers	40 – 120 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 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 energy recovery facilities, property, 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 the estimated economic lives or the finance lease period, whichever is the shorter
Operational properties	40 – 80 years
Energy recovery facilities (including major refurbishments)	25 – 40 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. Assets transferred from customers are recognised at fair value as set out in accounting policy (w).

The assets' residual values and useful lives 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 on a straight-line basis over the life of the lease.

The impact of the adoption of IFRS 16 'Leases' on 1 April 2019 is discussed in paragraph (a) above.

(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.

Non-financial assets other than goodwill that have been impaired are reviewed for possible reversal of the impairment at each reporting date.

Where a previously impaired asset or cash generating unit's recoverable amount is in excess of its carrying amount, previous impairments are reversed to the carrying value that would have expected to be recognised had the original impairment not occurred.

(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) Inventories

Inventories are stated at the lower of cost and net realisable value. The cost of finished goods and work in progress includes raw materials and the cost of bringing stocks to their present location and condition. It excludes borrowing costs. Net realisable value is the estimated selling price less cost to sell.

(n) 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.

(o) Financial instruments

Financial instruments are recognised and measured in accordance with IAS 39 until 31 March 2018 and in accordance with IFRS 9 from 1 April 2018. The Group classifies its financial instruments in the following categories:

i) Debt instruments at amortised cost

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

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.

ii) 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 expected credit losses (ECLs). In accordance with the terms and conditions of IFRS 9, since 1 April 2018, each Group entity performs an impairment analysis at each reporting date to measure the ECLs. Each entity does not track changes in credit risk but instead recognises a loss allowance based on lifetime ECLs at each reporting date. Each subsidiary has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the receivables and the economic environment.

iii) 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.

iv) Financial assets arising from 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 profit on the construction of assets, operation of the service and the provision of finance which is recognised in notional interest within finance income.

Notes to the financial statements
continued

2. Principal accounting policies continued

v) Derivative financial instruments and hedging activities

The Group uses derivative financial instruments, principally interest rate swaps, foreign exchange forward contracts and cross-currency interest rate swaps 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 recognised in 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 apportioned on a straight-line basis between non-current and current assets and liabilities based on the remaining maturity of the hedging derivative.

Derivative financial instruments deemed held for trading, which are not subject to hedge accounting, are classified as a current asset or liability with any change in fair value recognised immediately in the income statement.

The Group uses cross-currency swaps for some of its foreign currency denominated private placement borrowings. The swaps either have the effect of (i) converting variable rate foreign currency borrowings into fixed rate sterling borrowings, (ii) converting fixed rate foreign currency borrowings into fixed rate sterling borrowings, or (iii) converting fixed rate foreign currency borrowings into floating rate sterling borrowings.

vi) Financial instruments at fair value through profit

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

(p) Taxation including deferred tax

The tax charge for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in the statement of comprehensive income or directly in equity. In this case the tax is also recognised in the statement of comprehensive income or directly in equity as appropriate.

Current tax is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date. Management periodically evaluates tax items subject to interpretation and establishes provisions on individual tax items, where in the judgement of management, the position is uncertain.

The Group includes a number of companies, including the parent company, which are part of a tax group for certain aspects of the tax legislation. One of these aspects relates to group relief whereby current tax liabilities can be offset by current tax losses arising in other companies within the same tax group. Payments for group relief are included within the current tax disclosures.

Deferred tax is provided in full on temporary differences between the carrying amount of assets and liabilities in the financial statements and the tax base, except where they arise from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be realised. Deferred tax is determined using the tax rates enacted or substantively enacted at the balance sheet date, and expected to apply when the deferred tax liability is settled or the deferred tax asset is realised.

2. Principal accounting policies continued

(q) 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 notional interest within finance costs.

The Group's policies on specific provisions 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 is an integral part of a landfill site's future economic benefit, 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. Further provisions required after the operational life of a site are recognised immediately in the income statement.

iii) Underperforming contracts

Where the unavoidable costs of meeting a contract's obligations exceed the economic benefits derived from that contract, the unavoidable costs, less revenue anticipated under the terms of the contract, are recognised as a provision and charged to the income statement. An impairment loss on any assets dedicated to that contract is also recognised as described in accounting policy (j).

(r) 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 reissued. Where such shares are subsequently reissued, 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 Group plc Employee Benefit Trust, relating to employee share-based payments, which have not vested at the balance sheet date. These are shown as a deduction from shareholders' equity until such time as they vest. The Trust, which is registered in the United Kingdom, was formed on 18 December 2018 to supersede the Pennon Employee Share Trust which was registered in Guernsey.

(s) 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.

(t) Employee benefits

i) Retirement benefit obligations

The Group operates defined benefit and defined contribution pension schemes.

Defined benefit pension schemes

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the year less the fair value of plan assets. If the value of a plan's assets exceeds the present value of its obligations, the resulting surplus is only recognised if the Group has an unconditional right to that surplus.

The defined benefit obligation is calculated by independent actuaries who advise on the selection of Directors' best estimates of assumptions, using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds, and that have terms to maturity approximating to the terms of the related pension obligation. 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.

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

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in the statement of comprehensive income in the period in which they arise.

Defined contribution scheme

Costs of the defined contribution pension scheme are charged to the income statement in the year in which they arise. The Group has no further payment obligations once the contributions have been paid.

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 assumptions as to the number of shares which are expected to vest.

Notes to the financial statements
continued

2. Principal accounting policies continued

(u) Pre-contract and development costs

Pre-contract and development costs, including bid 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. These costs are included within other receivables as shown in note 19.

(v) Fair values

The fair value of interest rate swaps is based on the market price to transfer the asset or liability at the balance sheet date in an ordinary transaction between market participants. 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.

(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 as contract liabilities on the balance sheet. The contract liability reduces, and revenue is recognised in the income statement, as performance obligations are satisfied. 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.

The fair value of assets on transfer from customers is determined using a cost valuation approach allowing for depreciation.

(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.

(y) Perpetual capital securities

Perpetual capital securities are issued securities that qualify for recognition as equity. Accordingly any periodic returns are accounted for as dividends and recognised directly in equity and as a liability at the time the Company becomes obligated to pay the periodic return. This reflects the nature of the periodic returns and repayment of principal being only made at the Company's discretion. Any associated tax impacts are recognised directly in equity.

(z) Non-underlying items

Non-underlying items are those that in the Directors' view should be separately disclosed by virtue of their size, nature or incidence to enable a full understanding of the Group's financial performance.

3. Financial risk management

(a) Financial risk factors

The Group's activities expose it to a variety of financial risks: liquidity risk, market risk (interest rate and foreign currency risk) and credit risk.

The Group's treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs and to maintain reasonable headroom for contingencies, and manages inflation and interest rate risk.

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

These risks and treasury operations are managed by the Chief Financial Officer 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, optimise the use of surplus funds and manage overall interest rate performance. The Group does not engage in speculative activity.

i) Liquidity risk

The Group actively maintains a mixture of long-term and short-term committed facilities which are designed to ensure the Group has sufficient 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 28.

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

The Group and water business have entered into covenants with lenders. While terms vary, these typically provide for limits on gearing (primarily based on the water business's regulatory capital value and Viridor Limited's EBITDA plus interest receivable on service concession arrangements) and interest cover. Existing covenants are not impacted by subsequent changes to accounting standards.

3. Financial risk management continued

Contractual undiscounted cash flows, including interest payments, at the balance sheet date 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 2019					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	**86.8**	**41.1**	**672.8**	**1,288.0**	**2,088.7**
Interest payments on borrowings	**60.5**	**59.4**	**156.4**	**681.0**	**957.3**
Finance lease liabilities including interest	**92.2**	**55.5**	**242.1**	**2,153.9**	**2,543.7**
Trade and other payables	**298.0**	**–**	**–**	**–**	**298.0**
Guarantees	**201.7**	**–**	**–**	**–**	**201.7**
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	**3.8**	**(3.7)**	**(12.0)**	**(65.1)**	**(77.0)**
31 March 2018					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	181.5	129.1	426.2	1,144.9	1,881.7
Interest payments on borrowings	57.5	53.7	147.9	689.1	948.2
Finance lease liabilities including interest	52.1	87.1	223.7	2,121.7	2,484.6
Trade and other payables	342.0	–	–	–	342.0
Guarantees	185.1	–	–	–	185.1
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	4.1	2.4	(11.3)	(71.1)	(75.9)
Company					
31 March 2019					
Non-derivative financial liabilities					
Borrowings excluding intercompany borrowings	**51.8**	**6.1**	**551.7**	**431.9**	**1,041.5**
Interest payments on borrowings	**33.6**	**32.8**	**77.9**	**81.5**	**225.8**
Trade and other payables	**15.8**	**–**	**–**	**–**	**15.8**
Guarantees	**763.2**	**–**	**–**	**–**	**763.2**
Derivative financial liabilities					
Derivative contracts – net payments	**0.2**	**0.2**	**0.3**	**–**	**0.7**
31 March 2018					
Non-derivative financial liabilities					
Borrowings excluding intercompany borrowings	149.6	102.1	260.6	349.0	861.3
Interest payments on borrowings	31.4	27.4	69.8	76.8	205.4
Trade and other payables	57.1	–	–	–	57.1
Guarantees	734.7	–	–	–	734.7
Derivative financial liabilities					
Derivative contracts – net payments	0.7	–	–	–	0.7

No liability is expected to arise in respect of the guarantees noted above. Guarantees are analysed in note 42.

ii) Market risk

The Group has a policy of maintaining at least 60% of interest-bearing liabilities at fixed rates in order to manage the risk of fluctuating interest rates impacting the financial performance of the Group. 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 63% (2018 62%) of Group net borrowings were at fixed rates 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 23.

18% (2018 20%) of the Group's net borrowings are RPI index-linked. 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 cash generated from operations (note 38) are independent of changes in market interest rates.

For 2019 if interest rates on variable net borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year and equity would have increased/decreased by £2.4 million (2018 £1.3 million), for the equity sensitivity fair value, with derivative impacts excluded.

For 2019 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 and equity would have decreased/increased by £2.0 million (2018 £2.0 million).

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

Notes to the financial statements
continued

3. Financial risk management continued

iii) Credit risk

Credit counterparty risk arises from cash and cash deposits, derivative financial instruments and exposure to customers, including outstanding receivables. Further information on the credit risk relating to trade and other receivables is given in notes 19 and 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 board approved minimum criteria based on their short-term credit ratings and therefore of good credit quality.

(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.

The Group's policy is to have a minimum of 12 months pre-funding of projected capital expenditure. At 31 March 2019 the Group had cash and facilities, including restricted funds, of £1.2 billion, meeting this objective.

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 39 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:

	2019 £m	2018 £m
Net borrowings (note 39)	**3,079.5**	2,801.5
Total equity	**1,679.8**	1,639.1
Total capital	**4,759.3**	4,440.6
Gearing ratio	**64.7%**	63.1%

The water segment is also monitored on the basis of the ratio of its net borrowings to regulatory capital value. Ofwat's notional gearing target for the K6 (2015-20) regulatory period is set at 62.5%.

	Water business	
	2019 £m	2018 £m
Regulatory capital value	**3,504.7**	3,431.2
Net borrowings of South West Water Limited	**2,062.6**	2,068.1
Net borrowings/Regulatory capital value	**58.9%**	60.3%

The Group has entered into covenants with lenders and, while 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 principally 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 expected credit losses, of trade receivables and payables are assumed to approximate to their fair values.

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. Estimates are based on factors including historical experience and expectations of future events that management believe to be reasonable. However, given the judgemental nature of such estimates, actual results could be different from the assumptions used.

Estimates

Environmental and landfill restoration provisions

Environmental control and aftercare costs are incurred during the operational life of each landfill site and for a considerable period thereafter. The period of aftercare post-closure and the level of costs expected are uncertain and can vary significantly from site to site. Key factors are the type of waste, the speed at which it decomposes, the volume of leachate requiring treatment and regulatory requirements specific to the site. The amounts expected to be incurred are based on landfill site operating lives, taking account of the anticipated decline in landfill activity.

The provisions are based on latest assumptions reflecting recent historic data and future cost estimates.

The aftercare provision is particularly sensitive to the estimated volumes of leachate and their associated cost, together with the discount rate used to establish the provision.

The provisions are recognised in the financial statements at the net present value of the estimated future expenditure required to settle the Group's obligations. A discount rate 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.

Viridor assume an aftercare period of 60 years in calculating provision values. This is considered reasonable by management, is comparable to peers in the waste business and is consistent with Environment Agency bond periods.

The impact of a 0.1% change in discount rate is estimated to be in the region of £2.5 million.

As at 31 March 2019 the Group's environmental and landfill restoration provisions were £209.6 million (2018 £191.9 million) (note 32).

Where a restoration provision is an integral part of a landfill site's future economic benefits, an asset is recognised and depreciated in accordance with the Group's depreciation policy. As at 31 March 2019 these assets had a net book value of £30.8 million (2018 £18.4 million) (note 17).

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 last such valuation of the main scheme was as at 31 March 2016. The valuation as at 31 March 2019 is ongoing.

The pension cost and liabilities under IAS 19 are 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 member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2018 actuarial tables with an allowance for future longevity improvement. The principal assumptions used to measure schemes' liabilities, sensitivities to changes in those assumptions and future funding obligations are set out in note 30.

Taxation

The Group's current tax provision of £19.1 million, reduced from £24.4 million in 2017/18, includes £6.2 million related to prior year tax items.

The Group continues to have a small number of ongoing uncertain tax items primarily relating to the interpretation of tax legislation regarding different tax aspects of its energy recovery facilities. This is part of the normal course of business and the Group has paid in full the tax HMRC interpret as due, and therefore would benefit by a cash refund of up to £26 million (2017/18 £27 million) should these tax items be concluded in the Group's favour. The Group is continuing to work towards resolution of these matters with HMRC.

Service concession arrangements

Consideration from public sector entities for the operation of waste management service concessions is treated as contract receivables or other intangible assets, depending upon the right to receive cash from the asset. At the balance sheet date the Group recognised contract receivables of £188.3 million (2018 £234.1 million) and other intangible assets of £90.6 million (2018 £69.2 million) in relation to its service concession arrangements.

Consideration relating to contract receivables is split between profit on the construction of assets, operation of the service and provision of finance recognised as interest receivable. Management's judgement is used in the allocation between these three elements, this assessment reflects external market conditions according to the type of service provided and project specific cash flow expectations, including the recovery of costs from the original contractor on our Glasgow concession.

Notes to the financial statements
continued

4. Critical accounting judgements and estimates continued

Revenue recognition

The Group recognises revenue as performance obligations are satisfied. Payments received in advance of performance obligations being satisfied are recorded as contract liabilities.

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. Pennon Water Services raises bills and recognises revenue in accordance with its contracts with customers and in line with the limits established for the non-household periodic price-setting process where applicable. For water and wastewater 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 year end. Estimated usage is based on historic data, judgement and assumptions. The accrued income balance in this area at the balance sheet date, which represents the unconditional right to consideration, was £89.8 million (2018 £70.3 million) for South West Water and £29.1 million for Pennon Water Services (2018 £20.2 million). Each year a review of the actual amounts billed in comparison with the metered accrual recognised at the previous year end is undertaken to ensure that the methodology continues to be supported by historic experience.

Viridor estimates income from certain contractual revenue streams based on tonnages, cost and historic data which are dependent on agreement with the customer after the delivery of the service. Revenue is accrued from the sale of electricity from our generating assets based upon metered output delivered at rates specified under contract terms or prevailing market rates as applicable. The total accrued income balance in relation to these areas at the balance sheet date, which represents the unconditional right to consideration, was £54.7 million (2018 £53.4 million).

Provision for doubtful debts

At the balance sheet date the Group applies a simplified approach in calculating expected credit losses (ECLs) for trade receivables and contract assets. Therefore the Group does not track changes in credit risk but instead recognises a loss allowance based on lifetime ECLs at each reporting date. Each subsidiary has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the receivables and the economic environment.

The actual level of debt collected may differ from the estimated levels of recovery. As at 31 March 2019 the Group's current trade receivables were £360.2 million (2018 £325.0 million), against which £99.0 million (2018 £104.3 million) had been provided for expected credit losses (note 22).

Judgements

Impairment of non-financial assets

In order to determine whether impairments, or reversals of previous impairments, are required for non-financial assets, the Group assesses whether there are any indicators for further impairment or reversal during the year. The assessment includes a review of changes in markets and discount rates over the year, together with a review of CGU business performance against expectations. The 2018/19 review concluded there were no indicators of further impairment or reversal.

Non-underlying items

In establishing which items are disclosed separately as non-underlying, to enable a full understanding of the Group's financial performance, the Directors exercise their judgement in assessing the size, nature or incidence of specific items. See note 6 for further details.

Glasgow Recycling and Renewable Energy Centre (GRREC)

The facility successfully completed commissioning, becoming fully operational during the second half of the financial year.

Total spend on the project since commencement has been £273.0 million, comprising the original target of £155.0 million, a further £21.0 million invested to provide additional throughput capacity and £97.0 million to address remediation and non-conformities. Viridor is contractually entitled to recover the incremental remediation and non-conformities spend, including from the original contractor, Interserve Construction Limited, under certain circumstances. The Group believes these circumstances have been met for a substantial element which is recoverable from Interserve. Whilst dialogue with Interserve is ongoing, the Group is preparing to legally pursue the matter.

The project is accounted for in accordance with IFRIC 12 service concession arrangements and the spend of £273.0 million has contributed £117.0 million to a financial asset, £84.0 million to an intangible asset and a contract receivable from Interserve of £72.0 million, along with a contingent asset of £25.0 million which considers a broader range of counterparties to the project. As reported through 2018/19 and in line with IFRS 9, the Group has made credit related provisions recognising that Interserve's financial condition has been under stress. The Group has considered all relevant available public information concerning Interserve and at 31 March 2019 recognises a provision of £28.7 million, resulting in a net receivable due of £43.3 million (2018 £62.7 million). Due to uncertainty and the level of judgement associated with the provision related to the specific recovery from Interserve, it is possible the final outcome may differ from the net receivable recognised, with the boundaries for the possible outcome being zero and £72.0million.

5. Segmental information

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 earnings measures below are used by the Board in making decisions.

The water business comprises the regulated water and wastewater services undertaken by South West Water. The waste management business is the recycling and residual waste processing and transformation services provided by Viridor. The non-household retail business comprises the services provided by Pennon Water Services in the non-household water and wastewater retail market which, while regulated, is open to competition. 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 borrowings and exclude taxation. The other segment liabilities include the Company's financing arrangements and Group taxation liabilities. Capital expenditure comprises additions to property, plant and equipment, including additions resulting from acquisitions through business combinations.

	2019 £m	2018 £m
Revenue		
Water	**581.0**	571.3
Waste management	**852.7**	788.9
Non-household retail	**173.7**	165.9
Other	**21.4**	13.8
Less intra-segment trading*	**(150.6)**	(143.7)
	1,478.2	1,396.2
Segment result		
Operating profit before depreciation, amortisation and non-underlying items (EBITDA)		
Water	**367.1**	360.9
Waste management	**178.9**	150.2
Non-household retail	**1.0**	1.0
Other	**(0.8)**	(2.5)
	546.2	509.6
Operating profit before non-underlying items		
Water	**251.1**	247.8
Waste management	**100.9**	78.6
Non-household retail	**0.3**	0.4
Other	**(1.3)**	(2.9)
	351.0	323.9
Profit before tax and non-underlying items		
Water	**180.6**	180.5
Waste management	**88.5**	70.8
Non-household retail	**(1.6)**	(1.1)
Other	**12.7**	8.6
	280.2	258.8
Profit before tax		
Water	**184.6**	178.1
Waste management	**58.9**	77.3
Non-household retail	**(1.6)**	(1.1)
Other	**18.4**	8.6
	260.3	262.9

* Intra-segment transactions between and to different segments is under normal market based commercial terms and conditions. Intra-segment revenue of the other segment is at cost.

	Water £m	Waste management £m	Non-household retail £m	Other £m	Eliminations £m	Group £m
Balance sheet						
31 March 2019						
Assets (excluding investments in joint ventures)	**3,690.2**	**2,464.8**	**64.6**	**1,659.0**	**(1,470.2)**	**6,408.4**
Investments in joint ventures	**–**	**51.1**	**–**	**–**	**–**	**51.1**
Total assets	**3,690.2**	**2,515.9**	**64.6**	**1,659.0**	**(1,470.2)**	**6,459.5**
Liabilities	**(2,762.2)**	**(1,743.2)**	**(58.7)**	**(1,685.8)**	**1,470.2**	**(4,779.7)**
Net assets	**928.0**	**772.7**	**5.9**	**(26.8)**	**–**	**1,679.8**
31 March 2018						
Assets (excluding investments in joint ventures)	3,513.2	2,254.2	66.6	1,506.9	(1,199.3)	6,141.6
Investments in joint ventures	–	22.8	–	–	–	22.8
Total assets	3,513.2	2,277.0	66.6	1,506.9	(1,199.3)	6,164.4
Liabilities	(2,721.9)	(1,512.4)	(59.1)	(1,431.2)	1,199.3	(4,525.3)
Net assets	791.3	764.6	7.5	75.7	–	1,639.1

Segment liabilities of the water and waste management segments comprise of operating liabilities and borrowings. The other segment includes company only assets and liabilities as well as Group taxation liabilities and should be considered in conjunction with the eliminations column.

Notes to the financial statements
continued

5. Segmental information continued

	Notes	Water £m	Waste management £m	Non-household retail £m	Other £m	Group £m
Other information						
31 March 2019						
Amortisation of other intangible assets	7	**0.5**	**4.5**	**0.2**	**–**	**5.2**
Capital expenditure	17	**154.0**	**233.1**	**–**	**0.1**	**387.2**
Depreciation	7	**115.5**	**73.5**	**0.6**	**0.4**	**190.0**
Finance income	8	**2.3**	**20.0**	**–**	**1.2**	**23.5**
Finance costs (before non-underlying items)	8	**72.8**	**15.4**	**1.9**	**16.6**	**106.7**
31 March 2018						
Amortisation of other intangible assets	7	0.5	3.0	0.1	–	3.6
Capital expenditure	17	181.6	203.7	3.5	0.2	389.0
Depreciation	7	112.9	68.6	0.6	0.4	182.5
Finance income	8	1.2	21.8	–	1.2	24.2
Finance costs (before non-underlying items)	8	68.4	14.8	1.5	14.0	98.7

Finance income and costs above reflect the segment in which the amounts arise and exclude inter-company transactions.

The grouping of revenue streams by how they are affected by economic factors, as required by IFRS 15, is as follows:

	Water	Waste management (WM)					Non-household retail	Other	
Year ended 31 March 2019	UK total £m	UK £m	Rest of EU £m	China £m	Rest of world £m	WM total £m	UK total £m	UK total £m	Total £m
Segment revenue	**581.0**	**802.3**	**13.8**	**25.6**	**11.0**	**852.7**	**173.7**	**21.4**	**1,628.8**
Inter-segment revenue	**(124.9)**	**(0.3)**	**–**	**–**	**–**	**(0.3)**	**(4.0)**	**(21.4)**	**(150.6)**
Revenue from external customers	**456.1**	**802.0**	**13.8**	**25.6**	**11.0**	**852.4**	**169.7**	**–**	**1,478.2**
Significant service lines									
Water	**456.1**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**456.1**
Non-household retail	**–**	**–**	**–**	**–**	**–**	**–**	**169.7**	**–**	**169.7**
Waste management services	**–**	**655.8**	**–**	**–**	**–**	**655.8**	**–**	**–**	**655.8**
Energy	**–**	**88.9**	**–**	**–**	**–**	**88.9**	**–**	**–**	**88.9**
Recyclate	**–**	**57.3**	**13.8**	**25.6**	**11.0**	**107.7**	**–**	**–**	**107.7**
	456.1	**802.0**	**13.8**	**25.6**	**11.0**	**852.4**	**169.7**	**–**	**1,478.2**

	Water	Waste management (WM)					Non-household retail	Other	
Year ended 31 March 2018	UK total £m	UK £m	Rest of EU £m	China £m	Rest of world £m	WM total £m	UK total £m	UK total £m	Total £m
Segment revenue	571.3	733.9	12.3	31.0	11.7	788.9	165.9	13.8	1,539.9
Inter-segment revenue	(126.8)	(0.1)	–	–	–	(0.1)	(3.0)	(13.8)	(143.7)
Revenue from external customers	444.5	733.8	12.3	31.0	11.7	788.8	162.9	–	1,396.2
Significant service lines									
Water	444.5	–	–	–	–	–	–	–	444.5
Non-household retail	–		–	–	–	–	162.9	–	162.9
Waste management services	–	586.0	–	–	–	586.0	–	–	586.0
Energy	–	78.4	–	–	–	78.4	–	–	78.4
Recyclate	–	69.4	12.3	31.0	11.7	124.4	–	–	124.4
	444.5	733.8	12.3	31.0	11.7	788.8	162.9	–	1,396.2

The Group's country of domicile is the United Kingdom and is the country in which it generates the majority of its revenue. The Group's non-current assets are all located in the United Kingdom.

6. Non-underlying items

Non-underlying items are those that in the Directors' view should be separately disclosed by virtue of their size, nature or incidence to enable a full understanding of the Group's financial performance in the year and business trends over time. The presentation of results is consistent with internal performance monitoring.

	Notes	2019 £m	2018 £m
Revenue			
Construction contract settlement[4a]		**–**	3.2
Operating costs			
Pension past service cost (GMP equalisation impact)[1]		**(3.0)**	–
Provision for receivable (due from Interserve in respect of Glasgow Recycling Renewable Energy Centre)[2]		**(22.7)**	–
Earnings before interest, tax, depreciation and amortisation		**(25.7)**	3.2
Remeasurement of fair value movement in derivatives[3]	8	**5.8**	(2.4)
Write-down of joint venture shareholder loans[4b]		**–**	(19.2)
Refinancing of joint venture arrangement[4c]		**–**	22.5
Net tax credit arising on non-underlying items	9	**5.0**	3.4
Net non-underlying (charge)/credit		**(14.9)**	7.5

(1) On 26 October 2018, the High Court of Justice of England and Wales issued a judgment in a claim regarding the rights of female members of certain pension schemes to equality of treatment in relation to pension benefits (GMP equalisation). The judgment concluded that the claimant is under a duty to amend the schemes in order to equalise benefits for men and women in relation to guaranteed minimum pension benefit. The issues determined by the judgment arise in relation to many other occupational pension schemes.

The Group estimates, with advice from the Group's corporate actuary, that scheme liabilities will increase by an estimated £3.0 million as a result of the judgement. This cost has been recognised as a past service cost in the current year income statement. The charge is considered non-underlying due to its size and non-recurring nature.

(2) The financial statements recognise a gross receivable of £72.0 million from Interserve Construction Limited in relation to rectifications and completion costs for Glasgow Recycling Renewable Energy Centre. Under IFRIC 12 the difference between the gross contractual value and the expected recovery will be taken directly to the income statement. During the year, Interserve Plc (the holding company of Interserve Construction Limited) entered into administration. The operating company, Interserve Construction Limited with whom we contracted, is currently continuing to trade. As a result of the lack of certainty around the future of Interserve's business and in accordance with IFRS 9, we have sought to make an appropriate market-based credit assessment using the latest relevant public information available. Consequently a provision of £22.7 million has been recognised in the year against the receivable resulting in total cumulative provision at 31 March 2019 of £28.7 million. The charge is considered non-underlying due to its size and non-recurring nature. The financial stability of Interserve Construction Limited is judged to be outside the control of Pennon Group.

(3) In the year a credit of £5.8 million was recognised relating to non-cash derivative fair value movements associated with derivatives that are not designated as being party to an accounting hedge relationship. These movements are non-underlying due to the nature of the item being market dependent and potentially can be significant in value.

(4) In the prior year, on reset of the contracts associated with the Greater Manchester Waste Disposal Authority (GMWDA) an overall net credit before tax of £6.5 million was recognised as follows:

(a) A net amount of £3.2 million was recognised in revenue following the settlement of all outstanding claims relating to the construction of assets.

(b) On reset of the contracts associated with GMWDA ownership of Viridor Laing Holdings Limited passed to the GMWDA. On transfer £23.5 million of Viridor's shareholder loans were repaid, resulting in the write down of the remaining financial asset of £19.2 million.

(c) On reset of the contracts associated with GMWDA, repayment of external bank debt in our joint venture, INEOS Runcorn TPSCo Limited, was financed by GMWDA. This change in cash flows resulted in the recognition of income in this joint venture, with an amount deferred relating to a lower ongoing gate fee. The overall share of profit after tax related to the reset was £22.5 million, which contributed to an increase in investments in joint ventures recognised on the balance sheet to £22.8 million.

These items are considered non-underlying due to their size and non-recurring nature.

Notes to the financial statements
continued

7. Operating costs

	Notes	2019 £m	2018 £m
Employment costs before non-underlying items	13	**205.8**	192.9
Raw materials and consumables		**109.3**	108.7
Other operating expenses before non-underlying items include:			
Profit on disposal of property, plant and equipment		**(3.9)**	(2.5)
Operating lease rentals payable:			
– Plant and machinery		**18.2**	17.2
– Property		**9.3**	8.9
Research and development expenditure		**0.2**	0.1
Trade receivables impairment	22	**3.2**	7.5
Depreciation of property, plant and equipment:			
– Owned assets		**143.9**	139.4
– Under finance leases		**46.1**	43.1
Amortisation of other intangible assets	16	**5.2**	3.6

Operating costs include a charge of £25.7 million relating to non-underlying items, as detailed in note 6.

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

	2019 £000	2018 £000
Fees payable to the Company's auditors and its associates for the audit of parent Company and consolidated financial statements	**102**	91
Fees payable to the Company's auditors and its associates for other services:		
The audit of Company's subsidiaries	**621**	632
Audit related assurance services	**50**	50
Other non-audit services	**118**	111
Total fees	**891**	884
Fees payable to the Company's auditors in respect of Pennon Group pension schemes:		
Audit	**50**	37

Expenses reimbursed to the auditors in relation to the audit of the Group were £63,000 (2018 £57,000).

A description of the work of the Audit Committee is set out in its report on pages 83 to 86 which includes an explanation of how the auditors' objectivity and independence are safeguarded when non-audit services are provided by the auditors' firm.

8. Net finance costs

	Notes	2019 Finance cost £m	2019 Finance income £m	2019 Total £m	2018 Finance cost £m	2018 Finance income £m	2018 Total £m
Cost of servicing debt							
Bank borrowing and overdrafts		**(52.5)**	**–**	**(52.5)**	(48.6)	–	(48.6)
Interest element of finance lease rentals		**(39.2)**	**–**	**(39.2)**	(34.4)	–	(34.4)
Other finance costs		**(2.5)**	**–**	**(2.5)**	(3.9)	–	(3.9)
Interest receivable		**–**	**3.6**	**3.6**	–	2.5	2.5
Interest receivable on shareholder loans to joint ventures		**–**	**5.3**	**5.3**	–	7.9	7.9
		(94.2)	**8.9**	**(85.3)**	(86.9)	10.4	(76.5)
Notional interest							
Interest receivable on service concession arrangements		**–**	**14.6**	**14.6**	–	13.8	13.8
Retirement benefit obligations	30	**(1.4)**	**–**	**(1.4)**	(1.6)	–	(1.6)
Unwinding of discounts on provisions	32	**(11.1)**	**–**	**(11.1)**	(10.2)	–	(10.2)
		(12.5)	**14.6**	**2.1**	(11.8)	13.8	2.0
Net finance cost before non-underlying items		**(106.7)**	**23.5**	**(83.2)**	(98.7)	24.2	(74.5)
Non-underlying items							
Fair value remeasurement of non-designated derivative financial instruments providing commercial hedges		**5.8**	**–**	**5.8**	(2.4)	–	(2.4)
Write-down of joint venture shareholder loans	6	**–**	**–**	**–**	(19.2)	–	(19.2)
Net finance cost after non-underlying items		**(100.9)**	**23.5**	**(77.4)**	(120.3)	24.2	(96.1)

In addition to the above, finance costs of £15.2 million have been capitalised on qualifying assets included in property, plant and equipment (2018 £17.0 million, £14.7 million property, plant and equipment, £2.3 million other intangible assets).

9. Taxation

	Notes	2019 Before non-underlying items £m	2019 Non-underlying items (note 6) £m	2019 Total £m	2018 Before non-underlying items £m	2018 Non-underlying items (note 6) £m	2018 Total £m
Analysis of charge in year							
Current tax charge		**29.4**	**(5.5)**	**23.9**	26.1	(3.0)	23.1
Deferred tax charge		**13.3**	**0.5**	**13.8**	18.3	(0.4)	17.9
Tax charge for year		**42.7**	**(5.0)**	**37.7**	44.4	(3.4)	41.0

UK corporation tax is calculated at 19% (2018 19%) of the estimated assessable profit for the year.

UK corporation tax is stated after a credit relating to prior year current tax of £3.0 million (2018 credit of £3.6 million) and a prior year deferred tax credit of £9.9 million (2018 credit of £2.4 million).

Notes to the financial statements
continued

9. Taxation continued

The total tax charge for the year differs from the theoretical amount which would arise using the standard rate of corporation tax in the UK of 19% (2018 19%) as follows:

	2019 £m	2018 £m
Reconciliation of total tax charge		
Profit before tax	**260.3**	262.9
Profit before tax multiplied by the standard rate of UK corporation tax of 19% (2018 19%)	**49.5**	49.9
Effects of:		
Expenses not deductible for tax purposes	**1.7**	0.3
Joint ventures profits not taxed	**(2.4)**	(6.1)
Adjustments to tax charge in respect of prior years	**(12.9)**	(6.0)
Depreciation charged on non-qualifying assets	**3.7**	1.5
Other	**(1.9)**	1.4
Tax charge for year	**37.7**	41.0

The adjustment to the tax charge in respect of prior years represents a current tax credit of £3.0 million and a deferred tax credit of £9.9 million. These reflect agreements reached with the tax authorities in respect of open enquiries, the release of historical liabilities and the true-up of the previous year's provision to reflect the tax computations filed with HMRC.

The current tax charge for the year differs from the theoretical amount which would arise using the standard rate of corporation tax in the UK of 19% (2018 19%) as follows:

	2019 £m	2018 £m
Reconciliation of current tax charge		
Profit before tax	**260.3**	262.9
Profit before tax multiplied by the standard rate of UK corporation tax of 19% (2018 19%)	**49.5**	49.9
Relief for capital allowances in place of depreciation	**(54.2)**	(49.5)
Disallowance of depreciation charged in the accounts	**31.0**	31.2
Other timing differences	**0.2**	1.6
Adjustments to tax charge in respect of prior years	**(3.0)**	(3.6)
Joint venture profits not taxed	**(2.4)**	(6.1)
Expenses not deductible for tax purposes	**1.7**	0.3
Depreciation charged on non-qualifying assets	**3.7**	1.5
Relief for capitalised interest and foreign exchange gains/losses	**(2.6)**	(2.2)
Current tax charge for year	**23.9**	23.1

The Group's current tax charge is lower than the UK headline tax rate of 19%, primarily due to the availability of capital allowances. Capital allowances provide tax relief when a business incurs expenditure on qualifying capital items such as plant and machinery used by the business. The rates at which capital allowances are given are set by Government. Such allowances are typically higher than depreciation in the earlier years of investment. Over time however these will be equal to one another. As an infrastructure business, these allowances help the Group to plan major investment and consequentially to maintain lower customers bills, as corporation tax relief is given against the investments made.

As noted in the deferred tax note (note 31) the rate of UK corporation tax will reduce to 17% from April 2020.

Joint venture profits are not subject to any additional tax within the Group as these are included on a post tax basis already, as the joint venture entity is subject to UK tax itself.

In addition to the amounts recognised in the income statement the following tax charges and credits were also recognised:

	2019 £m	2018 £m
Amounts recognised directly in other comprehensive income		
Deferred tax (credit)/charge on defined benefit pension schemes	**(3.2)**	4.2
Deferred tax (credit)/charge on cash flow hedges	**(0.6)**	3.5
Amounts recognised directly in equity		
Deferred tax (credit)/charge on share-based payments	**(0.5)**	0.4
Current tax credit on perpetual capital securities periodic return	**–**	(3.8)

10. Profit of the parent company

	2019 £m	2018 £m
Profit attributable to ordinary shareholders' equity dealt within the accounts of the parent company	**194.8**	215.1

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 36), 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, the long-term incentive plan and the deferred shares element of the Annual Incentive Bonus Plan, based on performance criteria for the vesting of the awards.

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

	2019	2018
Number of shares (millions)		
For basic earnings per share	**419.6**	417.9
Effect of dilutive potential ordinary shares from share options	**1.3**	1.5
For diluted earnings per share	**420.9**	419.4

Basic and diluted earnings per ordinary share

Earnings per ordinary share before non-underlying items and deferred tax are presented as the Directors believe that this measure provides a more useful comparison on business trends and performance, since deferred tax reflects distortive effects of changes in corporation tax rates and the level of long-term capital investment. Perpetual capital returns are proportionately adjusted to allow a more useful comparison in the year as the full return is accrued at 31 March but not payable until May in the following financial year. Earnings per share have been calculated as follows:

	2019			2018		
	Profit after tax £m	Earnings per share Basic p	Earnings per share Diluted p	Profit after tax £m	Earnings per share Basic p	Earnings per share Diluted p
Statutory earnings	**214.3**	**51.1**	**50.9**	200.6	48.0	47.8
Deferred tax charge before non-underlying items	**13.3**	**3.1**	**3.1**	18.3	4.4	4.4
Non-underlying items (net of tax)	**14.9**	**3.6**	**3.6**	(7.5)	(1.8)	(1.8)
Proportional adjustment on Perpetual capital returns	**–**	**–**	**–**	1.3	0.3	0.3
Adjusted earnings	**242.5**	**57.8**	**57.6**	212.7	50.9	50.7

12. Dividends

	2019 £m	2018 £m
Amounts recognised as distributions to ordinary equity holders in the year		
Interim dividend paid for the year ended 31 March 2018: 11.97p (2017 11.09p) per share	**50.2**	45.9
Final dividend paid for the year ended 31 March 2018: 26.62p (2017 24.87p) per share	**111.8**	103.6
	162.0	149.5
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2019: 12.84p per share	**54.0**	
Proposed final dividend for the year ended 31 March 2019: 28.22p per share	**118.7**	
	172.7	

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

The proposed interim dividend for 2019 was paid on 4 April 2019 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting.

Notes to the financial statements
continued

13. Employment costs

	Notes	2019 £m	2018 £m
Wages and salaries		**184.3**	170.6
Social security costs		**19.1**	17.4
Pension costs – before non-underlying items	30	**21.9**	20.7
Pension costs – non-underlying items	6	**3.0**	–
Share-based payments	33	**3.6**	2.8
Total employment costs		**231.9**	211.5
Charged:			
Employment costs (excluding non-underlying items) – consolidated income statement		**205.8**	192.9
Employment costs (non-underlying items) – consolidated income statement		**3.0**	–
Capital schemes – property, plant and equipment		**23.1**	18.6
Total employment costs		**231.9**	211.5

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.

	2019	2018
Employees (average full time equivalent number)		
The average monthly number of employees (including Executive Directors) was:		
Water	**1,616**	1,575
Waste management	**3,426**	3,285
Non-household retail	**104**	81
Other	**93**	73
Group totals	**5,239**	5,014

The total number of employees (full-time equivalent) at 31 March 2019 was 5,382 (2018 5,190).

14. Directors' emoluments

	2019 £000	2018 £000
Executive Directors:		
Salary	**932**	914
Performance-related bonus paid or payable	**425**	398
Share-based payments	**936**	667
Other emoluments, including payments in lieu of pension provision	**307**	298
Non-Executive Directors	**508**	477
	3,108	2,754

The cost of share-based payments represents the amount charged to the income statement, as described in note 33. The aggregate gains on vesting of Directors' share-based awards amounted to a total of £nil (2018 £nil). Total gains made by Directors on the exercise of share options were £nil (2018 £nil).

Total emoluments include £nil (2018 £nil) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2019 one Director (2018 one) is accruing retirement benefits under defined benefit pension schemes in respect of which the Group contributed £29,000 (2018 £28,000).

At 31 March 2019 no Director (2018 no) is a member of the Group's defined contribution pension scheme in respect of which the Group contributed £nil (2018 £nil).

At 31 March 2019 two Directors received payments in lieu of pension provision (2018 two).

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 91 to 105.

15. Goodwill

	£m
Cost:	
At 1 April 2017	385.0
At 31 March 2018	385.0
At 31 March 2019	385.0
Carrying amount:	
At 1 April 2017	385.0
At 31 March 2018	385.0
At 31 March 2019	**385.0**

Goodwill acquired in a business combination is allocated at acquisition to the cash generating unit (CGU) expected to benefit from that business combination. £342.7 million of the goodwill balance is allocated to the waste management business, with the remaining £42.3 million allocated to the water business, representing the lowest levels at which goodwill is monitored and tested.

Impairment testing of goodwill
The Group tests goodwill for impairment annually, or more frequently if there are any indications that impairment may have arisen.

The recoverable amount of the water business segment, for which goodwill was recognised on acquisition of Bournemouth Water in 2015, is assessed using level 2 fair value hierarchy techniques, with reference to the market value of the merged water business, using a market based observable premium to regulated capital value.

The recoverable amount of the waste management segment, to which the majority of goodwill is allocated, is determined based on value-in-use calculations which, under IAS 36 'Impairment of Assets', require the use of base cash flow projections that reflect reasonable and supportable assumptions with specific restrictions on the estimates to be used. These include limitations on reflecting cash flows to take account of future cost restructuring, or improvement or enhancement of asset performance. Uncommitted projects are excluded. Discount rates are required to be derived independently of the Group's capital structure and those used reflect management's estimate of a rate that investors would require if they were to choose a similar investment ranging from 6-12% (2018 7-10%) across the CGUs' business activities.

The base cash flow projections have been derived from the Group's detailed budget and strategic plan projections. These cover a period of seven years and are prepared as part of the annual planning cycle. Long-term growth rates of 3%, based on forecast of growth in waste management markets and the UK economy, are applied to cash flows beyond the seven year period.

These plans are based on detailed market-by-market forecasts of projected volumes, prices and costs for each business activity. These forecasts reflect, on an individual operational site basis, numerous assumptions and estimates. The key assumptions include anticipated changes in market size and volumes; recyclate prices; energy selling prices; gate fees; the level of future landfill tax; and cost inflation. Management has determined the value assigned to each assumption based on historical experience, market surveys, industry analysis and current legislation. For business activities with an indefinite life a terminal growth rate has been used.

The results of tests performed during the year demonstrate significant headroom in both CGUs, and it is judged that no reasonable change in the key assumptions would cause the carrying amount of the CGUs to exceed the recoverable amount.

Notes to the financial statements
continued

16. Other intangible assets

	Service concession arrangements £m	Customer contracts £m	Patents £m	Other £m	Total £m
Cost:					
At 1 April 2017	61.5	34.3	0.2	2.6	98.6
Additions	8.1	–	–	1.0	9.1
At 31 March 2018	69.6	34.3	0.2	3.6	107.7
Additions	24.7	–	–	–	24.7
At 31 March 2019	94.3	34.3	0.2	3.6	132.4
Accumulated amortisation:					
At 1 April 2017	0.2	29.9	0.2	1.2	31.5
Charge for year	0.2	2.8	–	0.6	3.6
At 31 March 2018	0.4	32.7	0.2	1.8	35.1
Charge for year	3.3	1.2	–	0.7	5.2
At 31 March 2019	3.7	33.9	0.2	2.5	40.3
Carrying amount:					
At 1 April 2017	61.3	4.4	–	1.4	67.1
At 31 March 2018	69.2	1.6	–	1.8	72.6
At 31 March 2019	**90.6**	**0.4**	**–**	**1.1**	**92.1**

Service concession arrangements, once available for use, are amortised over the useful life of each contract. The average remaining life is 21 years (2018 22 years).

Customer contracts are amortised over the useful life of each contract which at acquisition ranged between 2 and 15 years. The weighted average remaining life is 1 year (2018 1 year).

Patents have been amortised in full over their estimated useful lives which at acquisition was 13 years.

Other, including computer software, is amortised over the useful life of the assets which at acquisition was 5 years. The average remaining life is 4 years (2018 5 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.

During the year borrowing costs of £nil million (2018 £2.3 million at an average borrowing rate of 3.7%) have been capitalised on qualifying assets.

17. Property, plant and equipment

	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
Group							
Cost:							
At 1 April 2017	539.4	1,854.8	706.4	2,734.2	71.7	372.3	6,278.8
Additions	12.3	13.2	1.8	45.4	11.1	305.2	389.0
Assets adopted at fair value	–	8.0	–	–	–	–	8.0
Grants and contributions	–	(2.2)	–	–	–	–	(2.2)
Disposals	(0.4)	(1.2)	–	(9.9)	–	–	(11.5)
Transfers/reclassifications	3.7	21.9	11.1	85.4	–	(122.1)	–
At 31 March 2018	555.0	1,894.5	719.3	2,855.1	82.8	555.4	6,662.1
Additions	5.2	16.4	2.2	50.0	22.8	290.6	387.2
Assets adopted at fair value	–	10.0	–	–	–	–	10.0
Grants and contributions	–	(2.2)	–	–	–	–	(2.2)
Disposals	(0.7)	(1.2)	–	(16.4)	–	–	(18.3)
Transfers/reclassifications	1.0	36.1	20.0	409.4	–	(466.5)	–
At 31 March 2019	560.5	1,953.6	741.5	3,298.1	105.6	379.5	7,038.8
Accumulated depreciation:							
At 1 April 2017	384.7	246.8	240.0	1,246.7	57.4	–	2,175.6
Charge for year	17.2	23.0	13.4	125.3	7.0	–	185.9
Disposals	(0.2)	(1.2)	–	(8.6)	–	–	(10.0)
At 31 March 2018	401.7	268.6	253.4	1,363.4	64.4	–	2,351.5
Charge for year	11.1	22.1	13.4	136.6	10.4	–	193.6
Disposals	(0.2)	(1.2)	–	(14.3)	–	–	(15.7)
At 31 March 2019	412.6	289.5	266.8	1,485.7	74.8	–	2,529.4
Net book value:							
At 1 April 2017	154.7	1,608.0	466.4	1,487.5	14.3	372.3	4,103.2
At 31 March 2018	153.3	1,625.9	465.9	1,491.7	18.4	555.4	4,310.6
At 31 March 2019	**147.9**	**1,664.1**	**474.7**	**1,812.4**	**30.8**	**379.5**	**4,509.4**

Of the total depreciation charge of £193.6 million (2018 £185.9 million), £1.6 million (2018 £1.5 million) has been charged to capital projects, £2.0 million (2018 £1.9 million) has been offset by deferred income and £190.0 million (2018 £182.5 million) has been charged against profits. Asset lives and residual values are reviewed annually. During the year borrowing costs of £15.2 million (2018 £14.7 million) have been capitalised on qualifying assets, at an average borrowing rate of 4.0% (2018 3.7%).

Groups of assets forming cash generating units are reviewed for indicators of impairment. No indicators of impairment were identified during the year.

Asset lives are reviewed annually. No significant changes were required in 2018/19.

Notes to the financial statements
continued

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	Construction in progress £m	Total £m
Group						
Cost:						
At 31 March 2018	–	416.9	463.7	673.7	0.2	1,554.5
At 31 March 2019	3.3	428.4	471.1	672.9	5.2	1,580.9
Accumulated depreciation:						
At 31 March 2018	–	63.3	119.4	305.3	–	488.0
At 31 March 2019	0.1	68.2	126.7	315.2	–	510.2
Net book amount:						
At 31 March 2018	–	353.6	344.3	368.4	0.2	1,066.5
At 31 March 2019	**3.2**	**360.2**	**344.4**	**357.7**	**5.2**	**1,070.7**

	Fixed and mobile plant, vehicles and computers £m
Company	
Cost:	
At 1 April 2017	0.3
Additions	0.1
At 31 March 2018	0.4
Additions	0.1
At 31 March 2019	0.5
Accumulated depreciation:	
At 1 April 2017	0.1
Charge for year	0.1
At 31 March 2018	0.2
Charge for year	–
At 31 March 2019	0.2
Net book value:	
At 1 April 2017	0.2
At 31 March 2018	0.2
At 31 March 2019	**0.3**

Asset lives and residual values are reviewed annually.

18. Financial instruments by category

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

		Fair value			Amortised cost		
	Notes	Derivatives used for fair value hedging £m	Derivatives used for cash flow hedging £m	Derivatives not in a hedge accounting relationship £m	Debt Instruments at amortised Cost £m	Trade receivables and trade payables £m	Total £m
Group							
31 March 2019							
Financial assets							
Trade receivables	22	**–**	**–**	**–**	**–**	**261.2**	**261.2**
Other receivables	19,22	**–**	**–**	**–**	**263.8**	**–**	**263.8**
Derivative financial instruments	23	**3.4**	**3.1**	**75.8**	**–**	**–**	**82.3**
Cash and cash deposits	25	**–**	**–**	**–**	**569.6**	**–**	**569.6**
Total		**3.4**	**3.1**	**75.8**	**833.4**	**261.2**	**1,176.9**
Financial liabilities							
Borrowings	28	**–**	**–**	**–**	**(3,649.1)**	**–**	**(3,649.1)**
Derivative financial instruments	23	**–**	**(20.5)**	**(0.5)**	**–**	**–**	**(21.0)**
Trade payables	26	**–**	**–**	**–**	**–**	**(127.6)**	**(127.6)**
Other payables	26	**–**	**–**	**–**	**–**	**(4.1)**	**(4.1)**
Total		**–**	**(20.5)**	**(0.5)**	**(3,649.1)**	**(131.7)**	**(3,801.8)**
31 March 2018							
Financial assets							
Trade receivables	22	–	–	–	–	220.7	220.7
Other receivables	19,22	–	–	–	266.6	–	266.6
Derivative financial instruments	23	4.1	7.0	72.3	–	–	83.4
Cash and cash deposits	25	–	–	–	585.3	–	585.3
Total		4.1	7.0	72.3	851.9	220.7	1,156.0
Financial liabilities							
Borrowings	28	–	–	–	(3,386.8)	–	(3,386.8)
Derivative financial instruments	23	–	(16.7)	(0.9)	–	–	(17.6)
Trade payables	26	–	–	–	–	(96.9)	(96.9)
Other payables	26,29	–	–	–	–	(48.0)	(48.0)
Total		–	(16.7)	(0.9)	(3,386.8)	(144.9)	(3,549.3)
Company							
31 March 2019							
Financial assets							
Amounts owed by subsidiaries	19,22	**–**	**–**	**–**	**1,064.5**	**–**	**1,064.5**
Other receivables	22	**–**	**–**	**–**	**0.1**	**–**	**0.1**
Derivative financial instruments	23	**3.4**	**3.1**	**–**	**–**	**–**	**6.5**
Cash and cash deposits	25	**–**	**–**	**–**	**284.8**	**–**	**284.8**
Total		**3.4**	**3.1**	**–**	**1,349.4**	**–**	**1,355.9**
Financial liabilities							
Amounts due to subsidiaries	26	**–**	**–**	**–**	**(0.1)**	**–**	**(0.1)**
Borrowings	28	**–**	**–**	**–**	**(1,325.4)**	**–**	**(1,325.4)**
Derivative financial instruments	23	**–**	**(0.9)**	**–**	**–**	**–**	**(0.9)**
Trade payables	26	**–**	**–**	**–**	**–**	**(0.2)**	**(0.2)**
Total		**–**	**(0.9)**	**–**	**(1,325.5)**	**(0.2)**	**(1,326.6)**
31 March 2018							
Financial assets							
Amounts owed by subsidiaries	19,22	–	–	–	886.9	–	886.9
Other receivables	22	–	–	–	0.3	–	0.3
Derivative financial instruments	23	4.1	6.5	–	–	–	10.6
Cash and cash deposits	25	–	–	–	303.3	–	303.3
Total		4.1	6.5	–	1,190.5	–	1,201.1
Financial liabilities							
Amounts due to subsidiaries	26	–	–	–	(5.7)	–	(5.7)
Borrowings	28	–	–	–	(1,144.9)	–	(1,144.9)
Derivative financial instruments	23	–	(3.6)	–	–	–	(3.6)
Trade payables	26	–	–	–	–	(0.1)	(0.1)
Other payables	26	–	–	–	–	(44.3)	(44.3)
Total		–	(3.6)	–	(1,150.6)	(44.4)	(1,198.6)

Notes to the financial statements
continued

19. Other non-current assets
Non-current receivables

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Amounts owed by subsidiary undertakings	**–**	–	**1,044.6**	846.0
Amounts owed by related parties (note 44)	**67.8**	39.4	**–**	–
Service concession arrangements	**188.3**	222.9	**–**	–
Other receivables	**0.3**	1.2	**–**	–
	256.4	263.5	**1,044.6**	846.0

Non-current receivables were due:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Between 1 and 2 years	**44.0**	12.9	**48.6**	35.5
Over 2 years and less than 5 years	**135.2**	34.9	**148.1**	108.1
Over 5 years	**77.2**	215.7	**847.9**	702.4
	256.4	263.5	**1,044.6**	846.0

The fair values of non-current receivables were:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Amounts owed by subsidiary undertakings	**–**	–	**1,160.4**	909.5
Amounts owed by related parties	**81.9**	70.6	**–**	–
Service concession arrangements	**188.3**	222.9	**–**	–
Other receivables	**0.3**	1.2	**–**	–
	270.5	294.7	**1,160.4**	909.5

The Group has a number of service concession arrangements with local authority clients in the waste management sector to build and operate recycling assets and energy recovery facilities. The terms of the contracts, including pricing and performance obligations, are established at the outset and the contracts are typically for a duration of 24 years. The assets revert to the local authority at the end of the contract. At 31 March 2019 the average remaining duration of the service concession arrangements was 21 years (2018 22 years). No material expected credit loss provision has been recognised in respect of service concession arrangements.

Service concession arrangements includes £nil (2018: £134.5 million) in respect of contract assets. The contract asset balance at 31 March 2018 related to the Glasgow Recycling and Renewable Energy Centre which was in the course of construction at that time and met the definition of a contract asset. Construction was completed during the year ended 31 March 2019.

The fair value of amounts owed by related parties is based on cash flows using a rate based on the borrowings rate of 2.4% (2018 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 12.6% (2018 12.6%).

Other receivables include site development and pre-contract costs of £nil (2018 £0.7 million).

A significant proportion of the non-current asset balances are due from local government authorities or joint venture companies which principally operate under long-term local government authority contracts.

20. Investments
Subsidiary undertakings

	£m
Company	
At 1 April 2017	1,624.2
Additions	356.7
Disposals	(0.1)
At 31 March 2018	1,980.8
At 31 March 2019	**1,980.8**

The recoverable amount of investments is determined based on value-in-use calculations, which are set out in note 15.

20. Investments continued
Joint ventures

	Shares £m
Group	
At 1 April 2017	0.1
Share of post-tax profit – underlying	9.4
Share of post-tax profit – non-underlying	22.5
Share of other comprehensive charges	(2.7)
Disposals	–
Dividends received	(6.5)
At 31 March 2018	22.8
Additions	20.9
Share of post–tax profit	12.4
Share of other comprehensive income	0.5
Dividends received	(5.5)
At 31 March 2019	**51.1**

In December 2018 John Laing Investments Limited, a joint venture partner with the Group in INEOS Runcorn (TPS) Holdings Limited (Runcorn I ERF) sold its holding. The Group exercised its pre-emption rights and paid a total cash consideration of £54.8 million for the 37.5% economic interest and 20% voting rights. The cash consideration has been allocated £20.9 million to investment in equity shares and £33.9 million to investment in shareholder loans. The acquisition increased the Group's economic interest in Runcorn I ERF from 37.5% to 75%, with the associated voting rights moving from 20% to 40%. With the acquisition the Group now has joint control over Runcorn I ERF and classifies its investment as a joint venture. Previously the Group had classified its investment as an associate because the other joint venture partners could have operated without the Group's agreement. The equity method of accounting is used for both classifications, so the same accounting treatment has been applied continuously.

Details of the Group's principal subsidiary and joint venture undertakings are set out in note 40.

The Group's joint ventures listed below all have share capital consisting solely of ordinary shares which is held directly by the Group.

Name of Entity	Place of business/ country of incorporation	% of ownership	Measurement method
Lakeside Energy from Waste Holdings Limited(1)	England	50	Equity
INEOS Runcorn (TPS) Holdings Limited(2)	England	40	Equity

(1) Lakeside Energy from Waste Holdings Limited provides energy recovery facility services.
(2) INEOS Runcorn (TPS) Holdings Limited provides energy recovery facilities. The Group's economic interest is 75% as set out in note 40.

The Group's joint ventures are all private companies and there are no quoted market prices available for their shares.

Summarised financial information for the Group's joint ventures:

Summarised balance sheet

	2019		2018	
	Lakeside Energy from Waste Holdings Limited £m	**INEOS Runcorn (TPS) Holdings Limited £m**	Lakeside Energy from Waste Holdings Limited £m	INEOS Runcorn (TPS) Holdings Limited £m
Current				
Cash and cash equivalents	**22.5**	**15.9**	16.1	15.5
Other current assets	**8.7**	**11.4**	8.6	10.0
Total current assets	**31.2**	**27.3**	24.7	25.5
Borrowings	**–**	**–**	–	–
Other current liabilities	**(6.2)**	**(0.1)**	(6.5)	(8.6)
Total current liabilities	**(6.2)**	**(0.1)**	(6.5)	(8.6)
Non-current				
Assets	**101.9**	**193.1**	109.8	270.3
Borrowings	**(88.8)**	**(86.7)**	(95.5)	(86.9)
Other liabilities	**(25.8)**	**(73.7)**	(28.4)	(145.1)
Total non-current liabilities	**(114.6)**	**(160.4)**	(123.9)	(232.0)
Net assets	**12.3**	**59.9**	4.1	55.2
Net debt	**(66.3)**	**(70.8)**	(79.4)	(71.4)
Associated shareholder loans	**15.4**	**86.7**	16.3	86.9
Net (debt)/funds (excluding shareholder loans)	**(50.9)**	**15.9**	(63.1)	15.5

Notes to the financial statements
continued

20. Investments continued

Summarised statement of comprehensive income

	2019		2018		
	Lakeside Energy from Waste Holdings Limited £m	**INEOS Runcorn (TPS) Holdings Limited £m**	Lakeside Energy from Waste Holdings Limited £m	Viridor Laing (Greater Manchester) Holdings Limited £m	INEOS Runcorn (TPS) Holdings Limited £m
Revenue	**52.8**	**43.6**	49.2	85.3	53.7
EBITDA	**37.4**	**24.8**	33.7	3.6	38.7
Depreciation and amortisation	**(7.9)**	**(9.7)**	(7.9)	(0.6)	(12.1)
Non-underlying credit (see note 6)	**–**	**–**	–	–	60.0
Interest receivable on service concessions	**–**	**–**	–	11.3	–
Other net interest charge	**(7.3)**	**(9.5)**	(7.5)	(14.5)	(20.3)
Pre-tax profit/(loss)	**22.2**	**5.6**	18.3	(0.2)	66.3
Income tax (expense)/income	**(4.0)**	**(0.9)**	(3.8)	0.1	(0.3)
Post-tax profit/(loss)	**18.2**	**4.7**	14.5	(0.1)	66.0
Other comprehensive income	**1.0**	**–**	3.9	–	36.7
Total comprehensive income	**19.2**	**4.7**	18.4	(0.1)	102.7
Dividends paid by joint venture	**(11.0)**	**–**	(13.0)	–	–

The information above reflects the amounts presented in the financial statements of the joint ventures adjusted for differences in accounting policies between the Group and the joint ventures. The information reflects 100% of the joint ventures' results and net liabilities. The prior year information for Viridor Laing (Greater Manchester) Holdings Limited covers the period from the start of the year to date of disposal.

Reconciliation of summarised financial information

Reconciliation of the summarised financial information presented to the carrying amount of its interest in the joint ventures.

	2019		2018		
	Lakeside Energy from Waste Holdings Limited £m	**INEOS Runcorn (TPS) Holdings Limited £m**	Lakeside Energy from Waste Holdings Limited £m	Viridor Laing (Greater Manchester) Holdings Limited £m	INEOS Runcorn (TPS) Holdings Limited £m
Opening net assets /(liabilities) 1 April	**4.1**	**55.2**	(1.3)	(34.9)	(47.5)
Profit/(loss) for the year	**18.2**	**4.7**	14.5	–	66.0
Other comprehensive income/(loss)	**1.0**	**–**	3.9	–	36.7
Dividends paid	**(11.0)**	**–**	(13.0)	–	–
Disposal	**–**	**–**	–	34.9	–
Closing net assets	**12.3**	**59.9**	4.1	–	55.2
Carrying value being net interest in share of net assets	**6.2**	**44.9**	2.1	–	20.7

21. Inventories

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Raw materials and consumables	**28.8**	24.6	**–**	–

22. Trade and other receivables – current

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Trade receivables	**360.2**	325.0	**–**	–
Less: allowance for expected credit losses in respect of trade receivables	**(99.0)**	(104.3)	**–**	–
Net trade receivables	**261.2**	220.7	**–**	–
Amounts owed by related parties (note 44)	**7.7**	4.3	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**19.9**	41.0
Other receivables	**5.9**	4.1	**0.1**	0.3
Prepayments and accrued income	**210.0**	186.9	**1.6**	1.4
	484.8	416.0	**21.6**	42.7

Trade receivables include accrued income relating to customers with water budget payment plans. The increased activity from the three additional Energy Recovery Facilities becoming operational in the Waste Management business during the year coupled with increased demand in water business has resulted in an increase in trade receivables balances.

In the current year prepayments and accrued income include a net receivable of £43.3 million (2018 £62.7 million) relating to gross contractual compensation amounts due totalling £72.0 million (2018 £68.7 million) arising from additional costs incurred in the construction of the Glasgow Recycling and Renewable Energy Centre (GRREC). A full credit risk appraisal has been carried out on this receivable and a provision of £28.7 million (2018 £6.0 million) has been recognised for expected credit losses as detailed in note 4. For other accrued income balances, no material expected credit loss provision has been recognised.

Prepayments and accrued income includes £nil (2018 £6.1 million) in respect of contract assets. The contract asset balance at 31 March 2018 related to the GRREC which was in the course of construction at that time. Construction was completed during the year ended 31 March 2019.

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 applies the simplified approach in calculating the expected credit losses for trade receivables allowing a provision matrix to be used which is based on the expected life of trade receivables, default rates for different customer categories within the collection process and forward-looking information.

As at 31 March, an analysis of the ageing of trade receivables is as follows:

	2019 £m	2018 £m
Group		
Not due	**152.2**	80.3
Past due 1 – 30 days	**22.5**	55.6
Past due 31 – 120 days	**25.2**	27.8
More than 120 days	**160.3**	161.3
	360.2	325.0

The aged trade receivables above are taken directly from aged sales ledger records before deduction of credit balances and other adjustments.

The Group's operating businesses specifically review separate categories of debt to identify an appropriate allowance for expected credit losses as outlined in note 2(o). South West Water Limited has a duty under legislation to continue to provide domestic customers with services regardless of payment. The expected credit loss rate applied ranges from 0% (not due) to 100% (>120 days and untraced previous occupier).

No material expected credit loss provision has been recognised in respect of amounts owed by subsidiary undertakings.

The movement in the allowance for expected credit losses in respect of trade receivables was:

	2019 £m	2018 £m
At 1 April	**104.3**	98.1
Associated with acquisition of trade receivables (non-household market)	**–**	3.0
Provision for expected credit losses	**3.2**	7.5
Receivables written off during the year as uncollectable	**(8.5)**	(4.3)
At 31 March	**99.0**	104.3

Notes to the financial statements
continued

23. Derivative financial instruments

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Derivatives used for cash flow hedging				
Non-current assets	**1.0**	3.4	**1.1**	3.4
Current assets	**2.1**	3.6	**2.0**	3.1
Current liabilities	**(10.7)**	(8.9)	**(0.2)**	(2.7)
Non-current liabilities	**(9.8)**	(7.8)	**(0.7)**	(0.9)
Derivatives used for fair value hedging				
Non-current assets	**2.6**	3.3	**2.6**	0.8
Current assets	**0.8**	0.8	**0.8**	3.3
Derivatives not in a hedge accounting relationship				
Non-current assets	**66.9**	63.8	**–**	–
Current assets	**8.9**	8.5	**–**	–
Current liabilities	**(0.4)**	(0.5)	**–**	–
Non-current liabilities	**(0.1)**	(0.4)	**–**	–

The Group's financial risks and risk management policies are set out in note 3. The fair value of 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 hedging relationships was £nil (2018 £nil).

During the year a £6.8 million charge (2018 £15.6 million) was recognised in profit and loss relating to cash flow hedges previously recognised through other comprehensive income and recorded in the hedging reserve. A £6.4 million charge (2018 £20.5 million credit) was recognised as an other comprehensive loss/income for cash flow hedges that may be classified subsequently to profit and loss.

Interest rate swaps, primarily cash flow hedges, and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 60% of Group net borrowings are at fixed rate. At 31 March 2019 63% of Group net borrowings were at fixed rate (2018 62%).

At 31 March 2019 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £1,529 million and a weighted average maturity of 3.2 years (2018 £978 million, with 2.1 years). The weighted average interest rate of the swaps for their nominal amount was 1.7% (2018 2.0%).

The periods for which cash flow hedges are expected to affect future profit or loss are as follows:

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Due over 5 years £m	Total £m
Group					
31 March 2019					
Assets	**2.1**	**0.5**	**0.5**	**–**	**3.1**
Liabilities	**(10.7)**	**(2.1)**	**(5.8)**	**(1.9)**	**(20.5)**
31 March 2018					
Assets	2.8	2.2	1.8	0.2	7.0
Liabilities	(8.9)	(7.8)	–	–	(16.7)
Company					
31 March 2019					
Assets	**2.0**	**0.5**	**0.6**	**–**	**3.1**
Liabilities	**(0.2)**	**(0.2)**	**(0.4)**	**(0.1)**	**(0.9)**
31 March 2018					
Assets	2.2	2.2	1.9	0.2	6.5
Liabilities	(2.0)	(0.8)	(0.8)	–	(3.6)

In addition, the Group has cash flow hedges that are expected to affect future amounts recognised in property, plant and equipment, amounting to assets of £nil million (2018 £3.0 million).

23. Derivative financial instruments continued

Valuation hierarchy

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 fair value of financial instruments not traded in an active market (level 2, 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 Group's financial instruments are valued using level 2 measures:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Assets				
Derivatives used for cash flow hedging	**3.1**	7.0	**3.1**	6.5
Derivatives used for fair value hedging	**3.4**	4.1	**3.4**	4.1
Derivatives not in a hedge accounting relationship	**75.8**	72.3	**–**	–
Total assets	**82.3**	83.4	**6.5**	10.6
Liabilities				
Derivatives used for cash flow hedging	**20.5**	16.7	**0.9**	3.6
Derivatives not in a hedge accounting relationship	**0.5**	0.9	**–**	–
Total liabilities	**21.0**	17.6	**0.9**	3.6

24. Financial instruments at fair value through profit

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Current liabilities	**3.8**	2.6	**0.4**	0.4
Non-current liabilities	**43.1**	46.6	**1.4**	1.7

Financial instruments at fair value through profit reflect the fair value movement of the hedged risk on a hedged item which had been designated in a fair value hedging relationship.

25. Cash and cash deposits

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Cash at bank and in hand	**110.5**	114.9	**109.7**	15.2
Short-term bank deposits	**45.0**	113.0	**45.0**	113.0
Other deposits	**414.1**	357.4	**130.1**	175.1
Total cash and cash deposits	**569.6**	585.3	**284.8**	303.3

Group short-term deposits have an average maturity of 1 working day.

Group other deposits have an average maturity of 61 days.

Group other deposits include restricted funds of £203.9 million (2018 £182.3 million) to settle long-term lease liabilities (note 28). Restricted funds are available for access, subject to being replaced by an equivalent valued security.

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

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Cash and cash deposits as above	**569.6**	585.3	**284.8**	303.3
Less: deposits with a maturity of three months or more (restricted funds)	**(203.9)**	(182.3)	**–**	–
	365.7	403.0	**284.8**	303.3

Notes to the financial statements
continued

26. Trade and other payables – current

	Group		Company	
	2019 £m	2018 (reanalysed) £m	**2019 £m**	2018 (reanalysed) £m
Trade payables	**127.6**	96.9	**0.2**	0.1
Contract liabilities	**10.3**	11.5	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**0.1**	5.7
Amounts owed to joint ventures (note 44)	**4.1**	3.7	**–**	–
Other tax and social security	**32.5**	48.4	**0.8**	0.6
Accruals and other payables	**123.5**	181.5	**14.7**	50.7
	298.0	342.0	**15.8**	57.1

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

At 31 March 2018 accruals and other payables included an amount of £44.3 million due to Nomura Structured Holdings plc on unwind of a synthetic derivative.

Prior year comparatives have been re-analysed to separately recognise contract liabilities in accordance with IFRS 15. Contract liabilities are recognised when consideration is received in advance of the Group performing its obligations to customers. The movement in the contract liabilities was:

Contract liabilities	**2019 £m**	2018 £m
At 1 April	**120.2**	112.3
Revenue recognised in the year	**(12.2)**	(9.5)
Consideration received in advance of completion of performance obligations	**18.4**	17.4
At 31 March	**126.4**	120.2

The analysis of contract liabilities between current and non-current is:

	2019 £m	2018 £m
Current	**10.3**	11.5
Non-current (note 29)	**116.1**	108.7
	126.4	120.2

Performance obligations related to the current contract liabilities balance above are expected to be satisfied, and revenue will be recognised, within the financial year ended 31 March 2020.

27. Current tax liabilities

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Current year creditor	**12.9**	11.8	**1.9**	(1.7)
Prior year tax items	**6.2**	12.6	**1.7**	25.6
	19.1	24.4	**3.6**	23.9

28. Borrowings

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Current				
Short-term loans	**59.8**	149.6	**51.8**	149.6
European Investment Bank	**27.0**	32.0	**–**	–
Amounts owed to subsidiary undertakings (note 44)	**–**	–	**283.9**	283.6
	86.8	181.6	**335.7**	433.2
Obligations under finance leases	**63.6**	28.2	**–**	–
Total current borrowings	**150.4**	209.8	**335.7**	433.2
Non-current				
Bank and other loans	**443.1**	229.0	**370.9**	149.1
Private placements	**616.2**	619.6	**509.3**	562.6
Bond 2040	**134.2**	133.9	**–**	–
RPI index-linked bonds	**434.5**	426.3	**–**	–
European Investment Bank	**373.9**	291.4	**109.5**	–
	2,001.9	1,700.2	**989.7**	711.7
Obligations under finance leases	**1,496.8**	1,476.8	**–**	–
Total non-current borrowings	**3,498.7**	3,177.0	**989.7**	711.7
Total borrowings	**3,649.1**	3,386.8	**1,325.4**	1,144.9

The Group has finance leases for various assets as shown in note 17.

The Company issued a £100 million private placement in July 2007 maturing in 2022. Interest is payable at a fixed rate of 3.3%.

South West Water Finance Plc issued a £200 million RPI index-linked bond in July 2008 maturing in 2057 with a cash coupon of 1.99%. South West Water Finance Plc issued a £150 million bond in July 2010 maturing in 2040 with a cash coupon of 5.875%.

Bournemouth Water Limited issued a £65 million RPI index-linked bond in April 2005 maturing in 2033 with a cash coupon of 3.084%. This instrument was transferred to South West Water Limited in April 2017.

The fair values of non-current borrowings, valued using level 2 measures (as set out in note 23) were:

	2019		2018	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Group				
Bank and other loans	**443.1**	**447.3**	229.0	232.8
Private placements	**616.2**	**657.7**	619.6	652.3
Bond 2040	**134.2**	**197.5**	133.9	197.5
RPI index-linked bond	**434.5**	**526.4**	426.3	495.5
European Investment Bank	**373.9**	**345.2**	291.4	251.5
	2,001.9	**2,174.1**	1,700.2	1,829.6
Obligations under finance leases	**1,496.8**	**1,431.6**	1,476.8	1,350.0
	3,498.7	**3,605.7**	3, 177.0	3,179.6
Company				
Bank and other loans	**370.9**	**484.8**	149.1	152.4
European Investment Bank	**109.5**	**109.5**	–	–
Private placements	**509.3**	**557.7**	562.6	595.4
	989.7	**1,152.0**	711.7	747.8

Where market values are not available, fair values of borrowings have been calculated by discounting expected future cash flows at prevailing interest rates.

The maturity of non-current borrowings was:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Between 1 and 2 years	**68.3**	190.6	**51.8**	102.0
Over 2 years and less than 5 years	**834.5**	574.3	**557.7**	260.6
Over 5 years	**2,595.9**	2,412.1	**380.2**	349.1
	3,498.7	3,177.0	**989.7**	711.7

The weighted average maturity of non-current borrowings was 18 years (2018 19 years).

Notes to the financial statements
continued

28. Borrowings continued

Finance lease liabilities – minimum lease payments were:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Within 1 year	**92.2**	52.1	**–**	–
Over 1 year and less than 5 years	**297.6**	310.8	**–**	–
Over 5 years	**2,153.9**	2,121.7	**–**	–
	2,543.7	2,484.6	**–**	–
Less: future finance charges	**(983.3)**	(979.6)	**–**	–
Present value of finance lease liabilities	**1,560.4**	1,505.0	**–**	–

The maturity of finance lease liabilities was:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Within 1 year	**63.6**	28.2	**–**	–
Over 1 year and less than 5 years	**188.9**	209.7	**–**	–
Over 5 years	**1,307.9**	1,267.1	**–**	–
	1,560.4	1,505.0	**–**	–

Included above are accrued finance charges arising on obligations under finance leases totalling £163.7 million (2018 £155.7 million), of which £3.7 million (2018 £3.4 million) is repayable within one year.

The period for repayment of certain leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £97.5 million at 31 March 2019 (2018 £87.9 million), are currently being held to settle the lease liability, subject to rights to release by negotiation with the lessor. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

The period for repayment of certain other existing leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £105.1 million at 31 March 2019 (2018 £92.5 million), are currently being held to settle the lease liability, subject to rights to release by negotiation with the lessor. The deposits are subject to a registered charge given as security to the lessor for the outstanding balance.

Undrawn committed borrowing facilities at the balance sheet date were:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Floating rate:				
Expiring within 1 year	**–**	180.0	**–**	100.0
Expiring after 1 year	**600.0**	405.9	**405.0**	125.0
	600.0	585.9	**405.0**	225.0

In addition at 31 March 2019 the Group had undrawn uncommitted short-term bank facilities of £30.0 million (2018 £30.0 million) available to the Company.

29. Other non-current liabilities

	Group		Company	
	2019 £m	2018 (reanalysed) £m	**2019 £m**	2018 (reanalysed) £m
Amounts owed to subsidiary undertakings	–	–	**8.6**	8.7
Contract liabilities	**116.1**	108.7	**–**	–
Deferred income	**7.5**	9.8	**–**	–
Other payables	**24.3**	21.6	**–**	–
	147.9	140.1	**8.6**	8.7

Non-current Contract liabilities relate to consideration received in advance of the Group performing its performance obligations to customers where performance obligations will not be completed within twelve months of the balance sheet date. The overall movement in total contract liabilities is disclosed in note 26. Contract liabilities reflect the fair value of assets transferred from customers in the water segment.

Included in 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. Further disclosures have not been provided in accordance with IAS 37 paragraph 92.

30. Retirement benefit obligations

During the year the Group operated a number of defined benefit pension schemes and also a defined contribution scheme. The principal plan within the Group is the Pennon Group Pension Scheme, which is a funded defined benefit, final salary pension scheme in the UK. The Group's pension schemes are established under trust law and comply with all relevant UK legislation.

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 £8.8 million (2018 £6.1 million).

Defined benefit schemes

Assumptions

The principal actuarial assumptions at 31 March were:

	2019 %	2018 %	2017 %
Rate of increase in pensionable pay	**3.3**	3.2	3.2
Rate of increase for current and future pensions	**3.2**	3.0	2.0
Rate used to discount schemes' liabilities and expected return on schemes' assets	**2.40**	2.70	2.55
Inflation	**3.3**	3.2	3.2

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 calculation based on CMI 2018 actuarial tables 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 as:

	2019	2018	2017
Male	**23.9**	24.9	24.8
Female	**26.3**	27.3	27.2

The average life expectancy in years of a future pensioner retiring at age 62, 20 years after the balance sheet date, is projected as:

	2019	2018	2017
Male	**25.0**	26.3	26.2
Female	**28.1**	29.6	29.5

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%	+/– 0.6%
Rate of increase in current and future pensions	+/– 0.5%	+/– 6.5%
Rate used to discount schemes' liabilities	+/– 0.5%	+/– 9.7%
Inflation	+/– 0.5%	+/– 6.7%
Life expectancy	+/– 1 year	+/– 4.7%

The sensitivity analysis shows the effect of changes in the principal assumptions used for the measurement of the pension liability. The method used to calculate the sensitivities is approximate and has been determined taking into account the duration of the liabilities and the overall profile of each schemes' membership. This is the same approach as has been adopted in previous years.

The amounts recognised in the balance sheet were:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Present value of financial obligations	**(974.2)**	(931.2)	**(58.5)**	(56.5)
Fair value of plan assets	**934.0**	898.5	**55.1**	53.2
Deficit of funded plans	**(40.2)**	(32.7)	**(3.4)**	(3.3)
Impact of minimum funding asset ceiling	**(20.6)**	(16.8)	**–**	–
Net liability recognised in the balance sheet	**(60.8)**	(49.5)	**(3.4)**	(3.3)

Notes to the financial statements
continued

30. Retirement benefit obligations continued

The movement in the net defined benefit obligation over the accounting period is as follows:

	2019			2018		
	Present value of obligation £m	**Fair value of plan assets £m**	**Total £m**	Present value of obligation £m	Fair value of plan assets £m	Total £m
At 1 April	**(948.0)**	**898.5**	**(49.5)**	(971.4)	903.4	(68.0)
Current service cost	**(13.1)**	**–**	**(13.1)**	(13.9)	–	(13.9)
Past service cost and gains and losses on settlements	**(3.0)**	**–**	**(3.0)**	(0.7)	–	(0.7)
Interest (expense)/income	**(25.2)**	**23.8**	**(1.4)**	(24.1)	22.5	(1.6)
	(41.3)	**23.8**	**(17.5)**	(38.7)	22.5	(16.2)
Remeasurements:						
(Loss)/Return on plan assets excluding amounts included in interest expense	**–**	**20.2**	**20.2**	–	(5.7)	(5.7)
Gain from change in demographic assumptions	**41.6**	**–**	**41.6**	1.0	–	1.0
(Loss)/gain from change in financial assumptions	**(75.8)**	**–**	**(75.8)**	30.6	–	30.6
Experience losses	**(3.2)**	**–**	**(3.2)**	(1.4)	–	(1.4)
	(37.4)	**20.2**	**(17.2)**	30.2	(5.7)	24.5
Contributions:						
Employers	**–**	**23.4**	**23.4**	–	10.2	10.2
Plan participants	**(1.0)**	**1.0**	**–**	(1.0)	1.0	–
Payments from plans:						
Benefit payments	**32.9**	**(32.9)**	**–**	32.9	(32.9)	–
	31.9	**(8.5)**	**23.4**	31.9	(21.7)	10.2
At 31 March	**(994.8)**	**934.0**	**(60.8)**	(948.0)	898.5	(49.5)

Past service cost for the current year includes a non-underlying charge of £3.0 million representing an estimate of the increase in liabilities that results from GMP equalisation requirements following a court case in 2018 (see note 6).

The movement in the Company's net defined benefit obligation over the accounting period is as follows:

	2019			2018		
	Present value of obligation £m	**Fair value of plan assets £m**	**Total £m**	Present value of obligation £m	Fair value of plan assets £m	Total £m
At 1 April	**(56.5)**	**53.2**	**(3.3)**	(58.0)	53.9	(4.1)
Current service cost	**(0.3)**	**–**	**(0.3)**	(0.3)	–	(0.3)
Past service cost and gains and losses on settlements	**(0.2)**	**–**	**(0.2)**	–	–	–
Interest (expense)/income	**(1.5)**	**1.4**	**(0.1)**	(1.5)	1.3	(0.2)
	(2.0)	**1.4**	**(0.6)**	(1.8)	1.3	(0.5)
Remeasurements:						
(Loss)/return on plan assets excluding amounts included in interest expense	**–**	**2.1**	**2.1**	–	(0.1)	(0.1)
Gain from change in demographic assumptions	**2.6**	**–**	**2.6**	–	–	–
(Loss)/gain from change in financial assumptions	**(4.5)**	**–**	**(4.5)**	1.8	–	1.8
Experience gains	**(0.2)**	**–**	**(0.2)**	(0.6)	–	(0.6)
	(2.1)	**2.1**	**–**	1.2	(0.1)	1.1
Contributions:						
Employers	**–**	**0.5**	**0.5**	–	0.2	0.2
Payments from plans:						
Benefit payments	**2.1**	**(2.1)**	**–**	2.1	(2.1)	–
	2.1	**(1.6)**	**0.5**	2.1	(1.9)	0.2
At 31 March	**(58.5)**	**55.1**	**(3.4)**	(56.5)	53.2	(3.3)

30. Retirement benefit obligations continued

The Group has one smaller pension scheme which is in surplus and is deemed to have irrecoverable assets in accordance with IFRIC 14 'The Limit on Defined Benefit Asset, Minimum Funding Requirements and their Interaction'.

Changes in the effect of the asset ceiling during the year were:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Irrecoverable asset at start of the year	**16.8**	15.8	**–**	–
Interest on irrecoverable surplus	**0.5**	0.4	**–**	–
Actuarial gains	**3.3**	1.1	**–**	–

The schemes' assets were:

	2019			2018		
	Quoted prices in active market £m	**Prices not quoted in active market £m**	**Fund %**	Quoted prices in active market £m	Prices not quoted in active market £m	Fund %
Equities	**234.5**	**–**	**25**	208.3	–	23
Government bonds	**134.6**	**–**	**14**	170.2	–	19
Other bonds	**247.1**	**–**	**26**	211.9	–	24
Diversified growth	**154.7**	**13.1**	**18**	182.3	7.9	21
Property	**68.1**	**3.4**	**8**	57.4	9.9	7
Insurance linked security	**55.2**	**–**	**6**	41.8	–	5
Other (including cash funds)	**23.3**	**–**	**3**	8.8	–	1
	917.5	**16.5**	**100**	880.7	17.8	100

Other assets at 31 March 2019 represented principally cash contributions received from the Group towards the year end which were invested during the subsequent financial year.

The Company's share of the schemes' assets at the balance sheet date was:

	2019			2018		
	Quoted prices in active market £m	**Prices not quoted in active market £m**	**Fund %**	Quoted prices in active market £m	Prices not quoted in active market £m	Fund %
Equities	**10.4**	**–**	**19**	10.5	–	20
Government bonds	**9.4**	**–**	**17**	10.7	–	20
Other bonds	**16.6**	**–**	**30**	13.3	–	24
Diversified growth	**8.9**	**–**	**16**	10.4	–	20
Property	**4.8**	**–**	**9**	4.7	–	9
Insurance linked security	**3.7**	**–**	**7**	3.3	–	6
Other	**1.3**	**–**	**2**	0.3	–	1
	55.1	**–**	**100**	53.2	–	100

Through its defined benefit pension plan, the Group is exposed to a number of risks, the most significant of which are detailed below:

Asset volatility	The liabilities are calculated using a discount rate set with reference to corporate bond yields; if assets underperform this yield, this will create a deficit. The schemes hold a significant proportion of growth assets (equities and diversified growth funds) which are expected to outperform corporate bonds in the long-term, but can give rise to volatility and risk in the short-term. The allocation to growth assets is monitored such that it is suitable with the schemes' long-term objectives.
Changes in bond yields	A decrease in corporate bond yields will increase the schemes' liabilities, although this will be partially offset by an increase in the value of the schemes' bond holdings.
Inflation risk	The majority of the schemes' benefit obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation). The majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit.
Life expectancy	The majority of the schemes' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the liabilities.

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 cash funds and bonds which are expected to be less volatile than most other asset classes and reflects market movements in the schemes' liabilities
- A proportion of equities, with fund managers having freedom in making investment decisions to maximise returns
- Investment of a proportion of the schemes' assets in alternative asset classes which give the potential for diversification (currently property, insurance linked securities and diversified growth).

Notes to the financial statements
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30. Retirement benefit obligations continued

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 increases in pensionable pay.

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 2016 triennial actuarial valuation of the principal defined benefit scheme has been agreed, with the actuarial valuation deficit and schedule of contributions being in line with the 2013 triennial actuarial valuation, requiring deficit recovery contributions of c.£13 million per annum rising with inflation from 2019 to 2022. During the year, the Group made a deficit recovery contribution to the main scheme of £13 million (2018 £ Nil). The Group monitors funding levels on an annual basis and expects to pay total contributions of around £24 million during the year ended 31 March 2020. The 2019 triennial actuarial valuation is underway.

31. Deferred tax

Deferred tax is provided in full on temporary differences under the liability method using enacted tax rates.

Movements on deferred tax were:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Liabilities/(assets) at 1 April	**295.6**	269.6	**(1.6)**	(2.3)
Charged/(credited) to the income statement	**13.3**	18.3	**0.2**	(0.2)
(Credited)/charged to equity	**(4.3)**	8.1	**0.2**	0.9
Other non-underlying credits/(charges) in the income statement	**0.5**	(0.4)	**–**	–
Liabilities/(assets) at 31 March	**305.1**	295.6	**(1.2)**	(1.6)

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.

The majority of the Group's deferred tax liability is expected to be recovered over more than one year. The majority of the Company's deferred tax asset is expected to be recovered over more than one year. All deferred tax assets and liabilities within the same jurisdiction are offset.

The movements in deferred tax assets and liabilities were:

Group
Deferred tax liabilities

	Accelerated tax depreciation £m	Fair value adjustments £m	Revenue on service concession arrangements £m	Derivatives £m	Other £m	Total £m
At 1 April 2017	241.8	22.1	41.7	–	0.4	306.0
Charged/(credited) to the income statement	18.1	(1.5)	2.0	–	(0.4)	18.2
Transfer from deferred tax assets	–	–	–	0.7	–	0.7
At 31 March 2018	259.9	20.6	43.7	0.7	–	324.9
Charged/(credited) to the income statement	12.1	(4.1)	4.4	(0.2)	–	12.2
Non-underlying charged to the income statement	–	–	–	1.0	–	1.0
Credited to equity	–	–	–	(0.6)	–	(0.6)
At 31 March 2019	**272.0**	**16.5**	**48.1**	**0.9**	**–**	**337.5**

31. Deferred tax continued

Deferred tax assets

	Long term liabilities including provisions £m	Retirement benefit obligations £m	Derivatives £m	Share-based payments £m	Tax losses £m	Fair value adjustment £m	Other £m	Total £m
At 1 April 2017	(6.4)	(11.5)	(2.4)	(1.6)	(1.7)	(10.0)	(2.8)	(36.4)
Charged/(credited) to the income statement	1.0	(1.1)	–	0.4	–	0.1	(0.3)	0.1
Non-underlying (credit) to the income statement	–	–	(0.4)	–	–	–	–	(0.4)
Charged to equity	–	4.2	3.5	0.4	–	–	–	8.1
Transfer to deferred tax liabilities	–	–	(0.7)	–	–	–	–	(0.7)
At 31 March 2018	(5.4)	(8.4)	–	(0.8)	(1.7)	(9.9)	(3.1)	(29.3)
Charged/(credited) to the income statement	0.1	0.5	–	0.1	0.5	1.3	(1.4)	1.1
Non-underlying (credit) to the income statement	–	(0.5)	–	–	–	–	–	(0.5)
Credited to equity	–	(3.2)	–	(0.5)	–	–	–	(3.7)
At 31 March 2019	**(5.3)**	**(11.6)**	**–**	**(1.2)**	**(1.2)**	**(8.6)**	**(4.5)**	**(32.4)**
Net liability:								
At 31 March 2018								295.6
At 31 March 2019								**305.1**

Company
Deferred tax assets

	Retirement benefit obligations £m	Derivatives £m	Share-based payments £m	Other £m	Total £m
At 1 April 2017	(0.7)	(1.1)	(0.4)	(0.1)	(2.3)
(Credited)/charged to the income statement	(0.1)	–	0.1	(0.2)	(0.2)
Charged to equity	0.2	0.6	0.1	–	0.9
At 31 March 2018	(0.6)	(0.5)	(0.2)	(0.3)	(1.6)
(Credited)/charged to the income statement	–	–	–	0.2	0.2
Charged to equity	–	0.2	–	–	0.2
At 31 March 2019	(0.6)	(0.3)	(0.2)	(0.1)	(1.2)

Deferred tax credited/(charged) to equity during the year was:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Remeasurement of defined benefit obligations	**3.2**	(4.2)	**–**	(0.2)
Cash flow hedges	**0.6**	(3.5)	**0.2**	(0.6)
Deferred tax on other comprehensive loss/(gain)	**3.8**	(7.7)	**0.2**	(0.8)
Share-based payments	**0.5**	(0.4)	**–**	(0.1)
	4.3	(8.1)	**0.2**	(0.9)

Capital allowances are available when a business incurs qualifying expenditure on capital items such as infrastructure assets. Capital allowances provide tax relief on these items in place of accounting depreciation which is not tax deductible. Over the period of ownership of an asset, cumulative depreciation and capital allowances will equalise. Capital allowance rates are set by the UK Government and every business receives the same rate of allowance. Capital allowance rates vary from 8% up to 100% in certain instances, with most items qualifying at either 8% or 18% per annum. The 8% rate reduces to 6% from April 2019.

The different accounting treatment of property, plant and equipment for tax and accounting purposes means that the taxable income of the Group is not the same as the profit reported in the financial statements. The adjustments for this are reflected in the current tax reconciliation (note 9).

Short-term temporary differences arise on items such as environmental provisions, retirement benefit obligations and revenue on service concession arrangements because the treatment of such items is different for tax and accounting purposes. These differences reverse over future years following that in which they arise, as reflected in the deferred tax charge in these financial statements.

Where interest charges or other costs are capitalised in the accounts, tax relief is either given as the charges are incurred or when the costs are taken to the income statement.

Notes to the financial statements
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32. Provisions

	Environmental and landfill restoration £m	Restructuring £m	Other provisions £m	Total £m
Group				
At 1 April 2018	191.9	3.4	24.2	219.5
Charged to the income statement	8.2	–	1.4	9.6
Capitalised	22.8	–	–	22.8
Utilised	(13.3)	(2.3)	(4.5)	(20.1)
At 31 March 2019	**209.6**	**1.1**	**21.1**	**231.8**

The amount charged to the income statement includes £11.1 million (2018 £10.2 million) charged to finance costs as the unwinding of discounts in provisions.

The analysis of provisions between current and non-current is:

	2019 £m	2018 £m
Current	**28.7**	38.0
Non-current	**203.1**	181.5
	231.8	219.5

Environmental and landfill restoration provisions are incurred during the operational life of each landfill site and for a considerable period thereafter. The period of aftercare post-closure and the level of costs expected are uncertain and can vary significantly from site to site. Key factors are the type of waste, the speed at which it decomposes, the volume of leachate requiring treatment and regulatory requirements specific to the site. Environmental and landfill restoration provisions are expected to be substantially utilised throughout the operational life of a site and for landfill sites within 60 years of closure. 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 Group has applied a discount rate of 4.825% (2018 4.825%) and an inflation rate of 2.5% (2018 2.5%) to its aftercare provision and a discount rate of 3.8% (2018 3.8%) and an inflation rate of 2.5% (2018 2.5%) to its restoration provision.

The restructuring provision relates principally to severance costs and will be utilised within one year.

Other provisions include underperforming contracts of £7.1 million (2018 £11.0 million), which are provided for at the net present value of the operating losses of the underperforming contracts and are to be utilised over the remaining period of the contract to which they relate. The weighted average contract life of underperforming contracts is five years (2018 six years).

33. Share capital
Allotted, called-up and fully paid

	Number of shares		
	Treasury shares	Ordinary shares	£m
Group and Company			
At 1 April 2017 ordinary shares of 40.7p each	8,443	413,893,293	168.4
Shares issued under the Scrip Dividend Alternative	–	5,223,293	2.1
For consideration of £0.5 million, shares issued to the Pennon Employee Share Trust	–	46,205	0.1
For consideration of £3.4 million, shares issued under the Company's Sharesave Scheme	–	580,392	0.2
At 31 March 2018 ordinary shares of 40.7p each	8,443	419,743,183	170.8
For consideration of £5.1 million, shares issued under the Company's Sharesave Scheme	–	777,415	0.3
At 31 March 2019 ordinary shares of 40.7p each	**8,443**	**420,520,598**	**171.1**

Shares held as treasury shares may be sold or reissued 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 £500 per month for three or five years. These savings can then be used to buy ordinary shares, at a price set at a 17% discount to the market value at the start of the savings period, at the third or fifth 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.

33. Share capital continued
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 **2019**	2018
29 June 2011	536p	2014 – 2017	**–**	26
29 June 2012	588p	2015 – 2017	**–**	2
3 July 2013	538p	2016 – 2017	**–**	94
14 July 2014	611p	2017 – 2018	**142**	159
24 June 2015	683p	2017 – 2020	**194**	933
29 June 2016	709p	2019 – 2021	**478**	605
28 June 2017	767p	2020 – 2022	**462**	671
3 July 2018	635p	2021 – 2023	**1,367**	–
			2,643	2,490

The number and weighted average exercise price of Sharesave options are:

	2019		2018	
	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	**2,490**	**700**	2,753	660
Granted	**1,456**	**635**	775	767
Forfeited	**(437)**	**717**	(411)	707
Exercised	**(777)**	**661**	(570)	597
Expired	**(89)**	**661**	(57)	667
At 31 March	**2,643**	**674**	2,490	700

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 750p (2018 798p). The options outstanding at 31 March 2019 had a weighted average exercise price of 674p (2018 700p) and a weighted average remaining contractual life of 2.0 years (2018 1.6 years). The number of exercisable Sharesave options at 31 March 2019 was 1,000 (2018 28,000) and the weighted average exercise price of exercisable Sharesave options was 683p (2018 540p).

The aggregate fair value of Sharesave options granted during the year was £0.8 million (2018 £0.9 million), determined using the Black-Scholes valuation model. The significant inputs into the valuation model at the date of issue of the options were:

	2019	2018
Weighted average share price	**801**	848
Weighted average exercise price	**635**	767
Expected volatility	**20.0%**	19.0%
Expected life	**3.3 years**	3.4 years
Risk-free rate	**0.5%**	0.3%
Expected dividend yield	**5.2%**	4.5%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous three years.

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. From 2017/18, no further awards are made under this Plan as it has been superseded by a Long-term Incentive Plan (see iii below).

The number and price of shares in the Performance and Co-investment Plan are:

	2019		2018	
	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	**571**	**865**	1,021	850
Vested	**–**	**–**	(50)	799
Lapsed	**(315)**	**820**	(400)	852
At 31 March	**256**	**920**	571	865

The awards outstanding at 31 March 2019 had a weighted exercise price of 920p (2018 865p) and a weighted average remaining contractual life of 0.3 years (2018 0.7 years).

Notes to the financial statements
continued

33. Share capital continued

iii) Long-term Incentive Plan (LTIP)

Executive Directors and senior management receive an annual grant of conditional shares. Share awards vest subject to the achievement of specific performance conditions measured over a performance period of not less than three years.

The number and price of shares in the LTIP are:

	2019		2018	
	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	**510**	**803**	–	–
Granted	**526**	**790**	537	803
Vested	**–**	**–**	–	–
Lapsed	**(74)**	**798**	(27)	803
At 31 March	**962**	**796**	510	803

The awards outstanding at 31 March 2019 had a weighted exercise price of 796p (2018 803p) and a weighted average remaining contractual life of 1.9 years (2018 2.4 years).

The aggregate fair value of awards granted during the year was £1.7 million (2018 £1.0 million), determined from market value. No option pricing methodology is applied since the vesting of the shares depend on non-market performance vesting conditions.

iv) 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:

	2019		2018	
	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	**405**	**843**	325	848
Granted	**191**	**761**	172	809
Vested	**(117)**	**791**	(51)	821
Lapsed	**(29)**	**790**	(41)	815
At 31 March	**450**	**825**	405	843

The awards outstanding at 31 March 2019 had a weighted average exercise price of 825p (2018 843p) and a weighted average remaining contractual life of 1.5 years (2018 1.5 years). The Company's share price at the date of the awards ranged from 761p to 950p.

The aggregate fair value of awards granted during the year was £1.1 million (2018 £0.9 million), determined from market value. No option pricing methodology is applied since dividends paid 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.

34. Share premium account

	£m
Group and Company	
At 1 April 2017	217.4
Adjustment for shares issued under the Scrip Dividend Alternative	(2.1)
Shares issued under the Sharesave Scheme	3.1
Shares issued to the Pennon Employee Share Trust	0.4
At 31 March 2018	218.8
Shares issued under the Sharesave Scheme	4.8
At 31 March 2019	**223.6**

35. 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
Group and Company	
At 1 April 2017	144.2
At 31 March 2018	144.2
At 31 March 2019	**144.2**

36. Retained earnings and other reserves

	Own shares £m	Hedging reserve £m	Retained earnings £m	Total £m
Group				
At 1 April 2017	(2.6)	(28.2)	715.2	684.4
Profit for the year	–	–	200.6	200.6
Other comprehensive income for the year	–	17.1	17.5	34.6
Redemption of perpetual capital securities	–	–	(5.2)	(5.2)
Dividends paid relating to 2017	–	–	(149.5)	(149.5)
Adjustment for shares issued under the Scrip Dividend Alternative	–	–	41.7	41.7
Credit to equity in respect of share-based payments (net of tax)	–	–	2.2	2.2
Charge in respect of share options vesting	0.8	–	(0.8)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(1.7)	–	–	(1.7)
At 31 March 2018	(3.5)	(11.1)	821.7	807.1
Profit for the year	–	–	214.3	214.3
Other comprehensive loss for the year	–	(5.8)	(13.5)	(19.3)
Dividends paid relating to 2018	–	–	(162.0)	(162.0)
Credit to equity in respect of share-based payments (net of tax)	–	–	4.4	4.4
Charge in respect of share options vesting	1.0	–	(1.0)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(1.5)	–	–	(1.5)
At 31 March 2019	**(4.0)**	**(16.9)**	**863.9**	**843.0**

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 Group plc Employee Benefit Trust to satisfy awards under the Group's Annual Incentive Bonus Plan.

The market value of the 520,000 ordinary shares (2018 440,000 ordinary shares) held by the Trust at 31 March 2019 was £3.8 million (2018 £2.8 million).

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 2017	(4.7)	1,010.1	1,005.4
Profit for the year	–	215.1	215.1
Other comprehensive income for the year	2.7	0.9	3.6
Dividends paid relating to 2017	–	(149.5)	(149.5)
Adjustment for shares issued under the Scrip Dividend Alternative	–	41.7	41.7
Redemption of perpetual capital securities	–	(5.2)	(5.2)
Credit to equity in respect of share-based payments (net of tax)	–	0.8	0.8
Charge in respect of share options vesting	–	(0.8)	(0.8)
At 31 March 2018	(2.0)	1,113.1	1,111.1
Profit for the year	–	194.8	194.8
Other comprehensive income for the year	0.2	–	0.2
Dividends paid relating to 2018	–	(162.0)	(162.0)
Credit to equity in respect of share-based payments (net of tax)	–	1.5	1.5
Charge in respect of share options vesting	–	(0.9)	(0.9)
At 31 March 2019	**(1.8)**	**1,146.5**	**1,144.7**

In making decisions about the level of dividends to be proposed the Directors take steps to check that retained earnings reflect realised profits and are therefore distributable within the requirements of the Companies Act 2006.

Notes to the financial statements
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37. Perpetual capital securities

	£m
Group and Company	
At 1 April 2017	294.8
Issuance of perpetual capital securities	296.7
Redemption of perpetual capital securities	(294.8)
Distributions to perpetual capital security holders	(25.3)
Current tax relief on distributions to perpetual capital security holders	3.8
Profit for the year attributable to perpetual capital security holders	21.5
At 31 March 2018	296.7
Distributions due to perpetual capital security holders	(8.6)
Profit for the year attributable to perpetual capital security holders	8.6
At 31 March 2019	**296.7**

On 22 September 2017 the Company issued £300 million 2.875% perpetual capital securities. Costs directly associated with the issue of £3.3 million were set off against the value of the issuance. They have no fixed redemption date but the Company can at its sole discretion redeem all, but not part, of these securities at their principal amount on 22 May 2020 or any subsequent periodic return payment date after this.

The Company has the option to defer periodic returns on any relevant payment date, as long as a dividend on the ordinary shares has not been paid or declared in the previous 12 months. Deferred periodic returns shall be satisfied only on redemption or payment of dividend on ordinary shares, all of which only occur at the sole discretion of the Company.

As the Company paid a dividend in the 12 months prior to the periodic return date of 22 May 2019, a periodic return of £8.6 million (2018 £5.8 million) has been recognised as a financial liability at the year end.

38. Analysis of cash flows given in the statement of cash flows

Reconciliation of profit for the year to cash generated from operations:

Cash generated from operations

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Continuing operations				
Profit for the year	**222.6**	221.9	**203.4**	236.6
Adjustments for:				
Share-based payments	**3.6**	2.5	**1.5**	0.9
Profit on disposal of property, plant and equipment	**(3.9)**	(2.5)	**–**	–
Depreciation charge	**190.0**	182.5	**–**	0.1
Amortisation of intangible assets	**5.2**	3.6	**–**	–
Non-underlying joint venture loan write off and credit	**–**	(6.5)	**–**	–
Non-underlying remeasurement of fair value movement in derivatives	**(5.8)**	2.4	**–**	–
Share of post-tax profit from joint ventures	**(12.4)**	(9.4)	**–**	–
Finance income	**(23.5)**	(24.2)	**(45.9)**	(42.5)
Finance costs (before non-underlying items)	**106.7**	98.7	**35.5**	34.6
Dividends receivable	**–**	–	**(196.7)**	(202.3)
Taxation charge/(credit)	**37.7**	41.0	**3.7**	(28.4)
Changes in working capital:				
Increase in inventories	**(4.2)**	(5.2)	**–**	–
(Increase)/Decrease in trade and other receivables	**(46.4)**	(36.9)	**(178.8)**	250.6
Decrease/(Increase) in service concession arrangements receivable	**6.8**	(15.2)	**–**	–
(Decrease)/Increase in trade and other payables	**(47.7)**	2.2	**(45.6)**	0.1
(Decrease)/increase in retirement benefit obligations from contributions	**(7.3)**	4.5	**(0.1)**	(0.3)
Decrease in provisions	**(21.6)**	(15.9)	**–**	–
Cash generated/(outflow) from operations	**399.8**	443.5	**(223.0)**	249.4

Reconciliation of total interest paid:

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Interest paid in operating activities	**83.9**	69.6	**36.8**	32.5
Interest paid in investing activities	**15.2**	17.0	–	–
Total interest paid	**99.1**	86.6	**36.8**	32.5

39. Net borrowings

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Cash and cash deposits	**569.6**	585.3	**284.8**	303.3
Borrowings – current				
Bank and other loans	**(59.8)**	(149.6)	**(51.8)**	(149.6)
Other current borrowings	**(27.0)**	(32.0)	**–**	–
Finance lease obligations	**(63.6)**	(28.2)	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**(283.9)**	(283.6)
Total current borrowings	**(150.4)**	(209.8)	**(335.7)**	(433.2)
Borrowings – non-current				
Bank and other loans	**(1,628.0)**	(1,408.8)	**(880.2)**	(711.7)
Other non-current borrowings	**(373.9)**	(291.4)	**(109.5)**	–
Finance lease obligations	**(1,496.8)**	(1,476.8)	**–**	–
Total non-current borrowings	**(3,498.7)**	(3,177.0)	**(989.7)**	(711.7)
Total net borrowings	**(3,079.5)**	(2,801.5)	**(1,040.6)**	(841.6)

The movements in net borrowings during the periods presented were as follows:

Group	Net borrowings at 1 April 2017 £m	Cash flows – other £m	Foreign exchange adjustments £m	Other non-cash movements £m	Net borrowings at 31 March 2018 £m
Cash and cash deposits	598.1	(12.8)	–	–	585.3
Bank and other loans due within one year	(74.9)	74.9	–	(149.6)	(149.6)
Other current borrowings	(41.1)	41.1	–	(32.0)	(32.0)
Finance leases due within one year	(30.5)	30.5	–	(28.2)	(28.2)
Bank and other loans due after one year	(1,439.3)	(106.9)	(2.3)	139.7	(1,408.8)
Other non-current borrowings	(323.4)	–	–	32.0	(291.4)
Finance leases due after one year	(1,353.8)	(117.1)	–	(5.9)	(1,476.8)
	(2,664.9)	(90.3)	(2.3)	(44.0)	(2,801.5)

	Net borrowings at 1 April 2018 £m	**Cash flows – other £m**	**Foreign exchange adjustments £m**	**Other non-cash movements £m**	**Net borrowings at 31 March 2019 £m**
Cash and cash deposits	**585.3**	**(15.7)**	**–**	**–**	**569.6**
Bank and other loans due within one year	**(149.6)**	**149.6**	**–**	**(59.8)**	**(59.8)**
Other current borrowings	**(32.0)**	**32.0**	**–**	**(27.0)**	**(27.0)**
Finance leases due within one year	**(28.2)**	**28.2**	**–**	**(63.6)**	**(63.6)**
Bank and other loans due after one year	**(1,408.8)**	**(275.0)**	**1.6**	**54.2**	**(1,628.0)**
Other non-current borrowings	**(291.4)**	**(109.5)**	**–**	**27.0**	**(373.9)**
Finance leases due after one year	**(1,476.8)**	**(75.3)**	**–**	**55.3**	**(1,496.8)**
	(2,801.5)	**(265.7)**	**1.6**	**(13.9)**	**(3,079.5)**

Company	Net borrowings at 1 April 2017 £m	Cash flows – other £m	Foreign exchange adjustments £m	Other non-cash movements £m	Net borrowings at 31 March 2018 £m
Cash and cash deposits	372.5	(69.2)	–	–	303.3
Bank and other loans due within one year	(74.9)	25.0	–	(99.7)	(149.6)
Amounts due to subsidiary undertakings	(282.9)	(0.7)	–	–	(283.6)
Bank and other loans due after one year	(848.2)	–	–	136.5	(711.7)
	(833.5)	(44.9)	–	36.8	(841.6)

	Net borrowings at 1 April 2018 £m	**Cash flows – other £m**	**Foreign exchange adjustments £m**	**Other non-cash movements £m**	**Net borrowings at 31 March 2019 £m**
Cash and cash deposits	**303.3**	**(18.5)**	**–**	**–**	**284.8**
Bank and other loans due within one year	**(149.6)**	**149.6**	**–**	**(51.8)**	**(51.8)**
Amounts due to subsidiary undertakings	**(283.6)**	**(0.3)**	**–**	**–**	**(283.9)**
Bank and other loans due after one year	**(711.7)**	**(225.0)**	**–**	**56.5**	**(880.2)**
Other non-current borrowings	**–**	**(109.5)**	**–**	**–**	**(109.5)**
	(841.6)	**(203.7)**	**–**	**4.7**	**(1,040.6)**

The increase in the value of Financial liabilities at fair value through profit in the year of £0.3 million for the Group and £0.3 million for the Company is attributable to other non-cash movements.

Notes to the financial statements
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40. Subsidiary and joint venture undertakings at 31 March 2019

Principal subsidiary companies	Registered office address	Country of incorporation, registration and principal operations
Water		
South West Water Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
South West Water Finance Plc	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Source Contact Management Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Waste management		
Viridor Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Exeter Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Suffolk Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (West Sussex) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Management Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor EnviroScot Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor Resource Management Limited	First Floor Offices, Riverside House, Sir Thomas Longley Road, Medway City, Rochester, ME2 4FN	England
Viridor Waste Kent Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Oxfordshire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor EfW (Runcorn) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Landfill Restoration) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Somerset) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Thames) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Greater Manchester) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Polymer Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Trident Park Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Glasgow) Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor (Lancashire) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Peterborough Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor South London Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Clyde Valley Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Non-household retail		
Pennon Water Services Limited*(1)	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Other		
Peninsula Insurance Limited*(2)	Level 5, Mill Court, La Charroterie, St Peter Port, GY1 1EJ	Guernsey

(1) 80% of share capital owned by Pennon Group plc. All shares in issue are ordinary shares.
(2) Captive insurance company established with the specific objective of financing risks emanating from within the Group.

Other trading companies	Registered office address	Country of incorporation
Dragon Waste Limited (81%)	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Leasing Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Properties (Exeter) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Defined Contribution Pension Trustee Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Pension Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Share Plans (Guernsey) Limited*(3)	Albert House, South Esplanade, St Peter Port, GY1 1AW	Guernsey
Pennon Trustee Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Raikes Lane Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Source for Business Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
SSWB Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England

(3) The company ceased operations during the year.

40. Subsidiary and joint venture undertakings at 31 March 2019 continued

Other dormant companies	Registered office address	Country of incorporation
A.A. Best & Sons Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Acetip	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Albion Water (Shotton) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Alderney Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Analaq Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Aquacare (BWH) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Astley Minerals Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Avon Valley Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Basecall Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Bournemouth Water Investments Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Bournemouth Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
BWH Enterprises Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Cambridge Water Business Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Centre for Environmental Research Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
City Reclamation Services Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Corby Skip Hire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
DMP (Holdings) Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
ELE Datasystems	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Exe Continental	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Greater Manchester Sites Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Greenhill Environmental Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Handside Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Haul Waste Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Hodgejoy Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Industrial Waste Disposals (Sheffield) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Lavelle & Sons Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Mac-Glass Recycling Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Oakley Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Oakley Skip Hire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Parkwood Environmental Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Parkwood Group Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Parkwood Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pearsons Group Holdings Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Water Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Power Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon South West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Waste Management Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
pHOX Systems Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pilsworth Forest (1996) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pilsworth Forest Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Roseland Plant Co. Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Rydon Properties Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Seal Security Systems Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Sheffield Waste Disposal Company Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Shore Recycling (Ozone) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
South Staffordshire Water Business Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
SWW Pension Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Thames Incineration and Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HT	England
Thames Incineration Services Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Thames Tankering Services Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Thames Waste Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England

Notes to the financial statements
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40. Subsidiary and joint venture undertakings at 31 March 2019 continued

Other dormant companies	Registered office address	Country of incorporation
The Metropolitan Water Company Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Tokenmarch Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Cheshire) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Community Recycling MK) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Community Recycling MKH) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Erith) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Martock) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Winsford) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Contracting Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Electrical Recycling (Holdings) Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor Electrical Recycling Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor Enterprises Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Glass Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor London Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor New England (EfW) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Resource (Peterborough) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Resource Transport Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor South Lanarkshire Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor South West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Adapt) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Allwaste Disposal) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Atherton) Holdings Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Atherton) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Bristol Holdings) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Bristol) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Bury) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Corby) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Earls Barton) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (East Anglia) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Medway Holdings) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Medway) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Sheffield) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Thetford) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Wastenot Recycling) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste 2 Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Disposal Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Hampshire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Wootton Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
VWM (Scotland) Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Waste Treatment Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Water West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
West Hampshire Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England

* Indicates the shares are held directly by Pennon Group plc, the Company.

The subsidiary undertakings are wholly owned unless stated otherwise and all shares in issue are ordinary shares. All companies above are consolidated in the Group financial statements.

40. Subsidiary and joint venture undertakings at 31 March 2019 continued

Joint ventures

All joint ventures and the subsidiary undertakings of Lakeside Energy from Waste Holdings Limited, INEOS Runcorn (TPS) Holdings Limited and Shelford Composting Limited are incorporated and registered in England which is also their country of operation. The registered office of Lakeside Energy from Waste Holdings Limited and Lakeside Energy from Waste Limited is Thames House, Oxford Road, Wallingford OX10 6LX. The registered office of Shelford Composting Limited is 900 Pavilion Drive, Northampton NN4 7RG. The registered office of INEOS Runcorn (TPS) Holdings Limited and INEOS Runcorn (TPS) Limited is PO Box 9, Runcorn Site Headquarters, South Parade, Runcorn, Cheshire WA7 4JE.

	Share capital in issue	Percentage held	Principal activity
Joint ventures			
Lakeside Energy from Waste Holdings Limited	1,000,000 A ordinary shares	–	
	1,000,000 B ordinary shares	100%	
Lakeside Energy from Waste Limited Shares in Lakeside Energy from Waste Holdings Limited are held by Viridor Waste Management Limited			Waste management
Shelford Composting Limited	50 A ordinary shares	–	
	50 B ordinary shares	100%	Waste management
INEOS Runcorn (TPS) Holdings Limited	1,000 A ordinary shares	40%	
	186,750 B1 ordinary shares	100%	
	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.

The Group's economic interest in INEOS Runcorn (TPS) Holdings Limited is 75%, as returns from the investment are based on holdings of B1 and B2 ordinary shares.

41. Operating lease commitments

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
The future aggregate minimum lease payments under non-cancellable operating leases are:				
Within 1 year	**12.5**	10.8	**–**	–
Over 1 year and less than 5 years	**37.7**	29.1	**–**	–
Over 5 years	**145.5**	123.0	**–**	–
	195.7	162.9	**–**	–

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 33 years and rentals are reviewed on average at five-yearly intervals.

The Group also leases plant and machinery under non-cancellable operating lease agreements.

Notes to the financial statements
continued

42. Contingencies
Contingent liabilities

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	**–**	–	**561.5**	549.6
Performance bonds	**201.7**	185.1	**201.7**	185.1
	201.7	185.1	**763.2**	734.7

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.

In connection with the application of the audit exemption under Section 479A of the Companies Act 2006 the Company has guaranteed all the outstanding liabilities as at 31 March 2019 of Viridor Waste 2 Limited since this company qualifies for the exemption.

Other contractual and litigation uncertainties
The Group establishes provisions in connection with contracts and litigation where it has a present legal or constructive obligation as a result of past events and where it is more likely than not an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Matters where it is uncertain that these conditions are met include a potential prosecution by the Health and Safety Executive.

Contingent assets
In addition to contractual receivables related to our construction contracts in respect of Glasgow Recycling and Renewable Energy Centre that are reflected in the financial statements, there are further possible recoveries that are contingent on events in the future that are not wholly within the Group's control. These contingent assets of £25 million, as disclosed in note 4, have not been recognised as at 31 March 2019.

43. Capital commitments

	Group		Company	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Contracted but not provided	**201.0**	287.7	**–**	–

44. Related party transactions
During the year Group companies entered into the following transactions with joint ventures who are not members of the Group:

	2019 £m	2018 £m
Sales of goods and services		
Viridor Laing (Greater Manchester) Limited	**–**	38.4
INEOS Runcorn (TPS) Limited	**16.6**	15.9
Purchase of goods and services		
Lakeside Energy from Waste Limited	**12.4**	12.0
INEOS Runcorn (TPS) Limited	**7.1**	6.0
Dividends received		
Lakeside Energy from Waste Holdings Limited	**5.5**	6.5

44. Related party transactions continued
Year-end balances

	2019 £m	2018 £m
Receivables due from related parties		
Lakeside Energy from Waste Limited (loan balance)	**7.7**	8.2
INEOS Runcorn (TPS) Limited (loan balance)	**65.0**	32.5
	72.7	40.7
Lakeside Energy from Waste Limited (trading balance)	**1.0**	1.0
INEOS Runcorn (TPS) Limited (trading balance)	**1.8**	2.0
	2.8	3.0
Payables due to related parties		
Lakeside Energy from Waste Limited (trading balance)	**0.9**	1.2
INEOS Runcorn (TPS) Limited (trading balance)	**3.2**	2.5
	4.1	3.7

The £72.7 million (2018 £40.7 million) receivable relates to loans to related parties included within receivables and due for repayment in instalments between 2018 and 2033. Interest is charged at an average of 13.0% (2018 13.0%).

Company
The following transactions with subsidiary undertakings occurred in the year:

	2019 £m	2018 £m
Sales of goods and services (management fees)	**19.7**	12.2
Purchase of goods and services (support services)	**2.0**	1.5
Interest receivable	**43.3**	39.9
Interest payable	**0.1**	0.1
Dividends received	**196.7**	202.3

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.

Year-end balances

	2019 £m	2018 £m
Receivables due from subsidiary undertakings		
Loans	**1,044.6**	870.8
Trading balances	**19.9**	16.2

Interest on £499.8 million (2018 £425.3 million) of the loans has been charged at a fixed rate of 5.0%, and on £18.1 million (2018 £20.3 million) at a fixed rate of 6.0%. Interest on £499.8 million of the loans is charged at 12 month LIBOR +2.2% (2018 £411.8 million charged at 12 month LIBOR + 1.0% and £13.4 million charged at 12 month LIBOR + 3.0%). These loans are due for repayment in instalments over the period 2020 to 2056. Interest on £13.5 million of the loans has been charged at a fixed rate of 5.0%. Interest on £13.4 million of the loans is charged at 12 month LIBOR + 3.0%. These loans are due for repayment in instalments over a five-year period following receipt of a request to repay.

No material expected credit loss provision has been recognised in respect of loans to subsidiaries (2018 £nil).

	2019 £m	2018 £m
Payables due to subsidiary undertakings		
Loans	**283.9**	283.6
Trading balances	**14.3**	14.4

The loans from subsidiary undertakings are unsecured and interest-free without any terms for repayment.

Alternative performance measures

Alternative performance measures (APMs) are financial measures used in this report that are not defined by International Financial Reporting Standards (IFRS). The Directors believe that these APMs assist in providing additional useful information on the underlying trends, performance and position of the Group as well as enhancing the comparability of information between reporting periods. As the Group defines the APMs they might not be directly comparable to other companies' APMs. They are not intended to be a substitute for, or superior to, IFRS measurements.

Underlying earnings

Underlying earnings are presented alongside statutory results as the Directors believe they provide a more useful comparison on business trends and performance. Note 6 in the financial statements provides more detail on non-underlying items, and a reconciliation of underlying earnings for the current year and the prior year is as follows:

Underlying earnings reconciliation 2019

£m	Underlying	Non-underlying items: GMP equalisation (pensions)	Non-underlying items: Glasgow receivable provision	Non-underlying items: Derivative fair value movements	Statutory results	Earnings per share (p)
EBITDA (see below)	**546.2**	**(3.0)**	**(22.7)**	**–**	**520.5**	
Operating profit	**351.0**	**(3.0)**	**(22.7)**	**–**	**325.3**	
Profit before tax	**280.2**	**(3.0)**	**(22.7)**	**5.8**	**260.3**	
Taxation	**(42.7)**	**0.6**	**5.5**	**(1.1)**	**(37.7)**	
Profit after tax (PAT)	**237.5**	**(2.4)**	**(17.2)**	**4.7**	**222.6**	
PAT attributable to perpetual capital holders					**8.6**	
Non-controlling interests					**(0.3)**	
PAT attributable to shareholders					**214.3**	**51.1**
Deferred tax before non-underlying items					**13.3**	**3.1**
Non-underlying items post tax					**14.9**	**3.6**
Underlying earnings					**242.5**	**57.8**

Underlying earnings reconciliation 2018

£m	Underlying	Non-underlying items: Reset of Greater Manchester contract	Non-underlying items: Derivative fair value movements	Statutory results	Earnings per share (p)
EBITDA (see below)	509.6	3.2	–	512.8	
Operating profit	323.9	3.2	–	327.1	
Profit before tax	258.8	6.5	(2.4)	262.9	
Taxation	(44.4)	3.0	0.4	(41.0)	
Profit after tax (PAT)	214.4	9.5	(2.0)	221.9	
PAT attributable to perpetual capital holders				21.5	
Non-controlling interests				(0.2)	
PAT attributable to shareholders				200.6	48.0
Deferred tax before non-underlying items				18.3	4.4
Non-underlying items post tax				(7.5)	(1.8)
Proportional adjustment on perpetual capital returns				1.3	0.3
Underlying earnings				212.7	50.9

EBITDA

EBITDA (Earnings before interest, tax, depreciation and amortisation) is used to assess and monitor operational underlying performance. An adjusted EBITDA is also presented that includes Viridor's share of EBITDA from its joint ventures and finance income on service concession arrangements. This measure is presented to aggregate earnings from all the Viridor ERFs which are accounted for differently depending upon the contractual relationships, as shown in the reconciliation below.

Adjusted EBITDA reconciliation

£m	2019 £m	2018 £m
Statutory EBITDA	**520.5**	512.8
Non-underlying items	**25.7**	(3.2)
Underlying EBITDA	**546.2**	509.6
IFRIC 12 interest receivable[1]	**14.6**	13.8
Joint venture EBITDA[1]	**31.9**	33.2
Joint venture IFRIC 12 interest receivable[1]	**–**	5.7
Adjusted EBITDA	**592.7**	562.3

(1) These adjustments relate to the waste management business, resulting in adjusted waste management EBITDA of £225.4million (2017/18 £202.9 million).

Effective interest rate

A measure of the mean average interest rate payable on the Group's net debt, which excludes interest costs not directly associated with Group net debt. This measure is presented to assess and monitor the relative cost of financing for the Group.

	2019 £m	2018 £m
Net finance costs after non-underlying items	**77.4**	96.1
Non-underlying net finance costs	**5.8**	(21.6)
Interest receivable on shareholder loans to joint ventures	**5.3**	7.9
Net interest on retirement benefit obligations	**(1.4)**	(1.6)
Unwinding of discounts on provisions	**(11.1)**	(10.2)
Interest receivable on service concession agreements	**14.6**	13.8
Capitalised interest	**15.2**	17.0
Net finance costs for effective interest rate calculation	**105.8**	101.4
Opening net debt	**2,801.5**	2,664.9
Closing net debt	**3,079.5**	2,801.5
Average net debt (opening net debt + closing net debt divided by 2)	**2,940.5**	2,733.2
Effective interest rate	**3.6%**	3.7%

Interest cover

Underlying net finance costs (excluding pensions net interest cost, discount unwind on provisions and IFRIC 12 interest receivable on service concession arrangements divided by Group operating profit before non-underlying items.

	2019 £m	2018 £m
Net finance costs after non-underlying items	**77.4**	96.1
Non-underlying net finance costs	**5.8**	(21.6)
Net interest on retirement benefit obligations	**(1.4)**	(1.6)
Unwinding of discounts in provisions	**(11.1)**	(10.2)
Interest receivable on service concession arrangements	**14.6**	13.8
Net finance costs for interest cover calculation	**85.3**	76.5
Operating profit before non-underlying items	**351.0**	323.9
Interest cover (times)	**4.1**	4.2

Dividend cover

Proposed dividends divided by profit for the year before non-underlying items and deferred tax.

	2019 £m	2018 £m
Proposed dividends	**172.7**	162.0
Profit for the year attributable to ordinary shareholders	**214.3**	200.6
Deferred tax charge before non-underlying items	**13.3**	18.3
Non-underlying items after tax in profit for the year	**14.9**	(7.5)
Adjusted profit for dividend cover calculation	**242.5**	211.4
Dividend cover (times)	**1.4**	1.3

Capital investment

Property, plant and equipment additions plus IFRIC 12 service concession expenditure (ERFs) less landfill restoration asset (spend accounted for through provisions). The measure is presented to assess and monitor the total capital investment by the Group.

	2019 £m	2018 £m
Additions to property, plant and equipment	**387.2**	389.0
Additions to intangible assets	**–**	1.0
Landfill restoration asset	**(22.8)**	(11.0)
IFRIC 12 additions to other intangible assets – service concession agreements	**24.7**	6.3
IFRIC 12 additions to Non-current assets – service concession agreements	**6.8**	12.1
IFRIC 12 additions to Current trade and other receivables – prepayments and accrued income	**3.3**	64.5
less: IFRIC 12 additions subject to legal contractual process	**(3.3)**	(63.7)
Capital investment	**395.9**	398.2

Capital payments

Payments for property, plant and equipment additions net of proceeds from sale of property, plant and equipment plus IFRIC 12 service concession expenditure (ERFs). The measure is presented to assess and monitor the net cash spend on property, plant and equipment.

	2019 £m	2018 £m
Cash flow statements: purchase of property, plant and equipment	**356.0**	390.6
Cash flow statements: purchase of intangible assets	**–**	1.0
Cash flow statements: proceeds from sale of property, plant and equipment	**(6.3)**	(10.6)
IFRIC 12 additions to other intangible assets – service concession agreements	**24.7**	6.3
IFRIC 12 additions to Non-current assets – service concession agreements	**6.8**	12.1
IFRIC 12 additions to Current trade and other receivables – prepayments and accrued income	**3.3**	64.5
Capital payments	**384.5**	463.9

Alternative performance measures
continued

Return on capital employed

The total of underlying operating profit, joint venture profit after tax and joint venture interest receivable divided by capital employed (net debt plus total equity invested). An average value for this metric is part of the long-term incentive plan for Directors.

	2019 £m	2018 £m
Underlying operating profit	**351.0**	323.9
Underlying joint venture profit after tax	**12.4**	9.4
Joint venture interest receivable	**5.3**	7.9
Adjusted profit for return on capital employed calculation	**368.7**	341.2
Values at year end:		
Net debt	**3,079.5**	2,801.5
Share capital	**171.1**	170.8
Share premium account	**223.6**	218.8
Capital redemption reserve	**144.2**	144.2
Perpetual capital securities	**296.7**	296.7
Capital employed for return on capital employed calculation	**3,915.1**	3,632.0
Return on capital employed	**9.4%**	9.4%

Operational cash inflows

Cash generated from operations before construction spend on service concession agreements, pension contributions and other tax payments. Other taxes include business rates, employers national insurance, fuel excise duty, carbon reduction commitment, environmental payments, climate change levy and external landfill tax.

	2019 £m	2018 £m
Cash generated from operations per Cash flow statements	**399.8**	443.5
IFRIC 12 additions to Other intangible assets - service concession agreements	**24.7**	6.3
IFRIC 12 additions to Non-current assets - service concession agreements	**6.8**	12.1
IFRIC 12 additions to Current trade and other receivables - prepayments and accrued income	**3.3**	64.5
Pension contributions	**32.2**	17.0
Other tax payments[1]	**137.9**	129.0
Payment in respect of terminated synthetic derivative, related to a prior period non-underlying charge	**44.3**	–
Operational cash inflows	**649.0**	672.4

(1) Other taxes include business rates, employers national insurance, fuel excise duty, carbon reduction commitment, environmental payments, climate change levy and external landfill tax.

Five-year financial summary

	2019 £m	2018 £m	2017 £m	2016 £m	2015 £m
Income statement					
Revenue before non-underlying items	**1,478.2**	1,393.0	1,353.1	1,352.3	1,357.2
Operating profit before non-underlying items	**351.0**	323.9	304.6	261.8	246.6
Net finance costs before non-underlying items	**(83.2)**	(74.5)	(58.8)	(54.1)	(40.8)
Share of profit in joint ventures	**12.4**	9.4	4.2	3.6	4.9
Profit before tax and non-underlying items	**280.2**	258.8	250.0	211.3	210.7
Net non-underlying items before tax	**(19.9)**	4.1	(39.5)	(5.0)	(13.7)
Taxation charge	**(37.7)**	(41.0)	(30.0)	(38.0)	(54.7)
Profit for the year	**222.6**	221.9	180.5	168.3	142.3
Attributable to:					
Ordinary shareholders of the parent	**214.3**	200.6	164.3	152.1	126.3
Perpetual capital security holders	**8.6**	21.5	16.2	16.2	16.0
Non-controlling interests	**(0.3)**	(0.2)	–	–	–
Dividends proposed/declared	**172.7**	162.0	149.5	138.5	129.5
Earnings per ordinary share (basic):					
From continuing operations					
Earnings per share	**51.1p**	48.0p	39.8p	37.0p	32.3p
Deferred tax before non-underlying items	**3.1p**	4.4p	4.5p	9.5p	4.7p
Non-underlying items (net of tax)	**3.6p**	(1.8)p	2.7p	(7.0)p	2.8p
Proportional adjustment on Perpetual capital returns	**–**	0.3p	–	–	–
Earnings per share before non-underlying and deferred tax	**57.8p**	50.9p	47.0p	39.5p	39.8p
Declared dividends per share	**41.06p**	38.59p	35.96p	33.58p	31.80p

	2019 £m	2018 £m	2017 £m	2016 £m	2015 £m
Capital expenditure					
Acquisitions (including investment in joint ventures)	**54.8**	8.4	–	91.0	–
Property, plant and equipment	**387.2**	389.0	377.5	284.2	301.4
Balance sheet					
Non-current assets	**5,364.5**	5,125.0	4,937.0	4,676.7	4,325.9
Net current assets	**583.9**	412.6	454.4	549.1	586.0
Non-current liabilities	**(4,268.6)**	(3,898.5)	(3,882.2)	(3,738.2)	(3,557.8)
Net assets	**1,679.8**	1,639.1	1,509.2	1,487.6	1,354.1
Number of employees (average full time equivalent for year)					
Water	**1,616**	1,575	1,589	1,706	1,408
Waste management	**3,426**	3,285	3,153	3,230	3,101
Non-household retail	**104**	81	–	–	–
Other businesses	**93**	73	57	51	49
	5,239	5,014	4,799	4,987	4,558

Shareholder information

Financial calendar

Financial year end	31 March
30th Annual General Meeting	25 July 2019
Ex-dividend date for 2019 final dividend	25 July 2019
Record date for 2019 final dividend	26 July 2019
2019 final dividend payable	3 September 2019
2019/20 half-yearly results announcement	26 November 2019
2020 interim dividend payable	April 2020
2019/20 final results announcement	2 June 2020
31st Annual General Meeting	23 July 2020
2020 final dividend payable	September 2020

Dividend Reinvestment Plan (DRIP) alternative*

Ordinary shares quoted ex-dividend	25 July 2019
Record date for final dividend	26 July 2019
Final date for receipt of DRIP applications	12 August 2019
Posting of dividend cheques	2 September 2019
Final dividend payment date	3 September 2019

* Subject to obtaining shareholder approval at the 2019 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2019.

Shareholder analysis at 31 March 2019

Holding of shares	Number of shareholders	% of total shareholders	% of ordinary shares
1-100	2,400	12.80	0.02
101-1,000	7,806	41.64	0.99
1,001-5,000	7,088	37.81	3.73
5,001-50,000	1,096	5.85	3.00
50,001-100,000	80	0.43	1.39
100,001+	276	1.47	90.87
	18,746		

	Number of accounts	% of total accounts	% of total shares
Individuals	16,531	88.18	6.21
Companies	131	0.70	0.20
Trust companies (pension funds etc.)	7	0.04	0.01
Banks and nominees	2,077	11.08	93.58
	18,746		

Major shareholdings

The net position on 31 March 2019 of investors who have notified interests in the issued share capital of the Company pursuant to the Financial Conduct Authority's Disclosure and Transparency Rules is as follows:

	Number of voting rights (direct and indirect)	% of voting rights
Lazard Asset Management LLC	41,575,771	9.98
Pictet Asset Management SA	25,599,217	6.10
BlackRock, Inc.	21,028,272	5.00
Ameriprise Financial, Inc.	20,328,154	4.84
RARE Infrastructure Limited	19,366,782	4.61
Invesco Limited	17,212,959	4.10

No changes to interests in the Company's issued share capital have been disclosed to the Company between 31 March 2019 and 29 May 2019 (being a date not more than one month prior to the date of the Company's Notice of Annual General Meeting).

Registrar

All enquiries concerning shareholdings including notification of change of address, loss of a share certificate or dividend payments should be made to the Company's registrar, Link Asset Services, who can be contacted as follows:

Link Asset Services

Pennon Group Share Register
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

Telephone: **0371 664 9234** (calls are charged at standard geographic rate and will vary by provider).

Lines are open 8.30am-5.30pm Monday-Friday, excluding public holidays in England and Wales.

Overseas telephone: **+44 371 664 9234** (calls outside the United Kingdom will be charged at the applicable international rate).

Email: **pennon@linkgroup.co.uk**

Website: **signalshares.com**

ShareGift 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 registrar, Link Asset Services, or by contacting ShareGift on **020 7930 3737** (**www.sharegift.org.uk**).

Individual savings accounts

Shareholders may gain tax advantages by holding their shares in the Company in an Individual Savings Account (ISA).

Dividend Reinvestment Plan (DRIP)

Subject to obtaining shareholder approval at the 2019 Annual General Meeting for the payment of a final dividend for the year ended 31 March 2019, full details of the DRIP and how to participate will be published on the Company's website at **www.pennon-group.co.uk/dividends/dividend-reinvestment-plan-drip**. The full timetable for offering the DRIP is given opposite.

The DRIP provides shareholders with an opportunity to invest the cash dividend they receive on their Pennon Group plc shares to buy further shares in the Company at preferable dealing rates.

Useful contacts

Registered office

Peninsula House
Rydon Lane
Exeter
Devon EX2 7HR

Company registration number: 2366640

Company Secretary

Simon A F Pugsley

Corporate brokers

HSBC Bank plc
Morgan Stanley & Co. International plc

Independent auditors

Ernst & Young LLP

Online portfolio service

The online portfolio service provided by Link Asset Services gives shareholders access to more information on their investments. Details of the portfolio service are available online at **www.signalshares.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 Link Asset Services' share portal. Go to **www.signalshares.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 proxy form) and your postcode, as well as entering an email address and selecting a password.

By registering to receive your shareholder communications electronically, you will also automatically receive your dividend confirmations electronically.

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 **www.signalshares.com**. Shareholders who register an email preference will not receive a paper proxy form. Instead, they will receive an email alert advising them of general meetings of the Company, with links to the notices of meetings and annual reports.

Pennon's website

www.pennon-group.co.uk provides news and details of the Company's activities plus links to its subsidiaries' websites.

The Investor Information section contains up-to-date information for shareholders including detailed share price information, financial results, dividend payment dates and amounts, and stock exchange announcements. There is also a comprehensive shareholder services section which includes information on buying, selling and transferring shares, and how to notify a change in personal circumstances, for example, a change of address.

Shareholder information
continued

Beware of share fraud

The following is taken from the ScamSmart section of the Financial Conduct Authority's website (**www.fca.org.uk/scamsmart**).

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment.

While high profits are promised, if you buy or sell shares in this way you will probably lose your money.

How to avoid share fraud

1. Keep in mind that firms authorised by the Financial Conduct Authority (FCA) are unlikely to contact you out of the blue with an offer to buy or sell shares.
2. Do not get into a conversation; note the name of the person and firm contacting you and then end the call.
3. Check the Financial Services Register from **www.fca.org.uk** to see if the person and firm contacting you is authorised by the FCA.
4. Beware of fraudsters claiming to be from an authorised firm, copying its website or giving you false contact details.
5. Use the firm's contact details listed on the Register if you want to call it back.
6. Call the FCA on **0800 111 6768** if the firm does not have contact details on the Register or you are told they are out of date.
7. Search the FCA Warning List of unauthorised firms at **www.fca.org.uk/scamsmart**. Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme. Seek impartial advice from a financial adviser before you make an investment.
8. Remember: if it sounds too good to be true, it probably is!

5,000 people contact the Financial Conduct Authority about share fraud each year, with victims losing an average of £20,000

Report a scam

If you are approached by fraudsters, please tell the FCA using the share fraud reporting form at **www.fca.org.uk/scams** where you can find out more about investment scams. You can also call the FCA Consumer Helpline on **0800 111 6768.**

If you have already paid money to share fraudsters you can report this at any time to Action Fraud using their Online Fraud Report Tool at **www.actionfraud.police.ul/reporting-fraud-and-cyber-crime** or by calling **0300 123 2040**.

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