



Bringing water to life –
supporting the lives of
people and the places they
love for generations to come.

Annual Report and Accounts 2021



Welcome to Pennon Group plc
Annual Report and Accounts 2021

Bringing water to life – supporting the lives of people
and the places they love for generations to come.





Photo: Tim Pestridge
Sunset near Westward Ho! Devon

Positioned to lead the way in UK Water

Pennon is one of the leading businesses in the UK Water sector, providing clean water and wastewater services.

We believe the role of responsible business is one of stewardship for sustainable living, supporting communities, customers and the environment to thrive, now and into the future.

South West Water and Bournemouth Water – water and wastewater services

Through South West Water and Bournemouth Water, we are focused on providing water and wastewater services in the most efficient and sustainable way possible.

Innovation, new technologies and the pioneering of a holistic approach to water and wastewater management are delivering service improvements and long-term value.

More information

 **Water and wastewater** pages 50 to 53

Pennon Water Services – water retail services

Pennon Water Services is a business water specialist providing water retail services for business customers' water management needs.

More information

 **Water retail services** pages 54 to 55

Viridor – waste management (discontinued operations)

On 8 July 2020, Pennon completed the sale of Viridor, our waste management business.

More information

 **Waste management** page 05

Bristol Water – water and water retail services

On 2 June 2021, Pennon approved the acquisition of 100% of the issued share capital of Bristol Water Holdings UK Limited, including its subsidiaries Bristol Water plc, which provides water only services to c.1.2 million customers in the Bristol region, and water2business Limited, which provides water retail services through a joint venture arrangement with Wessex Water Limited. The acquisition will complete on 3 June 2021 and will be reviewed by the Competition and Markets Authority.

More information

 **Water and wastewater** page 05

INTEGRATED AND ONLINE 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.

Find out more about Pennon:

Online Annual Report Summary

<https://annualreport.pennon-group.co.uk>



Scan me

Corporate website

www.pennon-group.co.uk

LinkedIn 

Pennon Group plc

INFORMATION KEY

Throughout this report we make reference to different resources both online and within the document. The following key reflects the symbolism of content throughout:



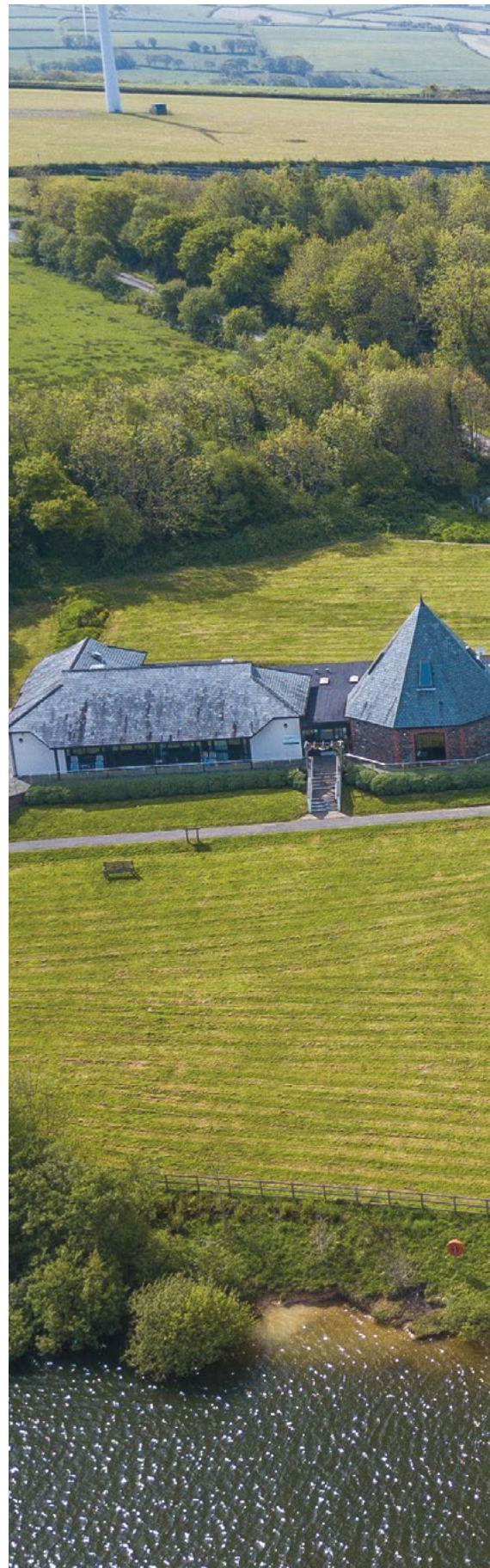
Page reference

Pages where you can find more information on a related subject



Environmental, Social and Governance (ESG) content

Content in green relates to environmental, social and governance case studies



Inside this report

“We take our role in society seriously, operating in the public interest. Water companies have a vital role today and everyday, providing customers with safe and clean drinking water, with the importance that has on health and hygiene. Bringing water to life – that’s a given.”

Susan Davy,
Chief Executive Officer

An aerial view of our site at Roadford Reservoir

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RESPONSIBLE PRINTING

As a responsible business, we have made sure this report has been printed on 100% recyclable material, using vegetable inks and a biodegradable laminate. We have also partnered with a CarbonNeutral® printer. If you are disposing of it, please help us and the planet, and recycle it.

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Strategic Report



Business model

[More information](#) pages 12 to 13



ESG strategy and performance

[More information](#) pages 24 to 29



Our stakeholders

[More information](#) pages 34 to 37

Highlights of the year

2020/2021 in review

Resilient finance

£645m

REVENUE UNDERLYING[^]

2019/20: £637m

2.5%

EFFECTIVE INTEREST RATE[^]

2019/20: 3.4%

£1.7bn

PROFIT ON SALE OF VIRIDOR

£157m

PROFIT BEFORE TAX UNDERLYING[^]

2019/20: £183m

£132m

**PROFIT BEFORE TAX INCLUDING
NON-UNDERLYING**

2019/20: £193m

£1.8bn

STATUTORY PROFIT AFTER TAX

31.9p

EPS UNDERLYING[^]

2019/20: 35.2p

21.74p

DIVIDEND

CPIH +2% increase

418.5p

**EPS – CONTINUING AND DISCONTINUED
OPERATIONS**

Alternative performance measures (APMs)

Measures with this symbol [^] are defined in the alternative performance measures section of the annual report on pages 207 to 210.

Sustainable operations

5m 38s

SUPPLY INTERRUPTIONS

2019/20: 9m 10s (39% improvement)



126.8

LEAKAGE (MEGALITRES PER DAY)*

2019/20: 124.2



* Three-year rolling average.

2.06

DRINKING WATER QUALITY (CRI) SCORE

2019/20: 3.64



130.87

WASTEWATER POLLUTION INCIDENTS*

2019/20: 106.44



* Per 10,000km of sewer based on EPA version 7.

1.34

**INTERNAL SEWER FLOODING
(PER 10,000 SEWER CONNECTIONS)**

2019/20: 2.08



2★

ENVIRONMENT AGENCY EPA SCORE



4

BATHING WATER QUALITY IMPROVEMENTS

12th out of 16

CUSTOMER SERVICE (CMeX)

1.41

**LOST TIME INJURY FREQUENCY RATE
(LTIFR#)**

2019/20: 1.17



LTIFR for employees and agency staff per 200,000 hours worked. Reflecting the Continuing Group.

Creating value for shareholders and stakeholders

SHAREHOLDER VALUE CREATION

£3.7bn

Viridor net sale proceeds

Positioning the Group sustainably

SUSTAINABLE BALANCE SHEET

£1.2bn⁽¹⁾

De-gearing

ADDITIONAL PENSION CONTRIBUTIONS

£0.1bn

Responsible employer

Reinvesting in UK water

SUPPORTING ORGANIC GROWTH

£0.1bn

Green Recovery
(De-gearing South West Water)

ACCRETIVE ACQUISITION

£0.4bn

Bristol Water

Recognising shareholder support

RETURN TO SHAREHOLDERS

£1.5bn

Special dividend

£0.4bn

Share buyback
up to £0.4bn

SECTOR LEADING DIVIDEND POLICY SUSTAINED

CPIH +2%

Future dividend increased by c.9%
reflecting Bristol Water

⁽¹⁾ Including debt make-whole costs of £0.1 billion and cash held in Pennon of c.£0.1 billion.

0.1

GHG EMISSIONS (MILLION tCO₂e)

2019/20: 0.1

(Continuing Group)

4.8

PWS TRUST SCORE

2019/20: 4.9



Viridor – Discontinued operations (1 April 2020 to 8 July 2020)

93%

ERF AVAILABILITY

0.19

LANDFILL VOLUMES TRADED (mT)

0.5mT

ERF VOLUME INPUTS (mT)

0.19

RECYCLING VOLUMES TRADED (mT)

0.34m

ERF POWER OUTPUT (MWh)

Our ongoing operations 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.

South West Water and Bournemouth Water – water and wastewater services

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

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 **Water and wastewater** pages 50 to 53

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

Pennon Water Services – water retail services

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

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 **Water retail services** pages 54 to 55

- 11** UK-based customer
service centre

Bristol Water – water and water retail services

On 2 June 2021, Pennon approved the acquisition of Bristol Water Holdings UK Limited, including its subsidiaries Bristol Water plc, which provides water only services to c.1.2 million customers in the Bristol region, and water2business Limited, which provides water retail services through a joint venture arrangement with Wessex Water Limited. The acquisition will complete on 3 June 2021 and will be reviewed by the Competition and Markets Authority.





Discontinued operations – Viridor

Viridor, our former waste management business – at the forefront of the resource sector in the UK transferring waste into energy, high-quality recyclates and raw materials.

We announced the proposed transaction to dispose of Viridor Limited to Planets UK Bidco Limited (Bidco), a newly formed company established by funds advised by Kohlberg Kravis Roberts & Co. L.P. (KKR) on 18 March 2020, and this sale completed on 8 July 2020.

In the period to disposal the business continued its focus on optimising Energy Recovery Facility (ERF) performance and progressing its investments in plastic processing facilities as part of its strategy to support a circular economy.

A purpose-led business

We're a business building a sustainable future.

We are reshaping the Group with a focus on UK Water. This, together with the impact of COVID-19 on society and communities, has been a catalyst for us in reviewing our purpose. Our purpose and our 'New Deal' establish our wider social contract with our customers and the communities we serve.





We all know that water companies have a vital role today and every day, providing customers with safe and clean drinking water and we understand the important impact that has on health and hygiene – Bringing water to life. That's why we exist.

We also believe we have a vital role to play in supporting the lives of people and the places they love for generations to come. That's what we do.

An aerial view of our Mayflower Water Treatment Works at Roborough

Chair's letter

“Pennon is a responsible business, building a sustainable future in the UK Water Industry.”

A year of challenge and opportunity

I am delighted and honoured to have been given the opportunity to chair Pennon at such a pivotal time for the Group.

This has undoubtedly been a challenging year for us, and for everyone who works within and supports the Group. The human tragedy of loss of life as a result of the pandemic, the disruption and difficulties experienced across society and the economic impact will weigh heavy on us all for generations to come, and there is every sense that things will never quite be the same again.

The worst of times brings out the very best in people and that's so true of everyone who works at Pennon. I am so proud of the way all of our employees and business partners have responded to the challenge.

My sincere thanks go to Susan and our Executive Leadership team, who have led the Group through this pandemic from the front, demonstrating what it takes to be resilient, agile and above all, compassionate. With an unwavering responsibility for our critical infrastructure, we have continued to deliver essential services to our customers and communities. This is due to the dedication of our talented and hard-working employees. It takes courage, determination and professionalism to continue to go out to work each day, during a pandemic, especially at the beginning, when we knew so little about the virus. On behalf of the Board, I thank you all.

The Board has also overseen the successful and significant milestone in the evolution of Pennon, enacting our strategic review, having consulted with our largest institutional shareholders and acting in the best interests of all shareholders. This resulted in the landmark sale of Viridor in July 2020, to KKR, generating £3.7 billion net cash proceeds, and creating an opportunity to refocus the Group exclusively on UK Water. The significant restructuring activity, involving people, systems and process change, has been delivered seamlessly, efficiently and effectively and aligned with our values.

The acquisition of Bristol Water will be an important next step in the evolution of the Group – a strong strategic fit, cementing Pennon as a leader in our chosen sector. The Group is now firmly focused on leading, transforming and optimising water and wastewater businesses, building on our strong credentials as an experienced consolidator.

Additionally, we have focused on ensuring the balance sheets of the Group are sustainably positioned for the future, right-sizing the Company's debt portfolio, and ensuring funds are retained for future growth. The Group also plans to invest a further £0.1 billion into South West Water in support of Green Recovery. Delivering on our credentials as a responsible employer, we will increase our contribution to Pennon's principal pension scheme, by approximately £53 million (including £36 million already contributed in H1 2020/21), which is over and above our normal contribution.

The Group has also recognised the ongoing loyalty of shareholders with a special dividend, representing an efficient means of returning capital to shareholders, combined with an associated share consolidation.

Penon's ongoing strength and resilience is clearly and reliably demonstrated with our continued sector-leading dividend policy of CPIH +2%, underpinned by the Board's confidence in the Group's sustainable growth strategy, continued RoRE outperformance, driven by the totex efficiency and outperformance in SWW.

For 2020/21, the Board has recommended a final dividend of 14.97 pence per share, subject to shareholder approval at the Annual General Meeting on 22 July 2021. Together with the interim dividend of 6.77 pence, this will result in a total dividend of 21.74 pence per share, an increase of 3.0%.

Your Board

In July 2020, we enacted our Board internal succession plan and I was delighted to take on the role of Chair, working alongside our diverse and talented Board, one of the legacies left to Penon by our outgoing Chair, Sir John Parker.

Our succession plan also included the retirement of Chris Loughlin, Group Chief Executive Officer, who stepped down after 14 years leading the Group through some exceptional times and changes.

Susan Davy, previously Chief Financial Officer of Penon, was appointed as the new Group Chief Executive Officer and Paul Boote was appointed as Group Finance Director, having held several senior finance positions in the Group.

At the same time, we reviewed our Committee structure to ensure that strong governance remains at the core of our management of the Group. All Non-Executives now attend all committees and, consistent with being a regulated company, South West Water Limited maintains separate governance arrangements. In recognition of the growing importance of ESG matters for all responsible businesses, we refreshed the focus of and renamed our Sustainability Committee, to ESG Committee, strengthening and prioritising ESG. We have also created a new dedicated Health and Safety Committee to enable the Board to focus on the delivery of our commitment to ensure all colleagues go home safe, each and every day. Chaired by Jon Butterworth, appointed to the Penon Board last year, we are already benefitting from his considerable operational experience. With an ambition to become a leader in Health and Safety performance in the industry by 2025, we know we have more to do.

UK Water Industry focus

Reshaping the Group, we have focused on driving sustainable growth, customer service and environmental excellence in the UK Water Industry.

This is what we do best. We have a long history and strong heritage in the Water Industry that our investors and shareholders value. We have a proven track record in delivering long-term value through our subsidiary businesses, South West Water and Penon Water Services. We have consistently demonstrated robust operational and resilient financial performance for many years. We are well placed, together with significant retained earnings, to provide a sustainable platform for delivery, investment and growth.

Operationally, we have made a strong start to the new regulatory period, with c.80% of ODIs ahead or on track. Despite the challenges posed by the pandemic, the performance of the business has been resilient, and testament to the hard work of all our employees.

We also acknowledge that we need to do more in some operational areas, notably pollutions. The Board has focused significant attention on this over the course of the year, ensuring we are working collaboratively with our regulators and have a robust reduction plan in place.

Purpose and culture

The completion of the Viridor sale in July 2020 recognised the full strategic value built up over many years of careful management. It was therefore fitting to refresh our purpose this year, post the Viridor sale, reflecting the wider social contract we have with all of our stakeholders and the region we support. Our new purpose, Bringing water to life – supporting the lives of people and the places they love for generations to come, shows the importance we place on operating in the public interest for the benefit of our shareholders, customers and our employees, for now and into the future, underpinned by our core values which guide everything we do.

Championing diversity

There has never been a more important time for responsible businesses to promote the widest level of diversity in the boardroom and beyond.

Our Board was pleased to note our ranking of 23rd in the FTSE 100 Hampton-Alexander review with 42.9% female diversity and our achievement in meeting the outcome of Sir John Parker's review ahead of the 2021 target for ethnic board diversity. We are one of only a very few FTSE businesses in the UK to have both a female Chief Executive and Chair. Alongside this, we have continued our membership of the 30% Club, and SWW has once again contributed to the industry's Women in Water initiative.

Penon also became the first water company to sign up to Change the Race Ratio, harnessing a desire to go further and faster and leading from the front. We know that change of this magnitude takes time and commitment especially given the demographic of the regions we support. We are committed to take every opportunity to make a broader societal impact on diversity and inclusion.

A sustainable future strategy

Our focus on UK Water, together with the geography of the region and communities we support, affords us an opportunity to aim to be at the forefront of environmental leadership.

As we all know, there is no silver bullet to achieving Net Zero and it requires new thinking and resolute leadership. I am personally delighted that the Water Industry is leading the way, with even more ambitious timelines to achieve Net Zero by 2030, 20 years ahead of the rest of the UK. The Board has set out an implementation roadmap, to transform the Group, focused around three key pillars – sustainable living, championing renewables and reversing carbon emissions. We are well placed to transform, delivering on our purpose and putting in place the core building blocks for our next price review and beyond.

Penon is a high performing business, focused on a sustainable future for all, focused on UK Water and committed to delivering for all stakeholders, now and into the future.



Gill Rider
Chair

2 June 2021

Our business model

Creating long-term, sustainable value

Our business model is designed to deliver sustainable shareholder value by providing high-quality environmental infrastructure and customer services.

What we do



Water

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

More information

Water and wastewater pages 50 to 53



Water retail services

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

More information

Water retail services pages 54 to 55

Our resources and relationships

Natural capital



Freshwater



Land
(including soils)



Species



Ecological
communities



Coasts



Atmosphere
(local and global)



Waste

Social and human capital



Community



Customers



Employees

Manufactured, intellectual and financial capital



Supply chain



Finance



Stakeholders & partnerships



Responsible business

More information

ESG Capitals framework pages 28 to 29

The strengths we rely on

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.

Our long-term priorities

1 Leadership in UK water

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

2 Efficient operations

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

3 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.

The value we create

Protecting places

c.100,000

TREES PLANTED ACHIEVING OUR INITIAL 2025 TARGET



85,100

HECTARES OF LAND ENHANCED FOR BIODIVERSITY (CUMULATIVELY)



Supporting people

73%

GREAT PLACE TO WORK SCORE



>2m

VISITORS TO OUR REGION



Creating value

89%

CUSTOMER SATISFACTION



75/100

SUSTAINALYTICS SCORE



Market and regulatory overview

Pennon operates at the forefront of the changing regulatory water markets and remains well placed to identify further growth opportunities.

More information

 **Our operations** pages 50 to 55

The UK 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.

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

These services are provided by 16⁽¹⁾ core regional companies, of which 10 are providers of both water and wastewater services.

Our competitive environment comprises the water and wastewater companies in England and Wales. As well as the competitive environment with our UK water peers, we benchmark customer service against other providers in the region and the UK. As a FTSE 250 publicly-listed company, other infrastructure companies are competitors from an investor (equity and debt) perspective.

WATER COMPANIES (2021)



- Water only companies: **6**
- Water and wastewater companies: **10**

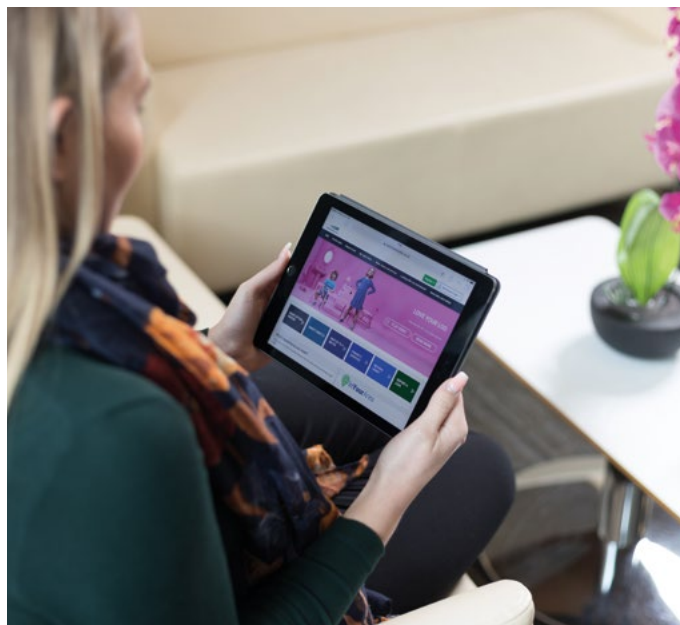
Source: Ofwat.gov.uk

(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 our supply chain to identify and implement best working practice across all areas of the business.

The regulatory framework



As a provider of water and wastewater services, we operate within a framework consisting of a variety of regulators. We are subject to regulation on price and performance by economic, quality and environmental regulators.

This regulatory framework is designed to safeguard the best interests of customers and the environment.

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

KEY WATER INDUSTRY REGULATORS (2021)



Our approach

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.

The non-household retail market



The non-household retail market allows 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. This 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.

MARKET CHOICE AND REGULATORS (2021)



● Switched: 12%
● Yet to switch 88%



Our approach

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

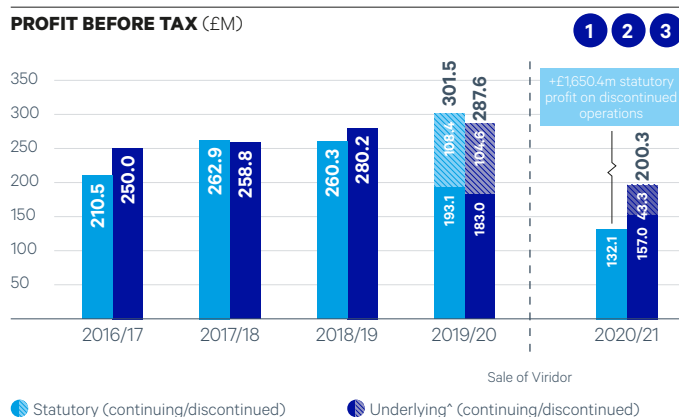
Key performance indicators

Sustained operations throughout the year

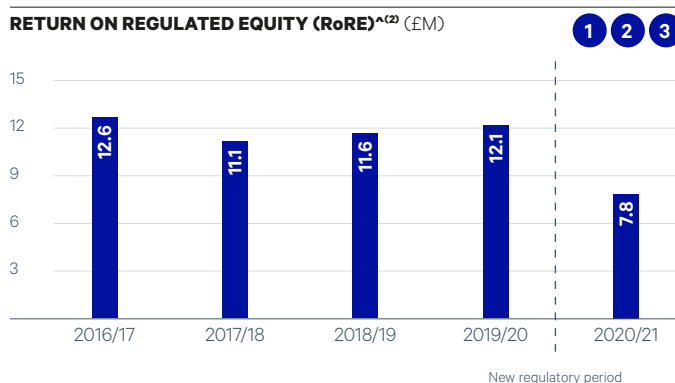
Annual⁽¹⁾

Operational

PROFIT BEFORE TAX (£M)



RETURN ON REGULATED EQUITY (RoRE)^{^(2)} (£M)



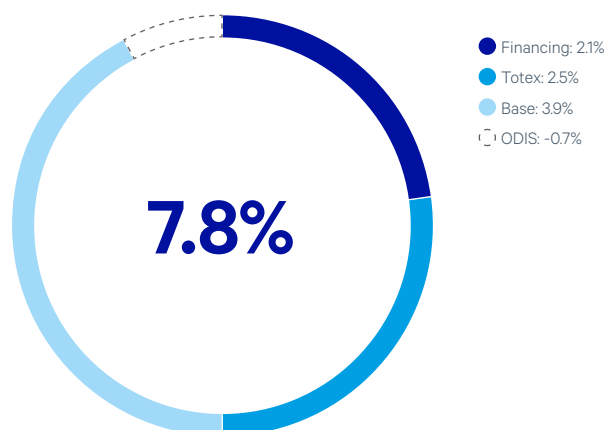
More information

Group Finance Director's report pages 56 to 63

More information

Our operations – Water and wastewater pages 50 to 53

2020/21 RETURN ON REGULATED EQUITY (RoRE)^{^(2)} (%)



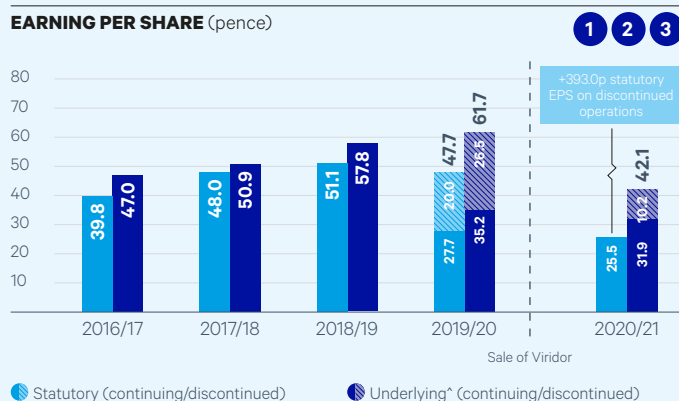
K7 RoRE performance reflecting strong start to new regulatory period.

More information

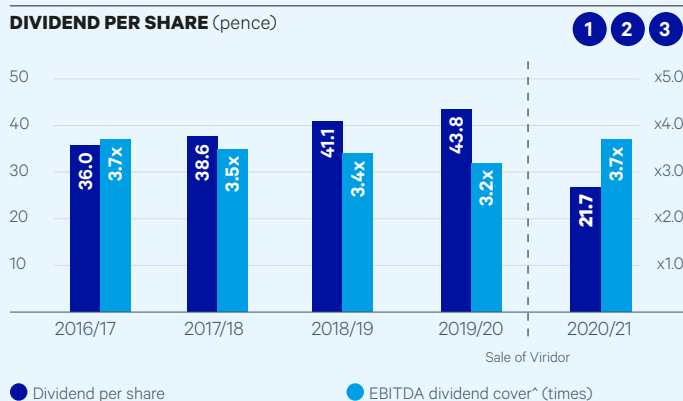
Our operations – Water and wastewater pages 50 to 53

Long-term

EARNING PER SHARE (pence)



DIVIDEND PER SHARE (pence)



More information

Group Finance Director's review pages 56 to 63

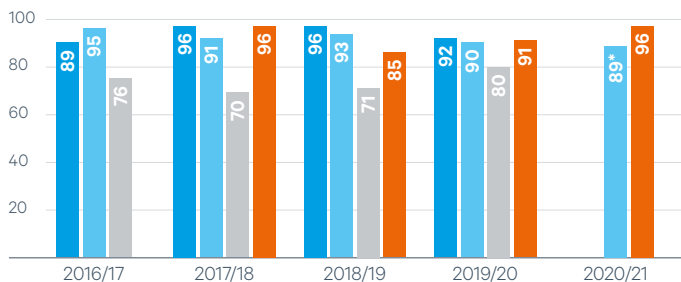
More information

Group Finance Director's review pages 56 to 63

Sustainable business

CUSTOMER SATISFACTION WITH OVERALL SERVICE* (%)

1 3



● Bournemouth Water ● South West Water ● Viridor ● Pennon Water Services

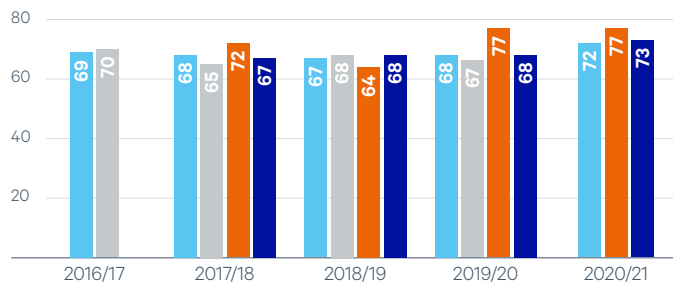
More information

Our operations pages 50 to 55

* Includes South West Water and Bournemouth Water customer satisfaction, recorded as a combined figure in K7.

EMPLOYEE ENGAGEMENT⁽³⁾ (%)

1 3



● South West Water ● Viridor ● Pennon Water Services ● Pennon Group

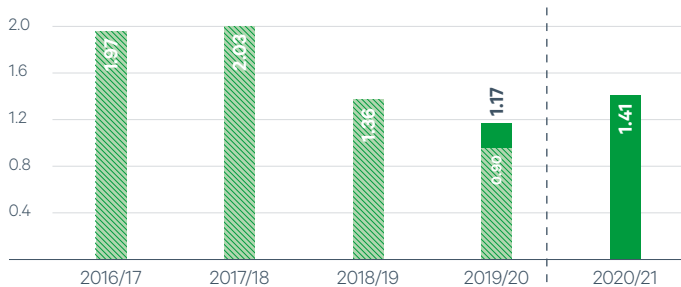
Up to the point of disposal, employee engagement was a key focus across the entire Group including Viridor.

More information

Our people pages 42 to 47

HEALTH & SAFETY⁽⁴⁾ (LTIFR)

1 2 3



● Group (including discontinued business) ● Continuing Group

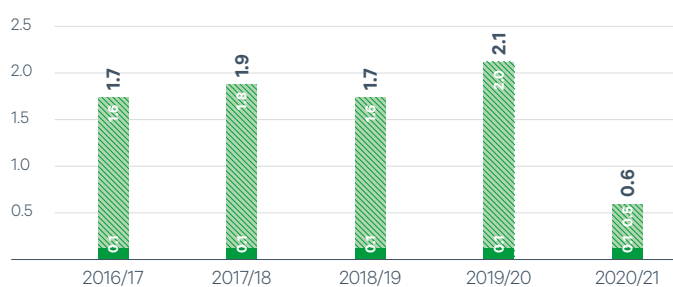
Sale of Viridor

More information

Our people page 47

GHG EMISSIONS⁽⁵⁾ (million tCO₂e)

1 3



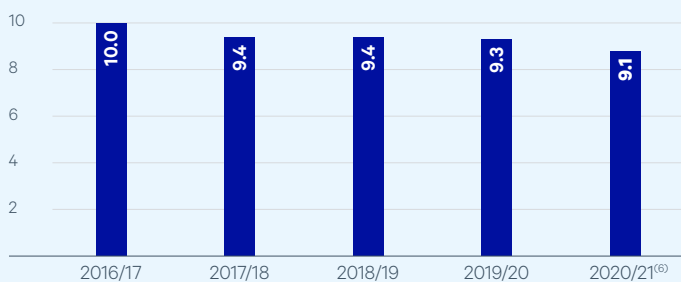
● Continuing Group ● Discontinued business

More information

Directors' report pages 130 to 135

RETURN ON CAPITAL EMPLOYED (ROCE)⁽⁶⁾ (%)

2 3



ALIGNMENT TO STRATEGY

Our KPIs are aligned to our three long-term priorities.

- Leadership in UK Water
- Efficient operations
- Sustainable growth

(1) For further information on the relevance to Executive Directors' remuneration see pages 108 to 109.

(2) 2020/21 RoCE reflects lower base allowed return of 3.9% under K7 methodology.

(3) In 2017/18 we introduced a Group-wide employee survey, which changed the methodology for calculating employee engagement.

(4) Lost time injury frequency rate (LTIFR) for employees and agency staff per 200,000 hours worked.

(5) Gross Scope 1 & Scope 2 emissions – million tonnes carbon dioxide equivalent (location-based).

(6) South West Water ROCE measure used for 2020/21. This provides a comparative figure to previous period continuing Group performance. See calculations provided in Alternative performance measures section on pages 207 to 210.

A purpose-led business

We want people to enjoy the environment they live in and the places they love – not just for today, but for generations to come – supporting the local economy, wellbeing and physical health.

Our focus on UK Water, with the geography and the regions we support, affords us the opportunity to be at the forefront of environmental leadership.





Our Upstream Thinking project is an award-winning programme, working with local partnerships to ensure a better future for farming, to improve wildlife habitats, restoring wetlands and future resilient water supplies.

We have delivered our commitment to plant 100,000 trees by 2025 and are increasing our target to 250,000. We pride ourselves on partnering with wildlife charities and national parks.

Chief Executive Officer's review

I believe that the best businesses are those that value people and promote teamwork.

This in turn drives innovation, agility and a passion for doing what's right – for the environment, customers and each other.

Our values



Trusted

We do the right thing for our customers and stakeholders



Responsible

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



Collaborative

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



Progressive

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



Unlocking potential to transform and deliver

One of my first priorities, as Group Chief Executive Officer, has been to focus everyone on helping make Pennon the best place to work for our employees, and the best company to work for in the South West. For me, great leadership is all about valuing people and unlocking the potential in everyone to deliver, driving innovation and agility. With over 2,000 employees at Pennon, we value everyone.

It was therefore great to see Pennon being recognised as the winner in Britain's Most Admired Companies (Utilities) – the longest-running annual survey of corporate reputation in the UK. Most importantly, our employees are telling us that too. This year we asked employees how it feels to work for Pennon using the Great Places to Work Best Workplace Survey™. We achieved our highest ever participation rate of 84% and have officially passed the threshold to become accredited as a Great Place to Work. In a year where the pandemic has changed lives and livelihoods for everyone, I am most proud of this.

In 2020/21, our absolute focus has been on supporting our employees through COVID-19. However, our Health and Safety LTIFR performance wasn't in line with our aspiration. We believe that everyone who works for and with the Group, should go home safely, every day. We remain committed to delivering on our strategy to 2025 to become industry leading on health and safety. For 2021/22, we aim to have our best performance ever, with a renewed focus on our cultural training and award winning HomeSafe programme, as well as continuing to focus on ensuring that all our sites and employees remain COVID-safe.

UK sector leading water focus

This has been a pivotal year for the Group as we have repositioned Pennon to focus on driving sustainable growth in the UK water sector, building stability for the longer term, and recognising ongoing shareholder loyalty.

In line with our strategy, we have transitioned the Group to become wholly focused on the UK Water sector, as an experienced consolidator with significant experience of leading, transforming and optimising water and wastewater businesses for the benefit of all our customers. As the only water company to have been fast tracked twice in successive price reviews, we have strong foundations on which to build.

We have also ensured Pennon is well positioned for the future, reinvesting for growth, and retaining sufficient funds to drive further value. The acquisition of Bristol Water is the next step in the growth of the Group, building on our strong reputation. It increases the size and scale of the Group to serve c.3.5 million customers, and also adds another 500 dedicated employees to the Group, enabling access to a new, wider and diverse talent pool in the South West, with further opportunities for the Group to become a widely recognised employer of choice.

Additionally, we have demonstrated our credentials as a responsible business, reducing debt levels, increasing pension contributions, and further supporting Green Recovery for the much-needed regeneration of our region.

Our sector leading dividend policy, together with the planned special dividend, recognises the ongoing loyalty of our shareholders, underpinned by the Group's confidence in our ongoing growth strategy, and building a sustainable future for all.

Pennon Water Services continues to acquire new customers in the highly competitive retail market, with a strategy focused on high quality, sustainable long-term partnerships, winning national customers. With market leading customer service, this continues to be a point of differentiation for future wins.

Building a new kind of water company

At the heart of what we do, and why we do it, is an unwavering ambition to put environmental, social and governance commitments at the forefront of our decision-making, driving sustainability.

The societal responsibility of business has been under more scrutiny than ever, from all stakeholders, and it's clear that organisations need to do more to tap into the public consciousness. Organisations everywhere, across every industry, are reassessing their priorities and purpose for the good of the planet, for people and for profit – in that order – for the longer term; they're building agility and flexibility into their strategies, to be able to respond as things change and really listen to public and social sentiment. Pennon is doing just that.

We aim to become a different kind of water company, as we scale up investment in the environment, kickstarting our race to Net Zero by 2030, focusing on sustainable living, championing renewables and reversing carbon emissions, and delivering sustainable solutions for customers, communities and the regions we operate in.

Our New Deal business plan includes our largest ever environmental programme in 15 years. Our award-winning Upstream Thinking programme has driven an increase in the region's biodiversity over the past 15 years and during 2020/21, we have realised another c.20,000 hectares in key catchments, improving both water quality and natural capital in our region. Our tree-planting commitment to plant 100,000 trees by 2025 has been achieved, and we continue to work closely in partnership with wildlife charities, national parks and farmers to deliver continued environmental benefits.

Getting the basics right is also core to what we do. This year, demand for our resources and access to clean drinking water has been the highest it's ever been. We are focused on delivering for our customers and ensuring quality is of the highest standard.

Innovating to deliver a new relationship with customers

I believe there's no better way to respond to or capture public sentiment than building a deeper relationship with customers – really engaging with them and putting them at the heart of our decision-making.

That's why, as part of our New Deal K7 business plan, we launched our innovative WaterShare+ scheme, sharing £20 million of outperformance with customers, and giving them not only a say in what we do, but a stake too.

One in 16 households in our region are now shareholders as well as customers, heralding a new era in customer ownership – a true partnership. Our new independent WaterShare+ panel have now held two quarterly panels with customers and it's providing a strong platform to empower customers. This is just the start of real and honest customer engagement, with a richer and deeper relationship with customers.

We're also tapping into the social consciousness of our customers in new ways – having just launched South West Water's industry first Water-Saving Community Fund, empowering customers to champion and drive initiatives to save water locally, whether that's using rainwater to flush a public toilet, or water butts in community allotments. Our new Neighbourhood Fund is also supporting communities with well needed help and support to build back better post the pandemic as well as encouraging employees to give an hour to support communities and causes close to their heart.

Operational delivery – driving improved performance and agility

South West Water has made a robust start to K7, thanks to the tireless efforts of all our employees, and continues to demonstrate resilient performance, even through the pandemic. c.80% of ODIs are on track or ahead of target, as we focus on operational delivery, efficiency and innovation. Year on year, we are able to report improving water quality, reduced customer supply interruptions and a resilient service and consistency of supply. 2020 was the 24th consecutive year without water restrictions in the South West Water region as well as maintaining Bournemouth Water's track record of none. Additionally, we are seeing a reduction in sewer collapses and internal flooding incidents and improved wastewater compliance.

“
It was great to see Pennon being recognised as the winner in Britain's Most Admired Companies (Utilities) – the longest-running annual survey of corporate reputation in the UK.

Chief Executive Officer's review continued

We care deeply about the environment and we have also been redoubling efforts in those areas where performance isn't where it needs to be, particularly around pollutions. We have halved the average monthly pollutions since implementing a new plan in September 2020, closing the gap through innovation, root cause analysis and improving control systems. This, together with additional resources, training and a relentless focus on delivering for customers and the environment – building stronger engagement with regulators, employees and the public – is the key to improvement.

For UK Water, this has been an unprecedented year operationally. We are accustomed to peak demand over the traditional tourist seasons and this year has been no exception but unusually we have also had higher underlying demand with more dispersed usage across our network away from our more concentrated urban environments. We have the largest proportion of second homes in Devon and Cornwall, and overall consumption has been higher than the previous year, with household consumption up +9% net of business usage down -22%.

We have concentrated on our customer's top priority of a continued supply of clean drinking water and we have not had water restrictions despite the higher demand. We have however, missed our leakage target this year despite significant activity on the network.

We have got a targeted plan in place to recover our performance, and in recent weeks we are already seeing an improvement to our position.

A responsible business in the communities we serve

The South West's economy has been one of the hardest impacted by the pandemic, and as a responsible employer in the region, South West Water has focused on opportunities to make a bigger societal contribution with our Green Recovery Initiative. We were pleased that our proposals to provide much needed investment, have been provisionally approved by Ofwat, with a range of projects focused on improving public health, protecting the environment and addressing climate change. Up to 500 jobs will be created across the region as well as opportunities for our existing workforce to gain new green skills.

We have also continued to expand our innovative affordability and WaterCare programme, undertaking over 3,600 virtual visits to homes and households struggling to meet financial commitments and helping to unlock £2.4 million in support funds for customers. We have also seen an 11% increase in customers benefitting from one or more of our social tariffs.

Our societal responsibilities also extend to promoting social mobility, addressing inequality, providing secure employment and ensuring that people are paid fairly for work today and in the future.

“The Board remains committed to exploring growth opportunities in the UK Water sector that are value adding.”

I am therefore proud to announce that Pennon has become a Living Wage Foundation employer and also one of the first companies in the South West to take placements as part of the government's Kick Start scheme – offering 16-24 year olds from disadvantaged backgrounds the opportunity for paid work at South West Water in a variety of roles, and we hope they will join permanently. We have also been extending our apprenticeship programme, aiming to attract 500 apprenticeships over the next five years and for 2021 announced a new Graduate scheme, bringing in talent and future leaders for the next generation.

Looking ahead to future growth

The acquisition of Bristol Water is an important next step in the evolution of the Group, a strong strategic fit, cementing Pennon as a leader in our chosen sector. The Group is now firmly focused on leading, transforming and optimising water and wastewater businesses. Building on strong credentials as an experienced consolidator, we are confident we can deliver more for shareholders, customers and employees. 2020/21 saw the expansion of our licence to include the Isles of Scilly, and work is well underway to deliver critical investments to improve infrastructure and assets.

The Board remains committed to exploring growth opportunities in the UK Water sector that are value adding. We will also continue to invest in environmental infrastructure projects that realise new revenue streams.

If the first year of my tenure as Group Chief Executive Officer for Pennon has taught me one thing, it's that with a great team around you, you can achieve anything, innovating and creating agility, whatever the circumstances. I believe Pennon, and everyone who works in it, has a clear ambition to deliver on our purpose, for the benefit of all our customers, shareholders and stakeholders, providing a safe and secure future for all, people and planet, and a strong platform on which to grow.



Susan Davy
Chief Executive Officer

2 June 2021

The things that matter most

LIVING OUR VALUES



Trusted

We do the right thing for our customers and stakeholders



Responsible

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



Collaborative

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



Progressive

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

DRIVEN BY OUR PURPOSE



c.2.3m

BENEFITTING FROM OUR SERVICES

Bringing water to life – supporting the lives of people and the places they love for generations to come.

UNDERPINNED BY SUSTAINABILITY



500

NEW JOBS GENERATED OVER FOUR YEARS

Our Green Recovery plan aims to generate up to 500 additional jobs over the next four years.

We are currently investing in our largest environmental programme in 15 years.

OUR RELATIONSHIP WITH OUR CUSTOMERS



1 in 16

HOUSEHOLDS BECOMING SHAREHOLDERS IN THE BUSINESS

Delivery of WaterShare+ benefits to all customers.

CREATING THE BEST PLACE TO WORK



600

NEW APPRENTICES AND GRADUATES

We are now certified as a Great Place to Work and a Living Wage Foundation employer.

DRIVING SHAREHOLDER VALUE



£4.2bn

AGREED SALE OF VIRIDOR

Net proceeds of c.£3.7 billion.

ESG strategy

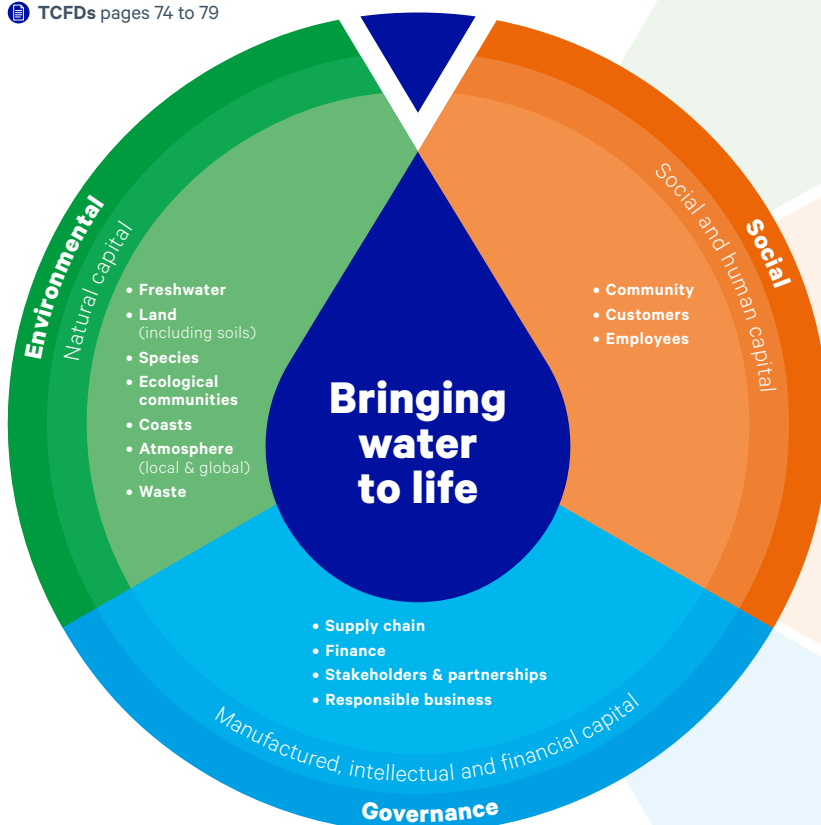
Sustainability at the heart of our business

Our ESG strategy continues to deliver during a year of significant change.

Highlights over the past year include the creation of our new ESG Capitals Strategy and Framework including new ESG targets. We showed strong performance across external ESG ratings, demonstrating our commitment and management of risk across the ESG agenda. And in a year of critical climate action we have made significant progress in implementing the recommendations of the Task Force on Climate-Related Financial Disclosures.

More information

TCFDs pages 74 to 79



ENVIRONMENTAL

Protecting and enhancing our environment for generations to come.



Freshwater



Land (including soils)



Species



Ecological communities



Coasts



Atmosphere (local & global)



Waste

SOCIAL

Supporting our people and communities (to increase our social value).



Community



Customers



Employees

GOVERNANCE

Being a responsible business for all our stakeholders.



Supply chain



Finance



Stakeholders & partnerships



Responsible business

ESG CAPITALS FRAMEWORK METHODOLOGY

We have identified key 'Elements' (e.g. Environmental: Freshwater, Social: Community, Governance: Finance) within our ESG Capitals Framework. We will track performance across a number of metrics to evaluate the performance of these capital elements. We recognise that 'Governance' relates to other capitals too, but has been framed in this way here to retain simplicity.

Selected highlights in 2020/21

c.20,000

HECTARES ENHANCED FOR BIODIVERSITY

c.100,000

TREES PLANTED

5

4 EEL PASSES AND 1 EEL SCREEN INSTALLED

>11,500

MWh OF RENEWABLE ENERGY GENERATED

Selected highlights in 2020/21

96

NEW TALENT RECRUITED (APPRENTICES, GRADUATES, KICKSTARTS)

73%

GREAT PLACE TO WORK SCORE

>2m

VISITORS TO OUR REGION

70%

CUSTOMER SATISFACTION WITH VALUE FOR MONEY (SWW)

Selected highlights in 2020/21

Improved

SUSTAINALYTICS ESG SCORES

75%

OF DEBT RAISED THROUGH SUSTAINABLE FINANCE FRAMEWORK

117

ENGAGEMENTS WITH INVESTORS

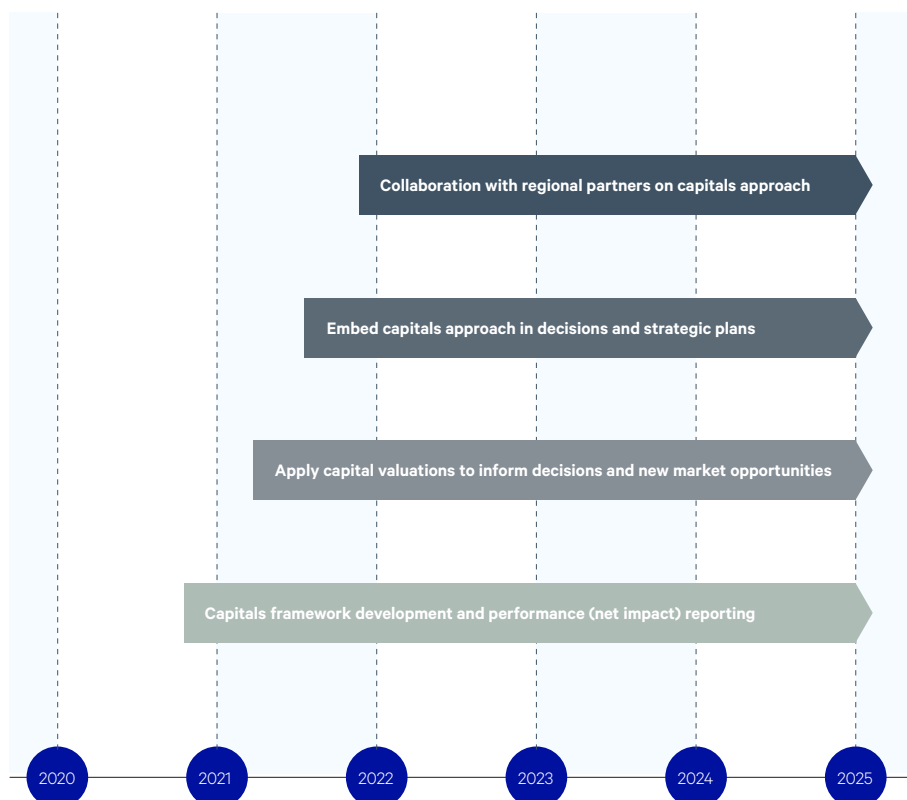
Maintained

ASSET HEALTH

Our Capitals Strategy

Our new Capitals Strategy will support decision making to deliver the best outcomes for our customers, communities and the environment. The reporting of our capital performance, which will allow us to evaluate and report on our overall 'net impact', is one phase of our planned capitals programme which also includes:

- Establishing an ESG aligned capitals framework and accompanying metrics
- Applying appropriate valuations to inform our understanding and use of capitals information
- Embedding our capitals approach in our decision making and planning
- Collaboration with regional partners to apply capitals thinking in practice
- Enhanced reporting and assurance of our performance.



CASE STUDY: NATURAL CAPITAL THINKING: USING 40,000 TREES TO HELP IMPROVE BATHING WATER QUALITY IN COMBE MARTIN



An ambitious project to plant 40,000 trees to help improve bathing water quality in Combe Martin began in early 2021. South West Water, in partnership with local landowners North Devon Biosphere Foundation, the Environment Agency, the Woodland Trust and Natural England's Catchment Sensitive Farming Partnership, will identify areas where tree planting, hedging and fencing can help protect the River Uمبر from bacteriological contamination. The River Uمبر flows into the sea at Combe Martin beach and can affect bathing water quality, especially during wet weather.

ESG KPI performance

2020/21 performance

Our targets are informed by a review of the issues we and importantly our stakeholders considered of greatest importance.

The materiality assessment which informed our 2020/21 targets is available on our website at www.pennon-group.co.uk/sustainability.

PERFORMANCE KEY



Achieved/
On track



Behind target



Missed

2020/21 KPI	2020/21 PERFORMANCE	COMMENTARY
To achieve at least a B-rated 'CDP Climate' disclosure assessment score	✓	Achieved 2020 B rating. Replaced with greenhouse gas reduction target under Atmosphere .
To achieve zero major or significant environmental incidents (Category 1 & 2)	✗	Three Category 2 incidents in 2020. Updated in 2021/22 to reflect Category 1-3 as per South West Water regulatory commitment under Freshwater .
Achieve 5% biodiversity net gain across all sites with biodiversity management plans in place	✓	New wildflower meadow delivered 293% improvement in biodiversity units (2.16 Biodiversity Units) at Roadford Reservoir. New target under Species .
Evaluate relevant operational areas and projects for net natural capital gain (using defined methodology), demonstrating 3% year on year improvement from a 2019/20 baseline	✓	Our 2020/21 natural capital account shows an overall improvement above 3% from the 2019/20 baseline. Our expanded capitals framework and the targets associated with this will replace this target for 2021/22.
Evaluate relevant operational areas and projects for net social capital gain (using defined methodology), demonstrating 3% year on year improvement from a 2019/20 baseline	✓	Our 2020/21 social capital account shows an overall improvement above 3% from the 2019/20 baseline. Our expanded capitals framework and the targets associated with this will replace this target for 2021/22.
Annual targeted reduction in Lost Time Injury Frequency Rate (LTIFR) with overall target of 0.5 by end of 2024/25	⊖	There have been 29 LTIs during the year, resulting in an LTIFR of 1.41*. The Homesafe programme and re-focused H&S efforts within the operational businesses should deliver an improving trend to get us back on track for our long-term target of 0.5 by 2025. Target retained under Employees .
Annual targeted improvement to increase proportion of female employees in the Group from 21% in 2019 to 25% in 2022	✓	At 31 March 2021, the Continuing Group has 29%* female employees. Target updated for 2021/22 to target at least 30% female employees by 2022 under Employees .
Achieve a 65% Trust Index score by 2021/22, as measured by our Great Place to Work employee survey, demonstrating continual improvement in building an engaged workforce	✓	Trust Index score rose to 68% in 2020. We achieved the Great Place to Work accreditation which we look to retain in 2021/22 under Employees KPI.
Achieve upper quartile scores in our peer group for leading external ESG disclosure assessments	✓	Majority ESG ratings and indices improved or maintained score with FTSE4Good score in 2020 an exception and expected improving trend in 2021 score. 2021/22 target to focus on Sustainalytics ESG rating under Responsible Business .
Target 25% of total finance raised within the Pennon Sustainable Financing Framework	✓	A total of c.£90 million of funding aligned to the framework was raised in 2020/21 which accounted for 75% of new and renewed facilities, in excess of the 25% target. Target increased in 2021/22 under Finance .
Ensure 2% year on year increase in customer satisfaction from a 2019/20 baseline	✓	SWW – C-MeX** performance has improved by 6% at 80.96 (against a 2019/20 baseline of 76.35). PWS – Trustpilot score of 4.8/5 for the year, 7% higher than 2019/20 baseline figure. Both C-MeX and Trustpilot retained as customer satisfaction targets under Customers element.
Targeted annual application to ensure all suppliers are 100% compliant with the objectives identified within our Sustainable Procurement Policy by end 2021/22	✓	Post the sale of Viridor, segmentation of our remaining 2,500 suppliers completed. Supplier ESG engagement and reporting programme to begin in 2021/22. Target retained under Suppliers .

* KPI assured by DNV.

** C-MeX – Customer Measure of Experience.

Priority programmes

Our priority programmes focus progress on particular areas of our ESG strategy. COVID-19 has of course impacted progress on some aspects but at the same time has accelerated other areas, for example, infrastructure to support our smarter working programme. A summary of progress in 2020/21 is provided below.



COMMUNITY BENEFIT & SOCIAL VALUE

- We launched South West Water's 2020-50 community vision: "To sustainably improve our services while having a positive impact on the communities we serve and the people we employ."
- We announced our new Neighbourhood and Water-Saving Community Fund, providing direct support to community groups and initiatives.
- We will be building on these programmes over the coming year whilst establishing ways to better measure our community impact to support our capitals framework and place-based approaches to investment.



SUSTAINABLE TRANSPORT, TRAVEL AND SMARTER WORKING

- COVID-19 has meant the planned roll out of new agile working approaches has been accelerated. This enabled all of our office based employees to work effectively from home. The new IT capability has facilitated new ways of working which will continue post lockdown.
- We are undertaking trials of new electric vehicles with the ambition to roll out further EVs across our fleet in support of our Net Zero strategy and we have announced continued support for sustainable travel choices such as the cycle to work scheme.



CIRCULAR WORKPLACE

- Over 90% of our employees told us in our recent company survey that we should be a leader in sustainability. The objective of the programme is to ensure a consistent approach to workplace sustainability, to implement and maintain the best standards possible at our head office and to facilitate improvements in Group-wide sustainability in our workplaces. This will involve employee engagement on sustainability best practice, collaboration with our key service providers, provision of new recycling infrastructure at our sites and link across to operational focused energy efficiency, waste management and water efficiency programmes.

ESG performance – external benchmarking

Our ESG performance is assessed by a number of independent ESG rating agencies. Our performance across these assessments is a useful indicator of our progress with our ESG strategy both in confirming ESG topics where we are performing well, but also, importantly, areas we still need to improve. Overall we improved or maintained performance across all indices except FTSE4Good (based on March 2020 assessment). We have worked hard over the past year to improve our overall ESG performance and disclosures and are confident this will return an improving trend when the 2021 scores are announced.

LATEST EXTERNAL ASSESSMENT SCORES



16.8

ESG RISK
(Previous rating: 19.9)

75/100

ESG RATING
(Previous rating: 69)



AA

MSCI ESG INDEXES
(Previous rating: AA)

Disclaimer

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S&P Global

SAP Global Corporation
Sustainability
Assessment (CSA)

52/100

(Previous rating: 49/100)



B Rating

**CDP CLIMATE
CHANGE RATING**
(Previous rating: B)

B-

**CDP WATER
SECURITY**
(Previous rating: B-)



FTSE4Good

3.5/5

(Previous rating: 3.6/5)



Prime status

ISS CORPORATE RATING
(Previous rating: Prime)



B

**GRESB INFRASTRUCTURE
PUBLIC DISCLOSURE**
(Previous rating: B)

New ESG Capitals framework

Our 2021/22 targets

We have updated our 2021/22 ESG targets*, as set out here, to reflect our new Group strategy and expanded ESG Capitals framework.





We will create new three-year targets over the coming year (for the period April 2022 – March 2025). To inform this update, we will review our materiality assessment, the UN Sustainable Development Goals (SDGs) and how our new targets can further support implementation of the goals.















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

* Targets are to be delivered by end 2021/22 unless otherwise stated.

Environment

CAPITAL	TARGET	LINK TO SDG
 Species	Increase our cumulative land in active management to 93,150 hectares, delivering biodiversity enhancements	
 Ecological communities	Plant 50,000 trees per year towards target of 250,000 by 2025	
 Land (including soils)	Restore 300 hectares of peatland across the South West	
 Freshwater	Reduce water use within our operations by 6 Megalitres/day	
	Reduce Category 1-3 pollution incidents per 10,000km sewers	
 Atmosphere (local & global)	Reduce Scope 1 & 2 (market based) emissions by 3% towards our Net Zero 2030 target	
	Increase renewable energy generation (MWh) by 4%	
 Coasts	Deliver projects to improve water quality at 2 designated bathing waters / beaches	
 Waste	Improve our operational waste recycling rate by 2%	

Social

CAPITAL	TARGET	LINK TO SDG
 Employees	Maintain the Great Place to Work accreditation	
	Increase REACH* recruitment by 2%	
	Increase the proportion of female employees in the Group to at least 30%	
	Target top 25 ranking in Hampton Alexander Index	
 Customers	Targeted reduction in Lost Time Injury Frequency Rate (LTIFR) towards 1.1 (23 LTIs) with overall target of 0.5 LTIFR by end of 2024/25	
	Target 2% year on year increase in SWW C-MeX ⁽¹⁾ performance	
	Target Trust Pilot score of 4.5 for Pennon Water Service customers	
 Community	Increase number of community investment schemes we support by 20	
	Increase number of visitors to our land by 2%	

* Race, Ethnicity and Cultural Heritage (REACH).

(1) C-MeX - Customer Measure of Experience.

Governance

CAPITAL	TARGET	LINK TO SDG
 Responsible business	Achieve Sustainalytics ESG Rating Score of 75 or above	
	Maintain asset health as measured by performance across basket of asset health metrics	
 Stakeholders & partnerships	Increase number of engagements with investors year on year	
 Finance	Target 50% of new and renewed finance raised through the Pennon Sustainable Financing Framework	
	Target 30,000 customers on one of our support tariffs	
 Supply chain	Target 100% compliance with the objectives within our Sustainable Procurement Policy	
	Pay all our suppliers within 30 days	

CASE STUDY: OUR GREEN RECOVERY INITIATIVE



The South West's economy has been one of the hardest hit by COVID-19, and as a responsible business in the region, South West Water is focused on opportunities to make an even bigger and more societal contribution.

Our Green Recovery Initiative provides much needed investment that will support the creation of up to 500 additional jobs across our regions over the next four years and provide further opportunities for South West Water's existing workforce to gain new green skills.

Our Initiative has been supported by our customers with an acceptance rating of 81% along with support from South West Water's independent WaterShare+ Advisory Panel.

Following a detailed assessment by regulators, in early May, Ofwat published their draft green economic recovery decision, outlining £81 million of additional environmental investment, with no impact to customer bills up to 2025.

Our proposals incorporate an important and manageable set of schemes in addition to our existing business plan commitments through to 2025, and allow us to take extra action on the most pressing environmental issues reflecting our customer priorities:

- **Knapp Mill Water Treatment Works advancement** – completion of a new water treatment works for Bournemouth customers, 18 months ahead of current schedule, benefitting c.160,000 customers with a more reliable, high-quality water supply.
- **Water resources grid enablement** – protecting water resources for future generations for c.250,000 customers, addressing supply risks in North Devon, and supporting resilience in other parts of the country.
- **Smarter, healthier homes** – empowering customers to save water, save money and have even safer and more resilient supplies to their homes, through new pilot initiatives to trial ways to help customers save water, protect customers from the costs of supply pipe failures, and reduce health risks from lead pipes.
- **Transforming river quality** – reducing harm from storm overflows and piloting approaches to improving river bathing water quality for the benefit of all those who use them.
- **Catchment management** – an extension to our award winning land regeneration schemes using nature-based solutions which improve water quality, alleviate flooding, enhance natural habitats and reduce the South West's carbon footprint on the road to achieving Net Zero.

up to 500

ADDITIONAL JOBS

£81m

ADDITIONAL INVESTMENT

81%

CUSTOMER ACCEPTANCE

10,000

HECTARES IMPROVED

Net Zero strategy

As part of a world first national sector-wide commitment of its kind, we have made a commitment to Net Zero Carbon by 2030. Additionally, we have signed the Race to Zero pledge through which we will extend the activities in our Net Zero boundary towards a 2045 target. Our commitments will focus our strategy, enabling us to transform into a different kind of water company. Our approach to Net Zero is aligned to our purpose and values as a responsible business.

Three key pillars

Our strategy is structured around three key pillars:



SUSTAINABLE LIVING

- Reducing emissions through changes to our operational practices, increasing energy efficiency, and switching to lower carbon fuel sources.
- Meeting our commitments to reduce leakage and help customers to use less – protecting the environment and saving carbon.



CHAMPIONING RENEWABLES

- Maximising our own self-generation of renewable energy at our sites across our region – working with partnerships and utilising our expertise.
- Where we cannot generate enough ourselves to meet all our needs, 100% of the energy we purchase will be from renewable sources.



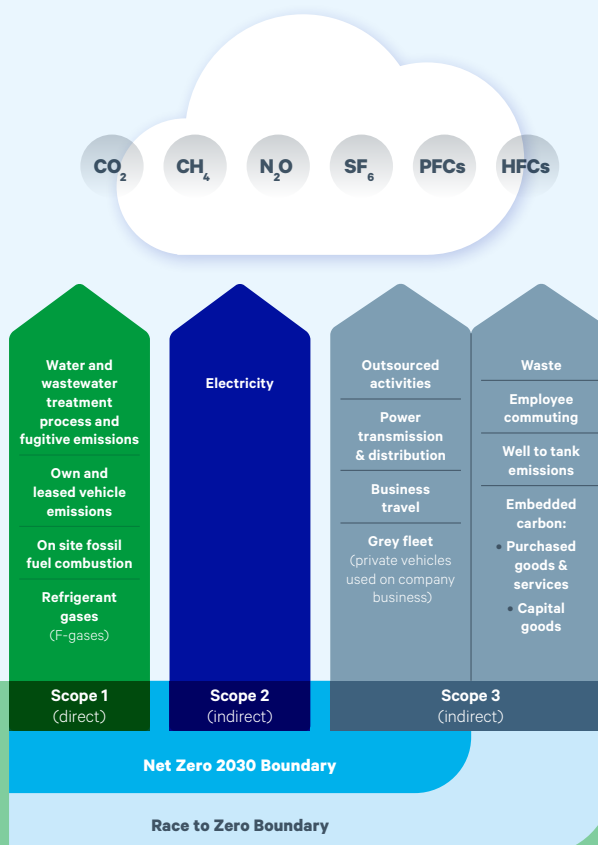
REVERSING CARBON EMISSIONS

- Working in partnership to deliver natural carbon sequestration through activities such as peatland restoration and tree planting.
- Supporting the development of innovative solutions to develop low carbon footprint processes through R&D.

Our Net Zero boundaries

Our 2030 Net Zero Carbon commitment aligns with the Water UK Net Zero Boundary which focuses on our own, operational (Scope 1 and 2) greenhouse gas (GHG) emissions as well as certain value chain (Scope 3) GHG emissions where a core activity is outsourced. Our Race to Zero pledge adopts the same Water UK Net Zero boundary to 2030 and thereafter includes additional Scope 3 activities including GHG emissions associated with purchased goods and services ('embodied' carbon) and those associated with waste generated. Our aim is to deliver Net Zero under this wider boundary by 2045.

The figure illustrates which activities are within our Net Zero Carbon 2030 and Race to Zero 2045 target boundaries based on the Greenhouse Gas Protocol boundaries.



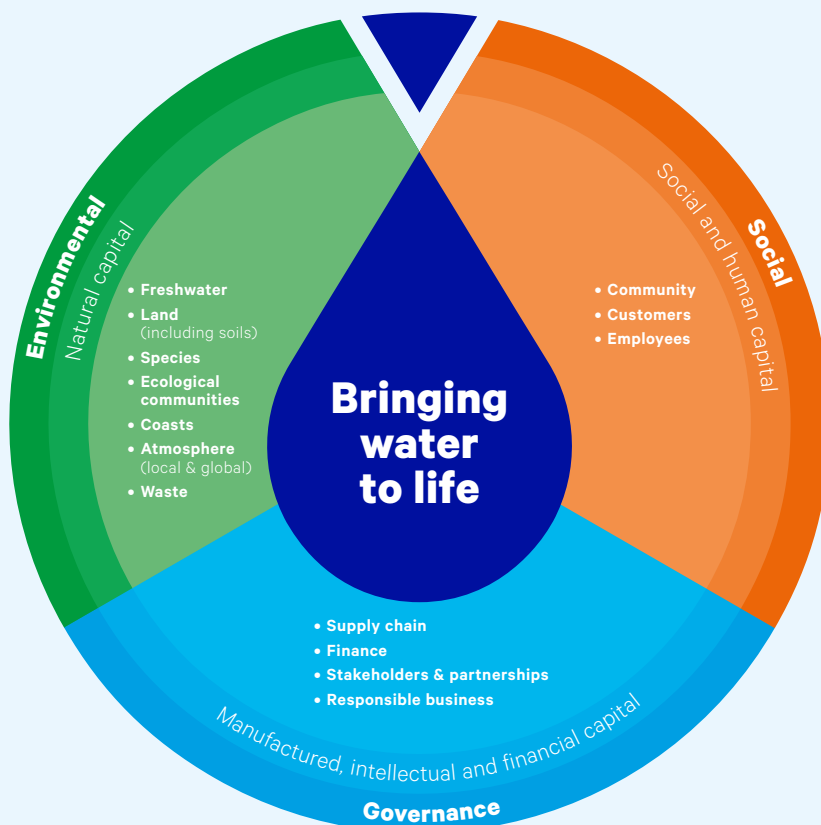
Alignment to ESG strategy

Our new ESG Capitals framework and strategy will ensure carbon is integrated into our decision making but also that Net Zero plans consider wider environmental and social impacts.

Our Net Zero strategy also supports our implementation of the TCFD recommendations. We will undertake scenario analysis to test and challenge the resilience of our Net Zero plans to different climate scenarios.

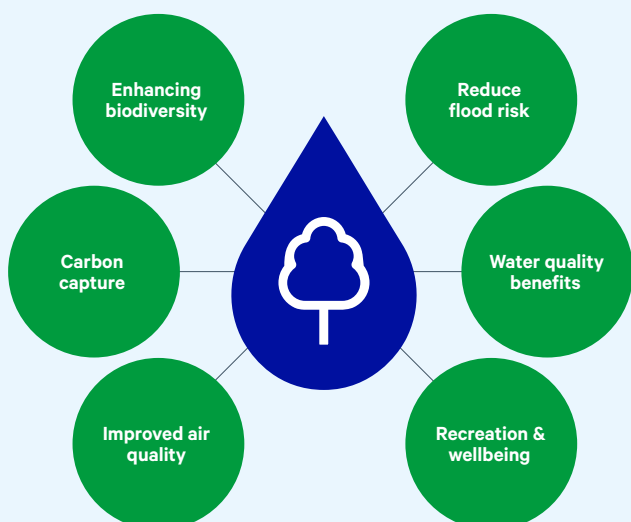
More information

[TCFDs pages 74 to 79](#)

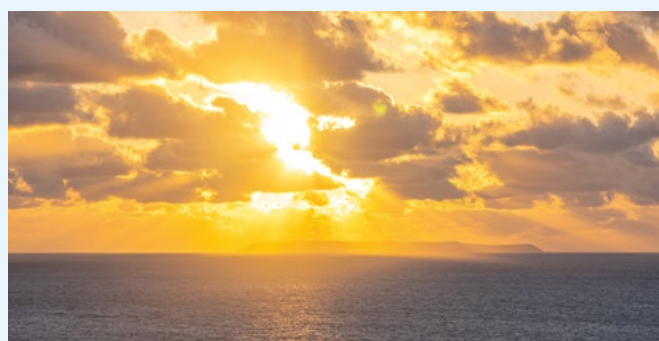


MORE THAN JUST CARBON

Our tree planting and peatland restoration activity will contribute to global climate regulation through protecting and enhancing these natural carbon stores as well as delivering further local environmental and societal benefits or 'ecosystem services' such as flood protection and water quality improvements.



NEXT STEPS ON OUR NET ZERO JOURNEY



We will look to transparently report our progress towards our Net Zero targets both in terms of our overall footprint and our wider contribution to positive climate action.

We are committed to better understanding emissions sources across our value chain. For example we have reported Scope 3 GHG emissions for the past two years and we will expand our collaboration and key suppliers in 2021 to obtain more specific information on GHG emissions associated with the goods and services they supply.

As our Net Zero Carbon journey evolves, we will report progress so we can work collaboratively with our stakeholders towards our common climate goals.

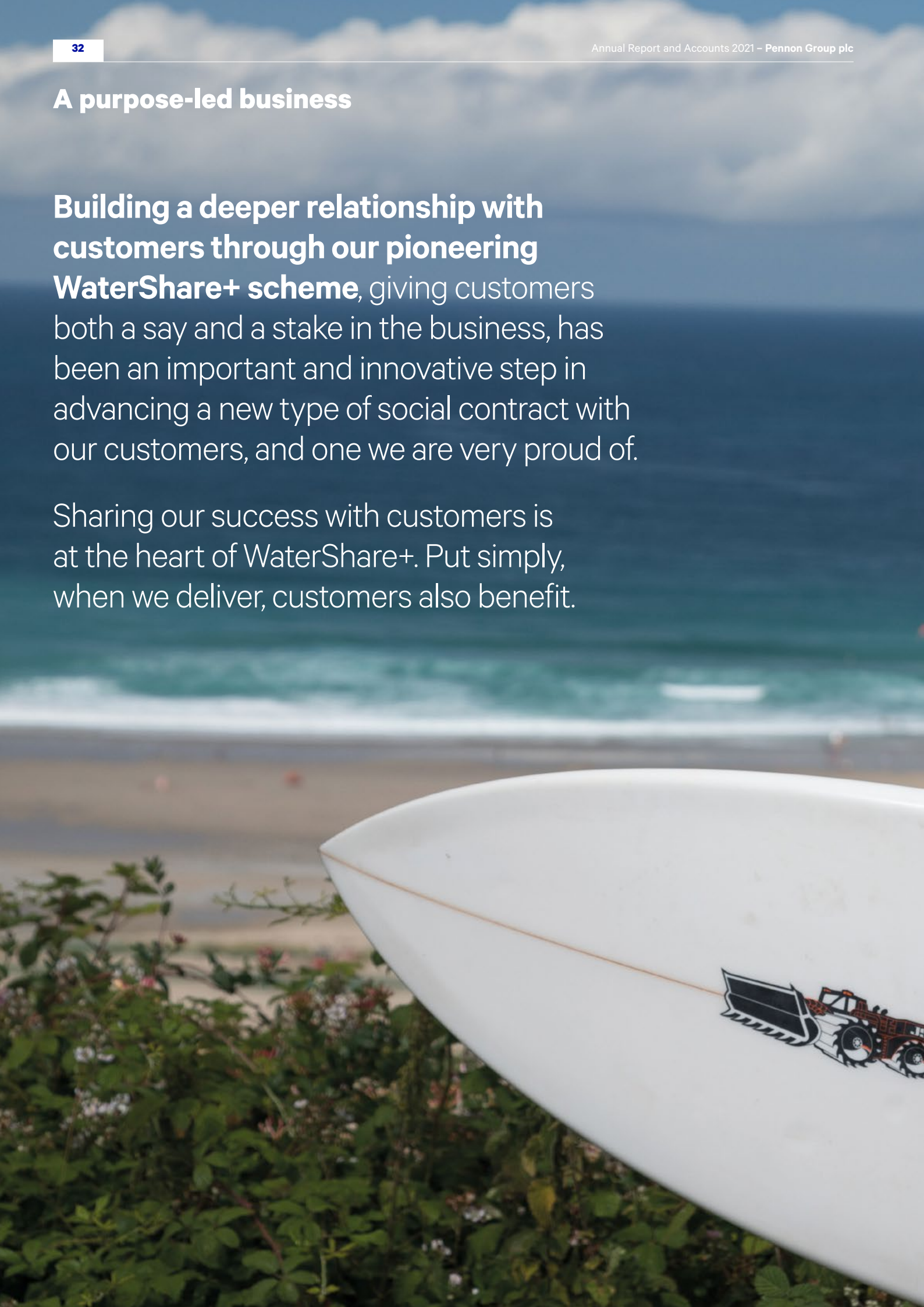
More information

[GHG emissions report page 132](#)

A purpose-led business

Building a deeper relationship with customers through our pioneering WaterShare+ scheme, giving customers both a say and a stake in the business, has been an important and innovative step in advancing a new type of social contract with our customers, and one we are very proud of.

Sharing our success with customers is at the heart of WaterShare+. Put simply, when we deliver, customers also benefit.





We've more than tripled the number of shareholders in Pennon. 1 in 16 households we serve are now our shareholders as well as our customers and we are heralding a new era in customer ownership.

Importantly, this means that customers and shareholders alike can benefit from our sector-leading dividend policy.

One of our customers at Portreath, Cornwall

Our stakeholders

Empowered by our purpose

The sector we operate in has a high profile with a wide stakeholder group. We are committed to listening, engaging and reflecting our stakeholders' needs and priorities in our business plans and operations.

The work we do delivers a wide range of benefits to a variety of stakeholders, creating long-term sustainable value. 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. This in turn shapes our strategy and social purpose:

Innovate and develop our business – by knowing how our business impacts and is perceived and understood by our stakeholders, we can improve our risk profile – an open and transparent approach helps us to see potential problems for us and our stakeholders before they materialise.

Build loyalty and satisfaction – engagement, particularly with employees, customers and investors, builds understanding and knowledge 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 – takes into account stakeholders' interests when making decisions.

More information

 **Stakeholder engagement** – Section 172 pages 38 and 39

Our customers



Our businesses supply water and wastewater services to around one million household customers and over 160,000 business customers.

Our engagement approach

We engage regularly with our customers on service quality, cost of service, value for money and our strategy. This includes regularly conducting customer satisfaction surveys, holding focus groups, co-creation workshops and convening forums, providing ongoing feedback to our teams to recognise good service and make improvements where needed. With the introduction of WaterShare+ as part of the New Deal 2020-25 business plan, customers now have a tangible stake and a say in the business, including the opportunity to participate in a customer Annual General Meeting, the first of which will be held in the autumn of 2021.

We also engage with key trade and customer bodies, including CCW⁽¹⁾ – the voice for water consumers. We have a well-established independent WaterShare customer panel which reviews and challenges our performance against our business plan commitments and, to support the development of our five-year business plan, we have established an independent WaterShare+ advisory panel.

89%

**SOUTH WEST WATER AND
BOURNEMOUTH WATER
CUSTOMER SATISFACTION**

Target: year on year increase in customer satisfaction scores

91%

**PENNON WATER SERVICE'S
CUSTOMER SATISFACTION**

Target: year on year increase in customer satisfaction scores

12th out of 17

**CUSTOMER SERVICE SCORE
(CMEX)**

94%

CUSTOMER TRUST SCORE

94% of customers have trust and confidence in South West Water and Bournemouth Water

(1) CCW – previously known as the Consumer Council for Water.

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 wellbeing, our organisational culture, promoting diversity and inclusion, training and development. We use our annual employee trust and engagement survey as a mechanism to measure progress and obtain feedback. Our senior leaders meet monthly with established engagement forums where staff representatives discuss business challenges. We also recognise trade union partners in our operational business within the Group and maintain an open dialogue with them. We hold weekly Big Chat video calls with employees, providing them with the opportunity to hear directly from the Penon Executive and ask any questions they wish. Employees can also directly email the Chief Executive with comments and questions via an 'Ask Susan' facility in addition to speak face to face during regular site visits.

27%

REDUCTION IN INJURIES

115 in 2020/21 from 158 in 2019/20

84%

COMPLETION RATE FOR OUR GREAT PLACE TO WORK SURVEY

Achieved our target of becoming a Great Place to Work with 73% of employees confirming this

68%

TRUST SCORE

Improving by 5% from 2019/2020

42.9%

FEMALE REPRESENTATION AT BOARD LEVEL

Continuing to exceed the 30% Club target

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 and host regular community liaison groups at 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 and the Royal Yacht Association.

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

£250,000

COMMUNITY INVESTMENT FOR SOUTH WEST WATER

392

VOLUNTEER VISITS

c.2m

VISITORS TO SOUTH WEST WATER'S RESERVOIRS

In line with 2019/20

76

BEACH CLEANS

Held through our BeachCare partnership removing 4 tonnes of waste

Our stakeholders continued

Our environment



We work closely with a range of environmental partners including South West Lakes Trust, Westcountry Rivers Trust, The Wildlife Trusts, Natural England and various conservation and environmental interest groups and charities to help ensure we deliver our environmental commitments.

Our engagement approach

We meet regularly with our environmental stakeholders on natural capital stewardship and other areas of focus. This includes regular meetings and liaison with the Wildlife Trusts in our operational areas and with the Westcountry Rivers Trust, both of whom are partners in our catchment management projects.

We also hold a twice-yearly BeachWise Forum with key stakeholders to discuss matters relating to bathing water quality.

Our suppliers



Our supply chain partners play a vital role in supporting sustainable growth and cost base efficiency across the business. We are committed to ensuring our supply chain partners align with the same values, standards and behaviours we expect of ourselves and share the principles set out in both our Code of Conduct for Supply Chain Partners and Sustainable Procurement Policy. Through rationalising and segmenting our supply base 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 whilst our e-procurement platforms support a structured, fair and transparent approach to supplier engagement. As a signatory to the EU Skills Accord, we work collaboratively to support skills development and investment throughout the supply chain and as part of our Sustainability and Net Zero strategy we will engage our supply chain so that we can better understand and manage our collective environmental impact through collaboration.

3

CATEGORY 2 INCIDENTS

3 category 2 wastewater pollution incidents, up from 1 in 2020

On track

TCFD COMPLIANCE

On track to comply with Task Force on Climate-related Financial Disclosures recommendations by 2020/21

c.250,000

TREE PLANTING COMMITMENT

The number of trees we are committed to planting by 2025, supporting Water UK's commitment to plant 11 million trees by 2030

Net Zero

OUR CARBON COMMITMENT

South West Water's commitment to achieve Net Zero Carbon emissions by 2030

85,100

HECTARES OF BIODIVERSITY ENHANCEMENT (CUMULATIVELY)

c.2,600

SUPPLY BASE

2021/22 target continued delivery of the Group's supply base rationalisation programme to reduce the current supply base of c.2,600 suppliers

100%

SUPPLY CHAIN COMPLIANCE

Following supplier segmentation and rationalisation, work with all suppliers to ensure 100% compliance with the five objectives⁽¹⁾ identified within our sustainable procurement policy by end 2021/22

100%

SUPPLY CHAIN ENGAGEMENT

100% of our suppliers to be engaged with our Code of Conduct for Supply Chain Partners by end 2021/22

Focused

ACTIVE PROMOTION

Of EU skills accord and environmental, social & governance (ESG) commitments

(1) see www.pennon-group.co.uk/sustainability/responsible-supply-chain.

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 USA each year in addition to conferences, investor and analyst briefings. In September, we hosted an event for analysts focused on the detailed financials following the sale of Viridor – a standout theme within the year. We also hold twice-yearly results presentations and Group Finance Director updates and we continue to provide trading updates between results.

54.2%

OF OUR SHAREHOLDER REGISTER MET OVER 2020/21

117

MEETINGS AND CALLS WERE HELD WITH INVESTORS

13

ROADSHOWS, EVENTS AND CONFERENCES ATTENDED

75%

FINANCE RAISED
Under Penron's Sustainable Finance Framework – against a target of 25%

75/100

2020 SUSTAINALYTICS SCORE
(up from 69 in 2019)

3.5/5

2020 FTSE4GOOD SCORE
(down from 3.6 in 2019)

Our regulators



We have an open dialogue and meet regularly with our regulatory bodies: Ofwat, the Department for Environment, Food & Rural Affairs (Defra), the Environment Agency, Drinking Water Inspectorate and the Health and Safety Executive (HSE) 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.

Our policy makers

Engaging with national and local Government, MPs and Peers, Local Enterprise Partnerships, the HSE, HM Revenue & Customs (HMRC), the Department for Business, Energy & Industrial Strategy (BEIS) and Defra, we have a good ongoing dialogue with policy makers and stakeholders who influence and 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, and through trade bodies including Water UK and British Water.

Engaging with stakeholders – Section 172

All our decisions are considered against the importance of acting in a sustainable, ethical and collaborative way, understanding the views of our different stakeholders and weighing their competing interests. Our Board leads and sets the tone by carefully noting the priorities of our stakeholders during its discussions and when it takes decisions. We also know the importance of continually assessing the long-term impacts of our decisions. This helps us live our purpose and our values, as a responsible, trusted and sustainable business acting in a way which benefits all our stakeholders as much as possible. Properly understanding the impacts of what we are doing has become part of how we operate and it permeates everything we want to achieve here at Pennon.

Our s.172 approach

Each Director has a duty to act in the way they consider, in good faith, would be most likely to promote the success of the Company for the benefit of members as a whole, and in doing so, must have regard to a range of broader issues. Therefore, when we make decisions, we always take proper account of all of the following:




- the long-term consequences of our decisions;
- the interests of our employees;
- the importance of having excellent business relationships with suppliers, customers and anyone else who we impact;
- the impacts our operations have on our communities and our environment;

- ensuring we maintain our reputation for the highest standards of business conduct; and
- we will always act fairly between our shareholders.


As part of every decision we make, we will look at how we will impact our stakeholders. To enable us to understand the points of view of our stakeholders and where our decisions could affect them, we have a stakeholder engagement programme. We see stakeholder engagement both as fundamental to development and delivery of our purpose and strategy and as critical for our long-term sustainable success. Although there are often competing interests and priorities involved, being clear on what matters to our stakeholders, allows our Board to weigh-up all relevant factors.

Matters considered by the Board

Below are examples of decisions taken by the Board during the year and how stakeholder views and inputs, as well as other s.172 (1) considerations, were considered.

DECISION	SECTION 172 CONSIDERATIONS	OUR ENGAGEMENT	THE BOARD'S ROLE
Board changes and governance framework for the continuing Group following the disposal of Viridor  More information pages 90 to 97	<p>The enactment of the Board's internal succession plan and new governance framework required to position Pennon favourably for the next phase of its growth strategy and re-focus on UK Water was considered by the Board to be essential for Pennon's long-term success.</p> <p>Noting these objectives, the following stakeholders were identified as key:</p> <ul style="list-style-type: none"> • Shareholders • Investors • Regulators • Employees • Customers 	<p>Our engagement methods were as follows:</p> <ul style="list-style-type: none"> • Shareholders approved the (re-) election of Pennon's Directors, in line with our succession plan, at the July 2020 AGM; • Investor and analyst presentations took place throughout the year with feedback noted; • The new Group purpose and culture were developed following consultation with regulators, employees and customers. 	<p>Key stakeholders were identified, feedback reviewed and the succession plan modified as appropriate. A number of Board committee meetings followed, including a review by the Nomination Committee.</p> <p>Throughout the process of enacting the succession plan and new governance framework, the Board oversaw and challenged management's engagement with stakeholders and had regard to the need to foster the Group's business relationships with shareholders, regulators and customers.</p>
Green Recovery Initiative  More information page 29	<p>We recognise our vital role in the region and our stewardship of essential resources, to ensure that we are supporting our communities and the places they love for generations to come.</p> <p>Noting these objectives, the following stakeholders were identified as key:</p> <ul style="list-style-type: none"> • Shareholders • Investors • Regulators • Employees • Customers • Suppliers 	<p>In line with our Strategic Plan, a significant part of which is focused on our environmental and social impacts, we developed our Green Recovery Initiative following discussion with our regulators and government, presentations to customer focus groups including the WaterShare+ Advisory Panel and reviews with suppliers. We received feedback from our shareholders and investors who are supportive of our ambitions.</p> <p>We engaged with our employees via the Big Chat and the Employee Survey, which indicated strong support from employees for our approach.</p>	<p>The Board's decision-making process was based on its objective to ensure that the business is environmentally and socially sustainable in the long-term. The Board reviewed the Green Recovery Initiative throughout its development taking into account the engagement with all those whose interests would be affected by its plans.</p> <p>The Board approved the Green Recovery Initiative for submission to our regulators in January 2021.</p>
WaterShare+  More information page 32	<p>The WaterShare+ scheme was developed to build a closer relationship with South West Water's customers by offering customers the opportunity to become shareholders in their water company, giving them a voice and a financial stake in our business.</p>	<p>During our engagement in the lead-up to our Business Plan for 2020-25, we consistently received feedback that customers would like to have a greater say in their water company and share in financial outperformance.</p> <p>WaterShare+ affords customers the opportunity to become a different type of stakeholder – a shareholder with a financial stake in their water company.</p>	<p>The Board had an active role in the development of the WaterShare+ scheme from its inception and continues to provide oversight of the scheme. Resolutions were brought to the 2019 and 2020 AGMs to enact the mechanism and authorise the Board to proceed with the WaterShare+ scheme.</p>

Matters considered by the Board continued

DECISION	SECTION 172 CONSIDERATIONS	OUR ENGAGEMENT	THE BOARD'S ROLE
WaterShare+ continued	<p>Noting these objectives, the following stakeholders were identified as key:</p> <ul style="list-style-type: none"> Customers Regulators Shareholders 	<p>WaterShare+ was an innovative component of our PR19 Business Plan and was positively received and supported by Ofwat. The WaterShare+ share scheme was designed to ensure that there was no dilution of existing shareholdings or existing voting rights so that our existing shareholders were unaffected.</p>	<p>Implementation of the scheme in 2020 was overseen by the Board and it continues to monitor the scheme through the WaterShare+ Advisory Panel and a separate customer Annual General Meeting to be held annually with the first meeting being held in September 2021.</p>
Pension scheme changes  More information page 62	<p>Our people are fundamental to our success and our ability to deliver our long-term aims. To ensure the retention of our valued employees and to attract new talent, Pennon is committed to providing appropriate and attractive employee benefits and being a responsible employer, including by providing modern, equitable and suitably managed pensions arrangements.</p> <p>Noting these objectives, the following stakeholders were identified as key:</p> <ul style="list-style-type: none"> Employees Customers Pension Trustees Regulators Shareholders 	<p>As part of the Group's long-term pensions strategy, the business engaged in an extensive consultation process with employees and trade unions on the Group's plans to modernise its pensions arrangements.</p> <p>The business simultaneously consulted with the Group's Pension Trustees regarding these plans as well as the Pensions Regulator.</p> <p>As a consequence of these consultations, the Group will contribute c.£59 million from the proceeds of the Viridor sale to the Group's principal pension scheme, ensuring appropriate levels of funding and reducing risk going forwards.</p>	<p>The Board provided regular input to the development of the Group's plans to modernise its pensions arrangements. The outcome of the consultation and allied reviews, resulted in a decision to close the Group's main defined benefit scheme to future accrual with effect from 1 July 2021 – with all employees transitioning to a new and bespoke defined contribution scheme offered through a master trust arrangement.</p>

Non-financial information statement

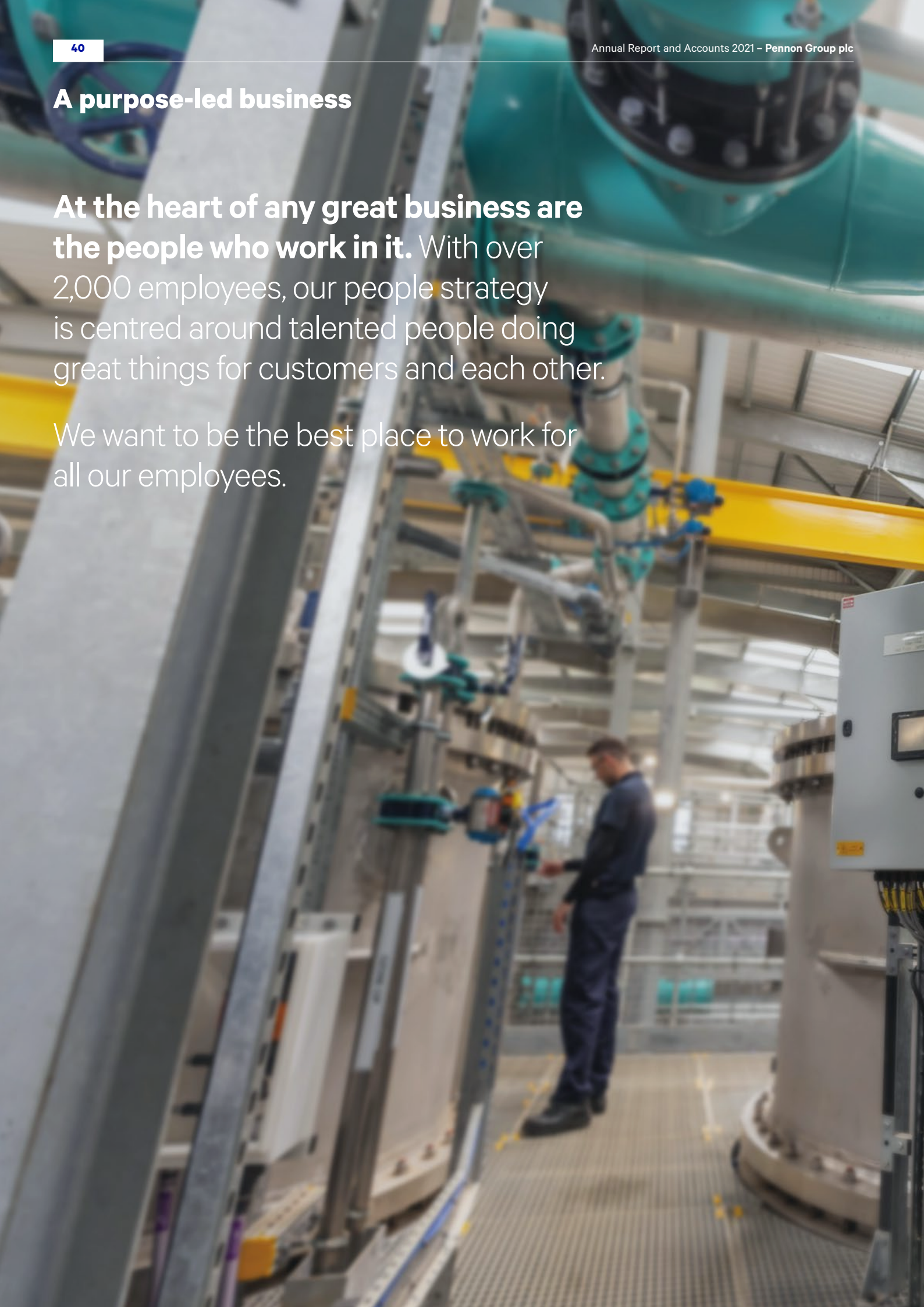
The following table summarises the information required by section 414CB Companies Act 2006, and/or indicates where this information can be found within the annual report. Due diligence is carried out on all of our suppliers, and all are required to adhere to our Code of Conduct for supply chain partners. As such, equivalent standards are expected from our suppliers as we expect from our employees in respect of each of the areas set out below.

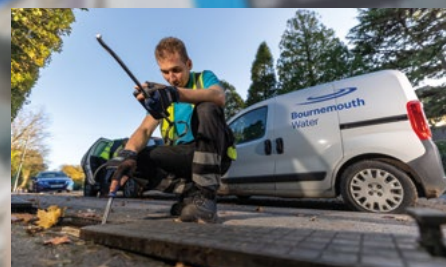
	DESCRIPTION OF POLICIES	POLICY OUTCOMES	PRINCIPAL RISKS AND RISK MANAGEMENT	KPIS
Environmental matters	<p>Our social and environmental policy ensures that we pursue activities that conserve, protect and enhance the natural environment. Environmental compliance is monitored as part of the regulatory framework within which the whole business operates.</p>	<p>The policy underpins the environmental improvement programmes set out on page 27.</p>	<p>Environmental non-compliance may lead to non-delivery of regulatory outcomes and performance commitments – see page 71.</p>	 More information pages 16 to 17
Employees	<p>Our range of employment policies that are designed to protect and support our workforce. The key features of these policies are disclosed on page 130 and as follows:</p> <ul style="list-style-type: none"> Health, safety and wellbeing (page 47) Diversity, respect and inclusion (pages 44 to 45) Our Code of Conduct (page 97). 	<p>Under these policies, we seek to achieve the highest workplace standards and an engaged workforce, as reported on page 43.</p>	<p>Health and safety risks and their mitigations are set out on pages 69 and 71.</p>	 More information pages 16 to 17
Social matters	<p>Our social and environmental policy requires us to undertake our activities in a way that minimises potential adverse effects on society and has a positive impact on the local economy. Our community relations and investment policy enables strong and clear governance, making positive community investments which create value, and benefits both the community and the business.</p>	<p>The policies support the social capital improvement programmes set out on page 28 and the activities reported on page 51.</p>	<p>A number of our principal risks would impact our communities and customers if they occurred, for example: business interruption, poor operating performance and cyber risks. See pages 71 to 73 for further information.</p>	 More information pages 16 to 17
Respect for human rights	<p>Pennon's Code of Conduct (described on page 97) sets out our respect for human rights throughout our operations and our anti-slavery and human trafficking policy requires the implementation and enforcement of systems and controls to ensure modern slavery is not taking place anywhere within our own business or in our supply chain.</p>	<p>We do not tolerate human rights abuses within the Group or modern slavery in any form and have developed processes and procedures to manage the risk of potential non-compliance (see page 46).</p>	<p>We explain the risks relating to non-compliance with laws and regulations and their mitigations on pages 69 to 70.</p>	<p>We have a zero tolerance approach across the Group and within our supply chains.</p>
Anti-corruption and anti-bribery	<p>A description of our policy on anti-bribery and anti-corruption (including due diligence and enforcement procedures) is provided on page 97).</p>	<p>The policy's outcomes are explained on page 97.</p>	<p>We explain the risks relating to non-compliance with laws and regulations and their mitigations on pages 69 to 70.</p>	<p>We have a zero-tolerance approach to bribery and corruption.</p>

A purpose-led business

At the heart of any great business are the people who work in it. With over 2,000 employees, our people strategy is centred around talented people doing great things for customers and each other.

We want to be the best place to work for all our employees.





We value the expertise, dedication, adaptability, flexibility and commitment of everyone who works with us as one amazing team.

Our people

Supporting the lives of people and the places they love for generations to come



Adele is the Group Chief People Officer for Pennon, accountable for HR, Health & Safety and Corporate Communications.

GREAT PLACES TO WORK BEST WORKPLACE SURVEY™ 2021 RESPONSE HIGHLIGHTS

94%

FAIR TREATMENT REGARDLESS OF PEOPLE'S RACE OR ETHNIC ORIGIN

92%

MANAGEMENT TAKING HEALTH & SAFETY SERIOUSLY

93%

FAIR TREATMENT REGARDLESS OF THEIR SEXUAL ORIENTATION

92%

UNDERSTANDING SAFETY-RELATED RESPONSIBILITIES

“

Our people strategy, approved by the Board in 2017, ‘talented people doing great things for customers and each other’ means that my team and I are focused on doing everything we can to recruit, train, develop and support all of our employees, whatever their background, experience or outlook, unlocking their potential now and for the longer term.

At Pennon, we believe our people are our best asset. It's an honour and a huge responsibility, supporting a team of over 2,000 amazing individuals, especially during a pandemic. The wellbeing and safety of everyone is our number one priority. However we strongly believe that if we all live by our values, with humility, care and compassion, we can achieve anything.

Supporting our employees through a challenging COVID-19 year

Our first priority has been to support employees during the pandemic. We have always been fully aware of the essential service we provide for customers and the requirements to ensure that whatever the weather or circumstance, we must keep water flowing 24 hours a day, seven days a week.

We ensured that none of our employees were furloughed or made redundant as a result of the pandemic and all employees who were shielding, self-isolating or supporting family members have remained on full pay. We also extended our 24/7 employee assistance service to cover additional family members and introduced a new Group-wide income protection scheme to support employees who are unable to work due to long-term illness. During the year we have actually increased headcount to enhance our service to customers.

83% of our employees believe we have supported and communicated with them well throughout the COVID-19 pandemic.

Creating the best place to work

Responsible and trusted businesses today have a duty to make a positive societal contribution – whether that's through promoting social mobility, addressing racial and gender inequality, or in providing secure and meaningful employment where all employees are paid fairly for the work they do.

At the heart of any great business are the people who work in it. With over 2,000 employees, our people strategy is centred around talented people doing great things for customers and each other, and creating the best place to work.



We want to be the best place to work for our employees and we value the expertise, dedication, adaptability, flexibility and commitment of everyone who works with us as one amazing team. It was great to see Penon being recognised as the winner in Britain's Most Admired Companies (Utilities) – the longest-running annual survey of corporate reputation in the UK. This award demonstrates our commitment to engaging employees in our strategy and the important role they play in delivering it. We know companies with high trust cultures enjoy better financial results, outperform the market by 2 to 3% a year over a 25-year period, have strong leadership, a talented workforce and are more collaborative and innovative.

We are officially a 'Great Place to Work'

This year we asked employees how it feels to work for Penon using the Great Places to Work Best Workplace Survey™. We achieved our highest ever participation rate of 84% and have officially passed the threshold to become accredited as a Great Place to Work with our Trust Index© score increasing to 68%. This is significantly higher than the national average of 53%.

The survey measures effectiveness in a range of categories including Innovation, Maximising Human Potential, Values, Leadership Effectiveness and Wellbeing. Our most improved category was Values, demonstrating that we are becoming a purpose led and value driven organisation. The Group's highest scoring questions for 2021 included people being treated fairly regardless of their race (94%) or their sexual orientation (93%) in recognition of the Group's approach to diversity, respect and inclusion and my manager takes health & safety seriously (92%) and I understand my safety-related responsibilities (92%) confirming our approach to health and safety being our number one priority.

These results show we have made good progress during the year in embedding the Group's HR strategy but importantly in a year dominated by COVID-19, how we have worked hard to ensure our employees have felt supported.

Listening and acting on employees' views

Under the Financial Reporting Council's (FRC) code of standards, companies are required to explain how they are incorporating employee views in Board decisions.

More information

[Our stakeholders page 35](#)

Over the course of this year, we have continued to develop and evolve the opportunities for employees' views and input as well as enabling staff forums across the Group to ensure employees are represented and have opportunities to understand and feed into discussions on matters that impact them and the work they do.

Employee forums

The South West Water Employee Engagement Forum has become a well-established forum which meets regularly to create a two-way communication between senior managers of the Group and employees and this year has been chaired by the Group Chief Executive Officer. This forum helps to influence and support business changes and ensures that our employees are front and centre in all that we do, including being the employee voice in the evolving changes to working arrangements in response to COVID-19 during the year. We also have trade union recognition agreements in place for our Craft and Industrial employees and continued to meet frequently across the year to discuss relevant topics including the modernisation of our pension schemes, pay awards, business planning, employee survey and engagement, IT system developments and innovation.

Speak Up

Our Speak Up whistleblowing policy continued to operate throughout 2020/21, providing 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.

More information

[The Board and its governance framework page 97](#)

SUPPORTING OUR PEOPLE

Your Big Chat

Over the course of the year, we have evolved our Big Chat to become Your Big Chat. Moving from a conference call facility to video has enabled all employees access to the Group Executive and created opportunities to ask questions and suggest topics that employees would like to hear more about. The frequency was also increased to weekly to ensure regular and timely updates are provided to employees. We continued to receive positive feedback from employees who welcome the opportunity to hear from the Directors and ask them questions on key business matters. In line with Government recommendation, where possible, many of our office-based teams have been working from home, placing greater importance on supporting our employees with timely communications. Discussions have largely focused on health & safety, Coronavirus working arrangements, employee wellbeing, business plan delivery and investments in apprenticeships and future workforce development.

For our remote teams, working tirelessly during the pandemic, we have carried out regular breakfast briefings hosted virtually by the Group Chief Executive Officer and other senior leaders and these have proved to be helpful in promoting more effective two-way communication. Additionally, all employees are invited to pose questions or comments to our Group Chief Executive Officer following the introduction of Ask Susan and this has developed into a popular route for further engagement.

Our people continued

Diversity and equal opportunities

We are now one of a handful of top FTSE businesses to have both a female CEO and Chair. If there was ever a time for us to put gender and ethnic diversity at the top of our agenda, leading from the top, then that time is now. Building a sustainable, agile and diverse workforce is a key pillar of our HR strategy. Once again, we were listed in the 2021 Bloomberg Gender Equality Index, as one of 380 companies globally committed to disclosing their efforts to support gender equality through policy development, representation and transparency.

We have continued to make progress in this area through strong leadership and our gender diversity has improved for the third year running. With a workforce of over 2,000 employees with a gender split of 71% male and 29% female, we have seen a 6% increase in the proportion of female employees during the year, largely driven by the divestment of Viridor from the Group. Our permanent workforce is supported by over 200 temporary and agency employees (not included in the diversity data).

Pennon largely operates and employs people in the South West of England which traditionally has some of the lowest proportions of ethnic diversity in the country. However, as a responsible business, we believe we have an important role in ensuring we support mobility of all types. Sometimes assumptions can be made, and actions taken, which unintentionally affect certain groups of people in a negative way, leading to a lack of opportunity, difficulty in accessing services or a failure to have a need identified. With less than 1% of employees currently self-identifying themselves as from an ethnic minority, we want to change this, either by encouraging our existing employees to have the confidence to share their backgrounds, or by encouraging diversity in our recruitment and attraction.



CBI Change the Race Ratio initiative

In 2020, Pennon pledged its support to the CBI Change the Race Ratio initiative, a campaign to increase racial and ethnic participation in the senior leadership of companies, as a route to encouraging more diversity at all levels, and was the first water company to do so.



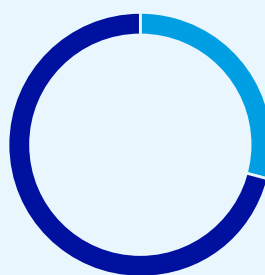
10,000 black interns initiative

One of the ways we intend to achieve this is by becoming a sponsoring business of the 10,000 black interns initiative. We have signed up to support the programme next year and see this as an important scheme to not only offer black students an opportunity to understand our business but also to improve the levels of ethnic diversity across our industry.

Diversity dashboard

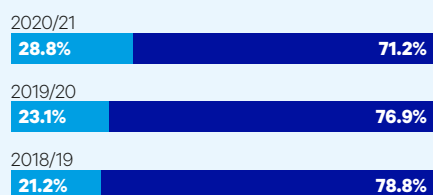
Pennon was listed in the 2021 Bloomberg Gender Equality Index, as one of 380 companies globally committed to disclosing their efforts to support gender equality through policy development, representation and transparency.

GENDER – EMPLOYEES

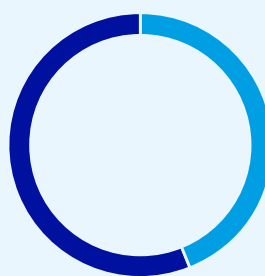


● Female: 28.8%
● Male: 71.2%

Female: 623 (28.8%) / Male: 1,538 (71.2%)



GENDER – SENIOR MANAGEMENT

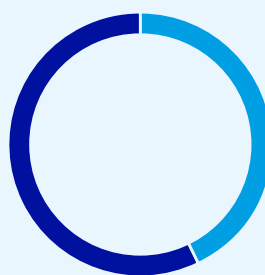


● Female: 44.0%
● Male: 56.0%

Female: 11 (44.0%) / Male: 14 (56.0%)

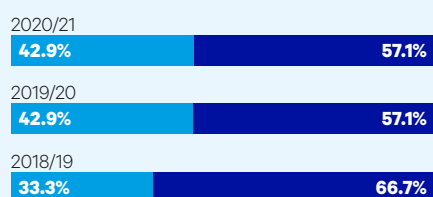


GENDER – BOARD



● Female: 42.9%
● Male: 57.1%

Female: 3 (42.9%) / Male: 4 (57.1%)



KEY

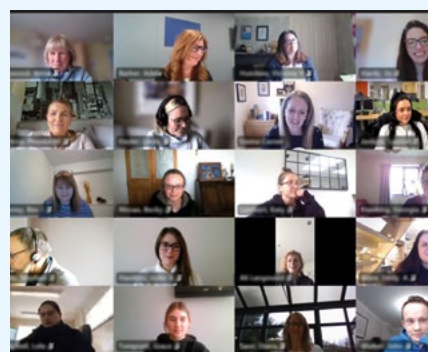
● Female ● Male

* 2020/21 figures are Continuing Group only – excluding Viridor.

INTERNATIONAL WOMEN'S DAY

We supported International Women's Day on 10 March 2021 – an annual worldwide event that celebrates women's achievements, while calling for gender equality.

We promoted the day on our social media channels and held a virtual get together for employees to share personal experiences, talk about role models and inspirations and celebrate our employees and their stories.



Recruitment

Changing our approach to diversity and inclusion has also changed the way we monitor diversity in all Group job applications. The Group now uses a software gender decoder tool which allows us to check all our job advertising for masculinity to reduce the potential risk of alienating female applicants. In addition, we have refreshed our equal opportunities forms to be included in all onboarding packs. The new version allows us to monitor, analyse and utilise diversity data to inform and shape our business activities to become a more diverse workplace.

Training

We have also commenced a new programme of unconscious bias training and will roll this out to most leadership and all hiring managers during the coming year. Across Penon we have been undertaking Lived Experience Group sessions to understand what it is like to work at Penon for employees from minority groups. The outputs have been shared with our Diversity Committee to understand these perspectives and consider appropriate actions when issues are raised.

Women in Water network

South West Water is part of the Women in Water network, supported by Water UK, and aims to encourage women into the water industry, support their development into more senior roles and ensure that their industry voices are heard.

Our gender pay gap

This is the fourth year where employers in Great Britain with more than 250 staff have been required by law to publish their gender pay gap on their own website and on a Government website. The current national average gender pay gap is 15.5% for all employees.

The aggregated Penon Group gender pay gap for 2020 is 5.7%, which is a 1.4% increase from 2019 and continues to be significantly lower than the national average. South West Water improved its gender pay gap to 4.9% from 5% last year, and of particular note is the improvement seen within Source, our customer facing business, which is now reporting a negative pay gap of -1.4%, a 7% improvement from 5.7%. This means that the average female hourly pay is marginally higher than that of their male colleagues for the first time.

We are pleased that the percentage of female employees within our Group has increased from 23% last year to 29% at the end of this year, largely driven by the divestment of Viridor from the Group. According to Energy & Utility Skills, across the water industry workforce 20% are identified as female, which places South West Water, at 29%, well ahead of the sector average.

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.

More information

 **Nomination Committee report** pages 104 to 105



CASE STUDY: LUCY RIDGMAN

Lucy Ridgman is a new Operational Apprentice Technician within the Resource & Production function who joined us in early 2021. Lucy is based at Northcombe Water Treatment Works and is undertaking a Level 3 Water Process Technician apprenticeship and following the Treatment pathway.

Lucy is thoroughly enjoying her apprenticeship and says she chose to do an apprenticeship because she knew she didn't want to continue with education full-time and wanted to get some experience working while still being able to complete a qualification.

She likes how everyone sees her as part of the team straight away despite being completely new to the company. She really likes the combination of work and training as it allows her to develop practical skills whilst learning key principles within the formal training sessions.

She says the thing she likes most about South West Water is the people; everyone is willing to help wherever they can and it makes her feel really welcome. Her manager encourages her to work on her diploma and has supported her in settling in to the team and getting used to everyday tasks.

Since starting her apprenticeship she has learnt how to do many of the daily tasks required on site and improve her teamworking and communication skills.

Lucy is expected to complete her apprenticeship in around 18 months and we wish her well with her studies and progression through her course and in becoming a fully qualified Water Treatment Technician.

Our people continued

Investing in training

We have a strong commitment to investing in the development of our employees and want to build and recognise talent across the Group.

9,905

EMPLOYEE TRAINING DAYS

160

CURRENT APPRENTICES IN TRAINING

20

GRADUATE PROGRAMME PARTICIPANTS

£812k

INVESTED IN APPRENTICESHIP TRAINING

646

NEW APPRENTICES SINCE 2017

50

NEW SENIOR LEADERS TALENT DEVELOPMENT PROGRAMME

Training and development

We have a strong commitment to investing in the development of our employees and want to build and recognise talent across the Group. Training and development is available for employees at all levels within the organisation. Our aim is to increase productivity, job satisfaction and safety, and to equip the next generation of leaders and employees with appropriate knowledge, skills and the competencies they need to thrive.

Apprenticeships

We continue to embrace apprenticeships and since 2017, 646 new apprentices have been employed across the Group. This increased by 71 during the last year with a greater focus on recruiting operational apprentices to ensure we have the future skills to deliver our essential services. To further demonstrate our ongoing commitment to apprenticeships, we have set a target to offer 500 new apprenticeships over the next five years. Find out more online at www.southwestwater.co.uk/careers/apprenticeships.

Graduate programme launch

More recently we have launched our 2021 graduate programme and will look to offer 20 new graduates the opportunity to experience a two-year structured programme of training, work experience and career development before moving into key permanent roles across our Group. The programme enables graduates to gain practical experience in our core business areas of Operations; Engineering; Projects; and Customer Service which will be vital in helping them find their ultimate leadership position.

During the year we have delivered 9,905 training days for our 2,161 employees, ensuring that on average each employee has received 34 hours of training.

Senior leaders development

We have developed a new senior leaders talent development programme to provide structured assessment and development opportunities for our top 50 leaders.

Employee turnover

Our Group-wide turnover rate in 2020/21 was 11.35%. This is significantly lower than the 18.05% seen last year which reflects the changes in our Group and lower turnover experience across the country due to Coronavirus.

Responsible employer

As a responsible employer, Pennon has worked hard during the year to mitigate and minimise the impact of COVID-19 on our business activities and the potential knock-on effects for customers and employees. Pennon has not taken any Government furlough funding and has not made any COVID-19 related redundancies.

Kickstart

We continued to live our values and demonstrate we are a responsible employer during the year, doing what we can to support communities in the South West. Pennon was therefore one of the first companies to sign up to participate in the Government's new Kickstart scheme this year, offering 16-24 years olds, deemed at risk of long-term unemployment, six month paid work placements and have committed to 50 placements.

Social Mobility Pledge

We also continue to be a signatory of the Social Mobility Pledge, the cross-party campaign to improve social mobility in the UK established by the 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. As part of our Social Mobility Pledge, we are undertaking a gap analysis to help us develop a detailed action plan to drive further improvements during this year. Our head office and customer call centre are based in Exeter, providing jobs and investment to the local community. In addition to directly employing 2,161 employees, Pennon employs a further 195 temporary employees and contractors.

Slave-Free Alliance membership

Pennon has maintained its membership of 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.

Human rights

We are fully supportive of the principles set out in the UN Declaration of Human Rights and the Group ethics policy 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 employees wherever they may work throughout the Group. These standards are also embedded in our sustainable supply chain and documented in our procurement policy and Code of Conduct for supply chain partners.

Health, safety and wellbeing

The health, safety and wellbeing of our employees is paramount. At Pennon, we believe everyone who works for us and with us should go home safe to their families and loved ones every day, and this has never had more resonance than in the current climate. Keeping our employees COVID-safe and our work environments COVID-secure has been our top priority throughout 2020/21 and we have worked hard to support employees physically and emotionally.



HomeSafe

The Group's flagship health & safety programme, HomeSafe, has continued to provide the framework for all health and safety related activities, and in response to COVID-19, a COVID-19 Steering Committee has met weekly supported by a COVID-19 Management Team who have overseen our approach to keeping employees safe including case management of suspected cases, occupational health support, employee communications, approach to testing, facilities management and ongoing policy and guidance. We modified our working practices to ensure our operational employees could continue to provide essential services for our customers. We have provided employees with additional PPE throughout the year to ensure they and our customers were kept safe. More broadly, through the Local Resilience Forum in the South West, we have continued to play an active role externally, supporting the localised industry response to the pandemic, as well as the transition from the EU.

E-learning

To better support employees' wellbeing and mental health, our e-learning module on Mental Health was reissued to all employees and we also extended our Employee Assistance Programme to include family members, allowing families to access trained independent counsellors for support.

E-learning has been our pandemic strategy to keep people's knowledge fresh and up to date. It was pleasing to see the high scores in the recent engagement survey with my manager takes health & safety seriously (92%) and I understand my safety-related responsibilities (92%) confirming our approach.



LTIFR

LTIFR continues to be the Group's primary measure of performance. Across the year we had 29 Lost Time Injuries compared to the 24 reported last year*. The higher levels of lone-working as a result of the pandemic restrictions may be an influencing factor in the increase of LTIs. In response to the higher number of injuries continuing to be related to strains and sprains, the Group has engaged an external partner to embed enhanced training around manual handling techniques to help mitigate against this type of injury. Reports to the HSE were the same as the previous year when comparing Continuing Group only. With a third of the injuries related to manual handling we have engaged international experts with an Olympic pedigree to carry out additional training for our most vulnerable workforce. We have additional resources in the field to:

- Embed the HomeSafe behavioural principles
- Deliver quicker asset investment to improve site safety
- Increase volume and quality of reporting to facilitate future analytics.

Future plans

During the year we also carried out independent benchmarking to help us better understand our strengths and development areas and this will be a key underpin for future plans. Our ambition for H&S is to be a leader for health and safety in the UK Water Industry by 2025.

CASE STUDY: KICKSTARTER CAREERS

We were one of the first companies to sign up to participate in the Government's new Kickstart scheme this year. The scheme offers 16-24 years olds, who are deemed at risk of long-term unemployment, a six-month paid work placement incorporating work readiness training. South West Water set a target of offering up to 50 opportunities and has already passed this half way point in the first few months of the scheme. We are also pleased that 52% of the current participants are female. Our unique programme offers Kickstarters the opportunity to train and learn and also a £500 completion bonus to encourage them to successfully complete their placements. Feedback from managers supporting the Kickstarters is very positive and we hope to recruit many of them into permanent roles at the end of their placements.

6 months

PAID WORK PLACEMENT

£500

COMPLETION BONUS

* Continuing Group only – excluding Viridor.

A purpose-led business

We have a good track record of providing innovative solutions to address affordability in our communities, and we want to do more.





In response to the pandemic, we were one of the first companies to expand our priority services register.

We continue to expand our accessibility and affordability support measures having unlocked c.£2.4 million of financial support by ensuring customers are receiving all eligible benefits.

Over 30,000 customers now receive support through reduced tariffs, with more than 67,000 customers supported through one or more of our affordability schemes.

We are committed to making bills more affordable starting with those households who pay more than 5% of their disposable income on their water bills.

The Knapp Mill water treatment works in Bournemouth

Our operations – South West Water

Delivering service excellence for customers

This is the first year of our K7 period (2020-2025) and South West Water has made a strong start in delivering its ambitious New Deal business plan, remaining resilient despite the global pandemic.

Water and wastewater snapshot



Major towns/cities

- | | |
|--------------|--------------------|
| 1 Penzance | 7 Plymouth |
| 2 Falmouth | 8 Torquay |
| 3 Truro | 9 Exeter |
| 4 Newquay | 10 Barnstaple |
| 5 St Austell | 11 Bournemouth |
| 6 Bude | 12 Isles of Scilly |

WTW = Water Treatment Works
STW = Sewage Treatment Works

Our operations

- | | |
|-----------------------------------|------------------------------|
| 1 Stithians Reservoir | 8 Countess West STW |
| 2 Restormel WTW | 9 Pynes WTW |
| 3 Colliford Lake Reservoir | 10 Wimbleball Lake Reservoir |
| 4 Mayflower WTW | 11 Alderny WTW |
| 5 Mary Tavy Hydroelectric Station | 12 Longham Lake Reservoirs |
| 6 Roadford Lake Reservoir | 13 Knapp Mill WTW |
| 7 Brokenbury Torbay STW | |

SOUTH WEST WATER IN NUMBERS

2.3m

TOTAL POPULATION SERVED

18,433

KM OF DRINKING WATER MAINS NETWORK

653

WASTEWATER TREATMENT WORKS

150

BATHING WATERS

23

RAW WATER RESERVOIRS

43

DRINKING WATER TREATMENT WORKS

19,049

KM WASTEWATER MAINS NETWORK

Delivering more of what matters for our communities

Sharing our success

Our innovative New Deal business plan, informed by our most extensive engagement programme to date. It sets out our focus to change the nature of our relationship with our customers. WaterShare+, a key aspect of our plan, was launched in October 2020, shared c.£20 million of outperformance from 2015-20 with customers, by offering a choice of a £20 credit to their bill or shares in Penon. We were delighted with the positive response to this trailblazing initiative, which saw 1 in 16 household customers opting to become Penon shareholders and giving them a tangible stake in the business.

WaterShare+ also seeks to give customers a greater say in what South West Water does and how the Company is run. The Independent WaterShare+ Advisory Panel meets in public on a quarterly basis (although held virtually where appropriate), with the panel reviewing South West Water's progress against targets and an opportunity for customers to have a real say in how the business operates.

This year South West Water will hold its first dedicated customer AGM in autumn 2021, designed to be more accessible for all customers who can hear and input into the Company's plans.

Supporting our communities

We recognise the importance of our role in the communities we serve, and we are committed to delivering more of what matters to them. During the year, we launched dedicated initiatives including our Neighbourhood Fund and the Water-Saving Community Fund.

The Neighbourhood Fund builds on our work to support our communities with funding available for community groups, offering physical activities, education, health and wellbeing and delivering positive environmental outcomes. Community groups supported to date include; The Hugs Foundation – offering therapeutic and supportive interventions for those suffering from mental ill health, social exclusion, disadvantages and disabilities, and the Cornwall Accessible Activities Programme – supporting families and children with additional needs to access activities during the school holidays.

Our Water-Saving Community Fund promotes ideas to help our customers and communities to get involved in water conservation projects including support for organisations to create drought tolerant gardens, to install water butts in community allotments or provide educational training and displays in schools.

In partnership with the South West Lakes Trust, an innovative, interactive new education centre is being set up at Roadford Lake informing and promoting water efficiency and the benefits of our work on communities and the environment. It is hoped this centre can help educate our customers to reduce water consumption and reduce the risk of sewer blockages and pollutions through sewer misuse.



Innovative affordability and WaterCare programme

Our New Deal included a pledge to eliminate water poverty by 2025 by expanding our toolkit of affordability support to those who need it most. During the year, our WaterCare advisors completed over 3,600 virtual home visits and unlocked c.£24 million of financial support by ensuring customers are receiving all eligible benefits. We continue to expand our affordability toolkit with over 67,000 customers now benefitting from one or more of our support measures, representing an 11% increase compared to 2019/20.

Operational delivery – driving performance through innovation

South West Water has made a robust start to K7, driving performance and efficiency through innovation.

Clean, safe and reliable drinking water

Our focus remains on ensuring the supply of clean, safe and reliable drinking water, whilst protecting the precious natural resources within our region.

Improving water quality for customers

We continue to target improvements in the quality of water supplied to customers and have seen a c.20% reduction in taste, smell and colour contacts over 2020/21.

During the year, we have introduced a range of innovative raw water management techniques including reservoir mixing at Wistlandpound Reservoir, and the introduction of sonic technology which reduces algae in raw water sources feeding our treatment sites.

We continue to target further improvements through our planned c.£90 million investment in new treatment works in the Bournemouth Water region (excluding Ofwat's draft decision on Green Recovery) with initial works commencing during the year.

Minimising customer supply interruptions

We understand the importance that our customers place on having a reliable supply of drinking water, and the inconvenience that supply interruptions can cause. During 2020/21, we achieved our best ever performance level of 5 minutes 38 seconds, a c.40% year on year reduction for those customers who have an outage for more than three hours, two years ahead of target. We have also delivered a c.80% reduction in supply interruptions lasting over 12 hours, achieving our 2025 target.

A key component of our strategy includes a dedicated, in-house supply continuity and alternative water supply team. Alongside this we have introduced innovative technology enabling repairs to the network under pressure. We have also introduced enhanced training and greater use of data analysis to support our focus on continuous improvement.

Delivering a resilient service

During the year, demand has been higher than the previous year, as a result of the sustained stay at home measures during lockdown, along with a peak in demand driven by the hot, dry period in the spring and an increase in 'staycations' during the summer. Throughout the year, we successfully managed our water resources, balancing supply across the network to maintain safe and resilient supplies at all times, and our reservoir levels at 31 March 2021 remain robust at 97.0%, broadly in line with the prior year.

2020 was the 24th consecutive year without water restrictions in the South West Water region and maintained Bournemouth Water's track record of no water restrictions ever.

Our customers feel very strongly that we should prevent water from being lost due to leakage, and we continue to invest significantly to prevent and manage leaks on our network. Our water network was tested throughout the year with increased demand due to customer behaviour during the multiple lockdown periods and a higher than normal regional population given the significant proportion of second home ownership in our region.

Our operations – South West Water continued

As a result, increased pumping has been required to more rural areas, away from concentrated urban environments. With a record number of bursts seen in early 2021, our teams provided a robust response to this increased network activity. This resulted in a c.40% increase in the number of leaks detected. Despite this, our leakage target was not achieved.

Our targeted action plan to recover leakage performance includes:

- Detection and repair – even more investment to reduce leak running times
- Focus on customer leaks – proactive identification and support for supply pipe repairs
- Data and control systems – increasing network monitoring and innovative combined smart meters
- Reducing our own use – making our operations more water efficient
- Reducing customer usage – water efficiency initiatives including customer education programmes to reduce demand

Reliable wastewater services

Reducing sewer collapses

During the year we have delivered a c.20% reduction in the number of sewer collapses per 10,000km compared to last year with benefits arising from our K7 early start enhanced sewer cleansing and monitoring programme.

Sewer blockages are a lead indicator for possible flooding and pollution from our network. The reducing trend demonstrates that our programmes of work to reduce blockages in the network through investigating, cleaning and repairing sewers and through publicity campaigns, will continue to help reduce the more significant impacts of pollution and flooding on our customers and the environment.

Reducing internal flooding incidents

We understand the impact that sewer flooding has on customers, and we continue to do all we can to reduce the likelihood of these events. As a result of our unwavering focus in this area we are pleased to have achieved our stretching 2025 commitment during 2020/21 – a c.35% improvement from 2019/20. We achieved this through the continuous review of processes and systems to deliver improvements, including a range of initiatives such as educational campaigns aimed at influencing customer behaviours, hydraulic modelling, enhanced CCTV and a dedicated investigation team supporting proactive targeting.

Improved wastewater compliance

South West Water has made considerable progress in improving the standard of the water it returns to the environment over the past five years. During the year we achieved our best ever performance of 99% for the number of compliant wastewater treatment works in 2020 as we work towards a goal of 100%. We have enhanced treatment processes by embedding innovative techniques including the use of I-Phyc's algae-based treatment to sustainably remove phosphorus and micro-pollutants from sewerage and introduction of peak load technology. This nature-based approach is beneficial to the environment, whilst reducing costs to operate with lower power and chemical consumption required.



“
During 2020/21,
we have recognised
improvements at
c.20,000 hectares
in key catchments,
improving both water
quality and natural
capital in our region.”

CASE STUDY: BOOSTING BIODIVERSITY IN OUR REGIONS

Our award winning 'Upstream Thinking' programme has driven an increase in the region's biodiversity since 2005. During 2020/21, we have recognised improvements on c.20,000 hectares in key catchments, improving both water quality and natural capital in our region.

We were pleased to have achieved our 2025 commitment to planting c.100,000 trees during the year and we continue to work closely in partnership with wildlife charities, national parks and farmers to deliver continued environmental benefits as we work towards planting an additional 150,000 trees over K7.

Our partnership with the North Devon Biosphere Foundation targets further improvement in water quality, quantity and soil health within the catchment. This project seeks to create a UK first, landscape scale environmental intelligence programme harnessing artificial intelligence, big data, remote sensing & satellite earth observation to build real-time and predictive models.

The Smart Biosphere triggers a range of economic activity, integrated supply chain development, apprenticeships and jobs in the emerging environment and natural capital economy, whilst also mitigating flood risks, and improving catchment predictability.

CASE STUDY: WATER SUPPLY INTERRUPTIONS

In 2020/21, we achieved our best-ever performance on water supply interruptions, recording 5m 38s per property (normalised value per total properties connected). This is a c.40% improvement from 2019/20 and now includes all our regions (South West Water, Bournemouth Water and Isles of Scilly). This value achieves not only our 2020/21 target (6m 30s) but also attains the increased performance level required in 2022/23.

This significant performance has been achieved in this area by substantial investment in people and new technologies.

Over the past few years we've ensured that the focus is on supply restoration during an event and we've supported this objective by the expansion of both our Alternative Water Supply (AWS) team (AWS technicians / tanker drivers) and our AWS fleet and equipment (including tankers, pumps, AWS vehicles). We've also engaged heavily with the supply chain (in particular our key partner for repairs and maintenance) and introduced a new working model that allows us to enhance our response and operational capability. They have been exceptional in their response to working with us to meet the challenging targets of 2020/25. We continuously monitor supply interruptions performance with our teams and review events for learning outcomes.

The following outlines the mindset and culture around event management:

- Early consideration of event scale / early assessment of likely duration
- Mobilise Alternative Water Supply (AWS) arrangements early – deploying AWS team and assets (tankers, pumps etc.).
- AWS teams focus on supply restoration whilst maintenance teams and network technicians focus on repairs of failed asset
- Early escalation to supervisors, managers, senior managers.
- Use of hydraulic models to assess options
- Network intelligence – increased number of dataloggers deployed.

In 2020/21, 197 properties were affected by an unplanned supply interruption greater than 12 hours. This was significantly lower than our performance commitment target for the year of 767 properties. With this performance we have achieved our target for the 2020/21 year and attained the performance level required in 2024/25 and it reflects a c.82% reduction from 2019/20 at 1,085.

40%

IMPROVEMENT ON 2019/20

Properties affected by unplanned supply interruptions greater than 12 hours

Driving for environmental leadership

Our New Deal business plan includes our largest environmental programme in 15 years, recognising that a healthy environment is vital for the long-term sustainability of the services we provide to customers.

Bathing water quality improvements

We are passionate about protecting and enhancing our regions' bathing waters. During the year we delivered capital improvements at four bathing waters, representing 50% of our commitment to 2025. The improvements to date include sustainable solutions such as sewer separation at Seaton in Cornwall with plans for separation at Dawlish and Budleigh Salterton in Devon. These projects help support our commitment to maintaining excellent quality bathing waters, supporting the region's economy.

Dedicated pollutions focus delivering results

We launched our Pollution Incident Reduction Plan in September 2020, which has delivered immediate and sustained improvements in our performance with the average number of monthly pollutions now less than half of that seen before the implementation of the new plan.

We are committed to delivering a step change in our performance in order to achieve the challenging targets set for K7. Our plan centres around the following key initiatives:

- Root cause analysis – enhanced data modelling supporting proactive interventions
- Control systems and early warning – dedicated task force and 24/7 incident recovery
- Asset-specific plans – accelerated investments at key hotspot locations
- Influencing customer behaviour – targeted educational campaigns.
- Improving our environmental culture – additional training, resources and empowerment for local teams to find and fix issues immediately.

Living our purpose – a sustainable future

Understanding our role in society is crucial to maximising the value we create for stakeholders. We are proud that our ongoing commitment to do the right thing, in the right way has continued to deliver sustainable results providing essential services to customers and communities.

Net Zero by 2030

The Group is committed to achieving net-zero carbon emissions by 2030 to support the drive for ambitious climate change action. Achieving Net Zero will enable us to transform into a different kind of water company. Our plans are driven by a combination of activities, structured through three key pillars – bringing wider benefits to the South West:

1. Sustainable living

- Reducing emissions through operational practices, increasing energy efficiency and using lower carbon fuel sources
- Reducing leakage and helping customers to use less – protecting the environment and saving carbon

2. Championing renewables

- Targeting c.50% renewable energy generation at our sites across the South West – working with partnerships and utilising our expertise in this area
- Where we cannot generate enough ourselves to meet all our needs, 100% of the energy we purchase will be from renewable sources

3. Reversing carbon emissions

- Working in partnership to deliver natural carbon sequestration through peatland restoration and tree planting
- Supporting the development of innovative solutions to develop low carbon footprint processes through research & development.

Delivering for shareholders

South West Water's strong operational and financial performance has contributed to a Return on Regulated Equity of 7.8%.

Totex savings of c.£70 million have been recognised during 2020/21 supported by efficient delivery, whilst advancing investments and additional expenditure on areas of focus including pollutions and leakage.

Our efficient financing strategy continues to drive outperformance with South West Water's effective interest rate¹ at 2.5% (2019/20 3.4%), significantly lower than Ofwat's nominal cost of debt of 4.2%.

In 2020/21, South West Water achieved c.80% of its ODIs (on or ahead of track) across a broad range of challenging bespoke, common and comparative measures.

CASE STUDY: NEIGHBOURHOOD FUND



Our Neighbourhood Fund builds on our work to support communities with funding available for community groups which inspire physical activities, education, health and wellbeing and deliver positive environmental outcomes. Community groups supported to date include:



The Hugs Foundation – offering therapeutic and supportive interventions for those suffering from mental ill health, social exclusion, disadvantages and disabilities, and the Cornwall Accessible Activities Programme – supporting families and children with additional needs to access activities during the school holidays.

Our operations – Pennon Water Services

Resilient and strong performance

Pennon Water Services demonstrated its resilience during a year of significant economic uncertainty by engaging proactively with its customer base whilst continuing to win new contracts and delivering against its strategic priorities, prioritising the safety of its employees, customers, and the communities it serves. Its continued focus upon simple, transparent, sustainable, and innovative retail services delivered low levels of customer attrition, strong growth and high levels of customer satisfaction.

Water retail services snapshot

PROTECTING OUR PEOPLE AND COMMUNITIES



100%

HOME WORKING EMPLOYEE CAPABILITY

SIMPLIFYING OUR BUSINESS BRANDS

**South West
Water Business**

**South Staffs Water
Business**

**Bournemouth
Water Business**

**CAMBRIDGE
WATER
BUSINESS**

**Source
for Business**

SERVING OUR CUSTOMERS DURING COVID-19

>386,000

BILLS ISSUED

>55,000

CALLS HANDLED

>4.8 out of 5

TRUSTPILOT INDEPENDENT REVIEW SCORES

37%

TACKLING COMPLAINTS



All customer contact channels remained open throughout the year

STRONG BUSINESS GROWTH

>£20m

NEW ANNUAL CONTRACT VALUE

<1.3%

SUPPLY POINT ATTRITION

>£9m

CONTRACTS RENEWED

>1,000

NEW BUSINESS ACCOUNTS

Focus upon safety, people and customer service

In response to the global pandemic and due to its investment in cloud-based technology, Pennon Water Services was able to swiftly implement business continuity plans. Prior to national lockdown, its employees were homeworking and connected to its network and systems without disruption to any of its services to customers. Video conferencing software allowed the business to stay in close contact with its employees to not only ensure key performance indicators were met but crucially to monitor and support their mental wellbeing. Additional training was provided to all employees to help them through a difficult personal and professional year with regular team and Company-wide engagement activities, supported by an increase in the number of trained mental health first aiders and pro-active wellbeing support. These measures were encompassed within a broader people plan focused upon employee development. This support allowed its employees to concentrate upon delivering excellent service to its customers.

Since inception, Pennon Water Services has at its core been a business focused upon its people and the service it delivers to its customers. Measured by the independent review site Trustpilot its customers rated it 4.85 out of 5, an increase from 4.55 and 4.25 in the two years prior. In more in-depth surveys with strategic water users, satisfaction with the service provided by its employees reached 4.92 out of 5. Its customers were offered jargon free advice and support to help them through a difficult trading period and to ensure they could wherever possible take advantage of relief measures available to them in the market and from the Government. In continuing its focus upon customer service, the business was able to deliver a reduction in its written complaint numbers of 175, 37% fewer than the prior year, positioning Pennon Water Services as one of the market leading retail companies.

Supporting the market

As well as its customers, throughout the year Pennon Water Services took an active role in engaging constructively with MOSL, regulators and other market stakeholders on measures designed to protect businesses and the water industry from the effects of COVID-19. It worked closely with Ofwat, the UK Water Retailer Council (WRC) and jointly chaired the Retail Wholesale Group (RWG) and as a Code Panel representative was instrumental in helping to form opinion on measures designed to protect the market and business interests. It devised customer support mechanisms in line with the resulting changes to the Customer Protection Code of Practice to assist businesses who were struggling to deal with the impacts of COVID-19, balancing its own interests by employing a fair but robust collections strategy.



Market share

In our prior year report, Penon Water Services spoke about being well placed to deliver against its long-term strategic objectives despite the difficult trading conditions, exacerbated by COVID-19. Its expectations were that the challenging environment would flow into the new financial year, which proved to be the case with widespread enforced business closure. Despite a landscape of economic uncertainty, Penon Water Services was able to grow its market share in line with its strategic plan through its strong reputation with market stakeholders and customers, delivering more than £20 million of new annual contract value and 14k megalitres in consumption, whilst retaining business secured in prior financial years. Its growth agenda was supported by low levels of customer attrition.

Brand consolidation

Towards the end of the year, Penon Water Services consolidated its trading brands under Source for Business, a brand it has been trading with successfully throughout the UK since April 2017. The change will enable it to create a single consistent voice and range of services, irrespective of customer location. The change was part of a project which linked into its measures to reduce long-term costs by improving self-serve capability. This has received positive feedback and engagement from customers and regulators.

Water efficiency and sustainability

As part of its brand change to Source for Business, Penon Water Services rebadged its value-added services under the acronym PURE. This represents its focus upon **protecting, understanding, reducing and enhancing** how businesses interact with water, saving them money and helping to create a more sustainable water future for us all. Its broad range of services which include smart metering, leak detection, leak repair, alternative water sources, water treatment and recycling, water hygiene and water efficiency helps its customers achieve their sustainability goals whilst supporting regional and national water efficiency efforts.

In using these services, customers benefitted to the tune of over £1 million through cost avoidance, retrospective rebates and allowances against investment of under £200k. These savings aid both lower usage and leakage reduction targets across the UK's water networks whilst at the same time supporting customer profitability and providing the opportunity to reinvest savings into further efficiency measures. Penon Water Services is a member of various project and working groups looking at how to reduce the amount of water used across UK networks. In addition it is reviewing options to work with wholesalers to access the Ofwat innovation fund, designed to grow the sector's capacity to innovate, enabling it to better meet the evolving needs of customers, society and the environment, meeting climate change challenges.

CASE STUDY: LEAKAGE



Water companies have committed to reducing 2017/18 leakage levels by 50% by 2050. Penon Water Services is working closely with its retail customers to convert manually read meters into smart meters capable of reporting consumption in 15 minute intervals. These devices along with analysis of consumption history from manual reads have allowed it to identify leaks, notifying customers and where needed providing pinpoint leakage detection and repair services. One such example of logger installation for a large industrial customer resulted in an alarm for increased flow. Following leak detection and repair work this prevented over £220,000 in wholesale charges and is expected to secure a sizeable rebate for the cost of lost water already incurred, which can be reinvested into other leakage and efficiency projects.

£220,000

WHOLESALE CHARGE PREVENTION

Group Finance Director's report

We have realised substantial value from the sale of Viridor, enabling further investments in UK water, repayment of Group debt, additional contributions into our pensions scheme and returns to shareholders.

Financial highlights of the year


Sale of Viridor

The sale of Viridor is the dominant feature of the results for this period.

 **More information on** page 57

Sustainable balance sheet

£1.1 billion of debt repaid ensuring sustainable and appropriate level of gearing.

 **More information on** page 60

Investing for growth in UK water

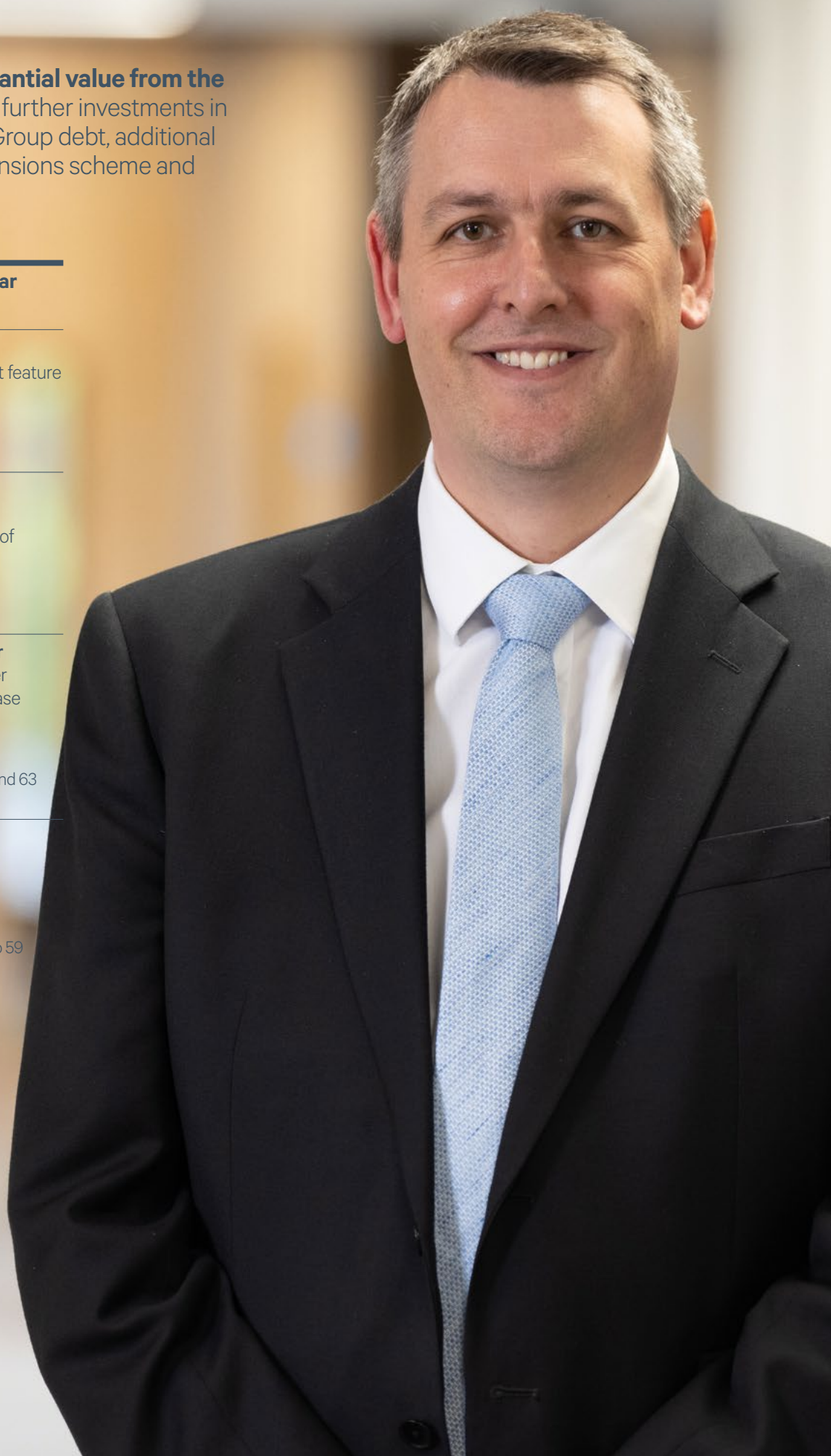
Bristol Water is expected to deliver long-term value through an increase in RCV earnings accretion and synergistic totex savings.

 **More information on** pages 62 and 63

Strong financial performance

Despite the challenges posed by COVID-19 the performance of the business has been resilient.

 **More information on** pages 57 to 59



Following the sale of Viridor, the Continuing Group in 2020/21 comprises the two operating companies of South West Water and Pennon Water Services.

The disposal of Viridor was announced prior to the previous financial year end and the comparatives as reported last year reflect the results of the Continuing Group.

Profit from discontinued operations

The sale of Viridor resulted in record profits in the year with profit from discontinued operations of £1,654.7 million, including trading to the date of disposal, non-underlying cost items associated with the disposal of £75.6 million (before tax), and the gain on disposal of £1,682.7 million.

The gain on disposal reflects our best estimate of the deferred consideration and finalisation of the completion balance sheet. As required under IFRS, a range of possible outcomes in connection with the deferred consideration has been considered and each outcome is probability weighted to determine the fair value of the deferred consideration recognised. The latest available information has been used to update this assessment and the fair value of deferred consideration has been adjusted accordingly. This adjustment does not impact the cash proceeds previously reported.

The results for discontinued operations include a tax credit of £4.3 million (2019/20 £24.6 million charge) relating to the trading of Viridor up to the point of disposal and subsequent retirement of debt originally drawn to fund Viridor's investment strategy. The gain on the sale of Viridor qualifies for the Substantial Shareholding Exemption and as such is not subject to corporation tax.

Resilient performance from the Continuing Group

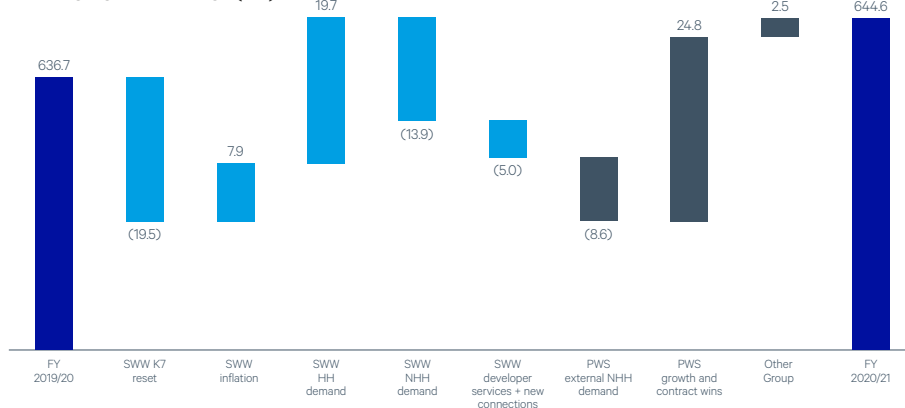
Despite the challenges posed by COVID-19 the performance of the business has been in line with management expectations, with revenues marginally higher than expected with the pandemic impacting demand patterns as outlined in more detail below.

Underlying Continuing Group revenue¹ has increased by 1.2% (£7.9 million) to £644.6 million (2019/20 £636.7 million). Higher than expected household demand, driven by lockdown restrictions, and the impact of new contract wins for Pennon Water Services outside the South West Water region has outstripped the expected reductions arising from the transition to the new K7 regulatory period (£19.5 million) and the impact of COVID-19 on non-household demand. The contract wins for Pennon Water Services contributed to revenue growth of £24.8 million compared to last year.

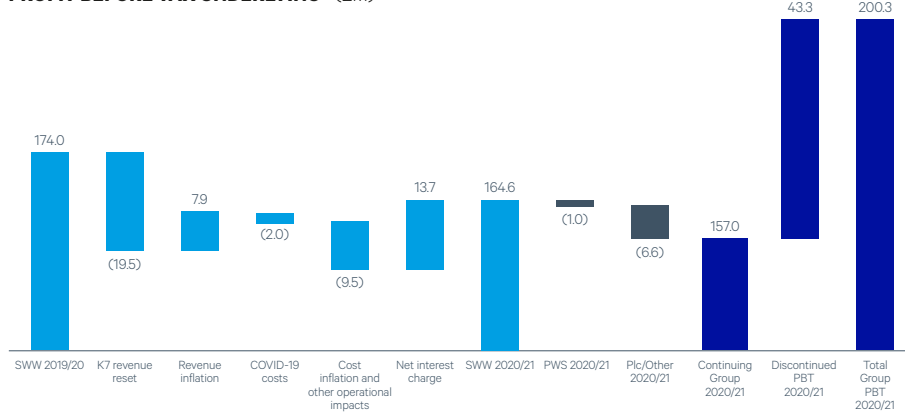
Statutory revenue of £624.1 million reflects the reduction from the £20.5 million WaterShare+ credit to customer bills.

Underlying operating costs are £309.9 million (2019/20 £271.4 million) reflecting inflationary impacts, specific costs relating to COVID-19 in South West Water and higher wholesale charges in Pennon Water Services from new business won outside of the South West Water region.

REVENUE UNDERLYING¹ (£M)



PROFIT BEFORE TAX UNDERLYING¹ (£M)



Cash collections in both South West Water and Pennon Water Services have remained robust throughout the year. Underlying expected credit loss charges of £2.8 million (0.5% of revenue) and £1.0 million (0.6% of revenue), respectively, are in line with the previous years' levels of 0.5% and 0.4%. At 31 March 2020 the Continuing Group recognised a non-underlying charge for expected credit losses in relation to COVID-19 of £7.9 million. The majority of the expected credit loss provision that was created from this non-underlying charge remains in place, with the full impact of the pandemic on collections not expected to be fully known until such point as the Government's relief measures are withdrawn and the economy starts to be fully re-opened.

Overall, profitability has been resilient with a modest financial impact from COVID-19. Group EBITDA¹, before non-underlying items, has reduced in line with our expectations by 8.4% to £334.7 million (2019/20 £365.3 million), reflecting the revenue impact of the K7 regulatory reset. Underlying profit before tax¹ was £157.0 million (2019/20 £183.0 million) and included the year on year reduction in net finance costs, benefitting from the efficient financing that has been put in place.

South West Water

South West Water underlying revenue for 2020/21 of £563.0 million has reduced by 1.3% (£7.3 million) compared with last year (2019/20 £570.3 million).

This expected reduction has arisen from the transition to the new K7 regulatory period, net of inflationary increases. South West Water has seen a net increase in demand from COVID-19 with higher household demand (c.9%) more than offsetting the expected reduction in non-household demand (c.22%) and developer services revenue as a result of reduced construction activity during lockdown and subsequent restrictions.

Operating costs of £222.4 million increased by £16.3 million compared to £206.1 million in 2019/20. This increase principally reflects:

- Cost increases including inflationary impacts of c.£8 million, reflecting annual pay increases, higher power costs, reflecting our energy risk management to mitigate volatility
- Additional operating costs of c.£2 million to support operations impacted by COVID-19, including personal protective equipment and IT related costs
- Expansion to the Isles of Scilly of c.£1 million
- Other cost increases including the impact of maintaining supplies during peak demand have been partly offset by continued efficient delivery.

Group Finance Director's report continued

A COVID-19 bad debt provision of c.£3 million was recognised in March 2020 and remains largely intact. Cash collections have remained robust with underlying bad debt costs c.0.5% of revenue, in line with last year.

South West Water's underlying EBITDA[^] and operating profit reduced by 6.5% and 9.4%, respectively, in line with our expectations for the first year of the new regulatory period.

The Group's efficient funding and hedging strategy resulted in a reduction in net interest costs for South West Water of £13.7 million to £57.7 million (2019/20 £71.4 million), as new hedges at lower rates commenced at 1 April 2020.

South West Water's capital expenditure this financial year was £168.2 million, compared to £161.0 million in 2019/20, reflecting planned and advanced expenditure in both water and wastewater operations offset by efficient delivery of schemes in conjunction with key partners.

Advanced expenditure includes the delivery of two bathing water quality improvements ahead of schedule with economies of scale achieved through the delivery of multiple schemes at the same time.

Significant investment continues to be advanced with earlier than planned upgrades in our network to accelerate our plan to deliver a 15% reduction in leakage by 2025. This includes proactive network replacement at susceptible locations and the installation of combined smart meters with acoustic loggers to improve monitoring.

Upgrades to water treatment works continue with the completion of the granular activated carbon filters installation at College water treatment works and the commencement of installation of granular activated carbon and UV filters at other locations including Stithians and Littlehempston. Work also commenced during the year on our new water treatment works in Bournemouth with pilot plants built to test our innovative technology with the unique raw water supplies in those catchments.

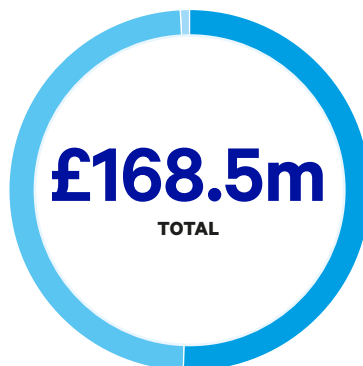
As part of our focus on reducing wastewater pollution incidents, additional expenditure has been incurred upgrading wastewater treatment works and pumping stations at key locations with a greater risk of pollution events.

Pennon Water Services

Throughout 2020/21 Pennon Water Services' business customers have been impacted by COVID-19. The initial lockdown in the first quarter of 2020/21 caused a significant reduction in non-household demand whilst businesses adjusted to new ways of working. Demand increased across the second quarter of 2020/21 with a largely normal summer holiday season but was further impacted by business closures over the winter, particularly in the leisure and hospitality industries.

The overall impact on revenues for Pennon Water Services, excluding the impact of new contract wins, is a reduction of c.16% compared to the prior year. Despite the impact of the pandemic, Pennon Water Services has made revenue gains through tender activity with c.£20 million of new business compared to last year. Non-wholesale operating costs have remained stable and the business has maintained positive EBITDA[^] despite the significant demand reductions.

MAJOR CATEGORIES OF CAPITAL EXPENDITURE



- Water: **£85.8m**
- Wastewater: **£82.4m**
- Other: **£0.3m**

SWW AVERAGE INTEREST RATE[^]

90 basis point reduction

2.5%

Year	Rate
2020/21	2.5%
2019/20	3.4%
2018/19	3.5%
2017/18	3.5%
2016/17	3.2%

The business continues to maintain its focus on targeting high quality, sustainable customers who will benefit from the value-added services that form part of Pennon Water Services' differentiated service proposition.

Pennon Water Services demonstrated its resilience during a year of significant economic uncertainty by engaging proactively with its customer base whilst continuing to win new contracts and delivering against its strategic priorities. Overall, the business had the largest revenue impact of COVID-19 for the Group because of temporary business closures. Pennon Water Services has continued to leverage its deep customer knowledge, supporting those customers who find themselves in financial difficulty. With the reopening of non-essential businesses, a return to more normal levels is anticipated during 2021/22.

Group net finance costs

The Group continues to secure funding for South West Water through its Sustainable Financing Framework and has efficiently hedged c.50% of its interest rate risk through the K7 regulatory period.

As a result, the effective interest rate[^] for South West Water is 2.5%, representing a 90 basis point reduction in comparison to last year.

Underlying net finance costs for the Continuing Group of £58.3 million are £4.2 million lower than last year (2019/20 £62.5 million), benefitting from the efficient financing that has been achieved.

Profit before tax before non-underlying items

Group underlying profit before tax[^] is £157.0 million compared with the prior year of £183.0 million. This reflects the expected reductions in South West Water of £9.4 million, resulting from the K7 revenue reset offset by financing efficiencies, in addition to losses before tax in Pennon Water Services of £1.0 million and other costs of £6.6 million. The other segment includes interest costs on debt held at the Pennon company level for the Continuing Group offset by interest receivable on cash retained from the Viridor disposal.

Non-underlying items before tax

For the Continuing Group, non-underlying items for 2020/21 total a charge before tax of £24.9 million (2019/20 credit of £10.1 million). The Directors believe excluding non-underlying items provides a more useful comparison of business trends and performance.

The non-underlying charge of £24.9 million consists of:

- £20.5 million reduction in revenue being the recognition in full of WaterShare+, a pioneering scheme which shares our success with customers, empowering customers with a stake and a say in the business. Customers were given the option to receive their share, which equates to £20 per customer, as either a credit on their bill, or as shares in Pennon Group
- A non-underlying curtailment charge of £4.4 million has been recognised in respect of the Continuing Group's principal pension scheme which arises from the decision to close the main defined benefit scheme to future accrual with effect from 1 July 2021.

A tax credit of £4.8 million has been recognised on the above items.

Taxation

The overall tax charge for the Continuing Group is £24.8 million (2019/20 £70.6 million). On an underlying basis, the net tax charge for 2020/21 for the Continuing Group of £296 million (2019/20 £38.4 million) consists of:

- Current year current tax charge of £23.7 million, reflecting an effective tax rate of 15.1% (2019/20 £28.6 million, 15.6%). 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 and tax relief on pension contributions made during the year and in recent years
- Current year deferred tax charge of £6.2 million (2019/20 £6.7 million) primarily reflects capital allowances across the Group in excess of depreciation charged together with relief on pension contributions
- In relation to prior years, there is a:
 - Current tax credit of £0.7 million (2019/20: £0.3 million credit), as a result of the submission of the tax computations in prior years
 - Deferred tax charge of £0.4 million (2019/20: £3.4 million charge), reflecting the submission of the tax computations in prior years.

The 2020/21 non-underlying items result in a £4.8 million credit (2019/20 £32.2 million charge), reflecting current tax relief on the cost of the WaterShare+ scheme and future tax relief available on pension contributions.

Earnings per share

Statutory earnings per share from the Continuing Group and discontinued operations of 418.5 pence (2019/20 47.7 pence) include the profit from the sale of Viridor and non-underlying charges in discontinued operations resulting from the restructuring of debt that was drawn to fund Viridor's growth programme.

Robust cash collections

Cash generation has remained robust despite the potential for disruption from COVID-19. The Continuing Group's total operational cash inflows^{*} in 2020/21 were £396.8 million (2019/20 £449.4 million) with the reduction being driven from the expected decline in underlying EBITDA (c. £30 million) and the impact of the WaterShare+ scheme being applied to customer bills in the second half of the year (c. £20 million). Working capital has remained stable with significant focus on managing collections. Cash collections have remained resilient throughout the year in both South West Water and Pennon Water Services, despite the increased risks arising from the pandemic.

These funds adequately support our effective finance structures (net interest paid £66.3 million⁽¹⁾) and capital investment programme^{*} (£157.6 million). Interest payments for the Continuing Group are higher than the net finance costs recognised in the income statement due to the timings on interest settlements impacting the levels of accrued interest compared to this same time last year.

“**Through the challenges posed by COVID-19 the performance of the business has been resilient.**”

The sale of Viridor generated net cash proceeds of £3,690.2 million after transaction costs⁽²⁾ and settlement adjustments required under the purchase agreement. The Group's net debt was further reduced by the net debt disposed of with Viridor of £179.0 million.

Other significant impacts on net debt include the Group's decision to repay its perpetual capital securities of £300.0 million in May 2020, a £36.0 million contribution to its principal pension scheme, other pension payments in settling obligations transferred from Viridor and costs incurred in restructuring debt following the Viridor sale.

Following the above, and the payment of our interim and final dividends for full year 2019/20, the Group held a net cash position at 31 March 2021 of £64.3 million (31 March 2020 total Group net debt £3,264.0 million).

Efficient long-term financing strategy

The Group has undertaken a review of the portfolio of Pennon company debt following the sale of Viridor and at the year end was in a net cash position.

During the year the Group has repaid the perpetual capital securities and restructured the remaining Pennon Group company debt, repaying c.£11 billion of debt originally drawn to fund Viridor's investment strategy, to provide an ongoing sustainable portfolio aligned to the Group's requirements.

South West Water's cost of finance, with an effective rate^{*} of 2.5%, is among the lowest in the industry, continuing to benefit from the use of finance leasing as the main source of funding in the portfolio which provides long maturity at fixed margins, secured at the inception of each lease.

South West Water has a mix of fixed/swapped (£1,350 million, 62%), floating (£270 million, 12%) and index-linked borrowings (£579 million, 26%). South West Water's debt has a maturity of up to 36 years with a weighted average maturity of c.19 years. New debt has been fixed to align to iBoxx indices in line with Ofwat's approach to allowed cost of debt. Where appropriate, derivatives are used to fix the rate on floating rate debt.

South West Water's index linked debt is below Ofwat's notional assumption of 33% and is amongst the lowest in the industry. This gives a comparative advantage through the regulatory transition from RPI to CPIH, given the uncertainty and volatility around pricing of the wedge between RPI and CPI. In addition to this, the CPI and CPIH markets have continued to develop over the last year, and following the announcement regarding RPI reform the Group is following these developments and we will seek to issue new index-linked instruments to maintain our position as required, following our first CPI instrument in 2019/20.

The combined South West Water and Bournemouth Water debt to RCV⁽³⁾ ratio is 64.8%⁽⁴⁾ (31 March 2020 62.3%). Gearing at South West Water is expected to fall during this regulatory period with a trajectory towards Ofwat's notional structure of 60% by 2025.

^{*} Measures with this symbol ^{*} are defined in the alternative performance measures section of the annual report on pages 207 to 210.

(1) Total Group interest paid of £80.2 million less Total Group interest received of £4.3 million, less net interest paid relating to discontinued operations of £96 million.

(2) Transaction costs of £63 million.

(3) RCV as published in South West Water's Final Determination (2020-25), recognising the omission of data not included by Ofwat in relation to IFRS 16: Leases.

(4) Based on regulatory capital value (RCV) at 31 March 2021 and South West Water Group net debt including impact of IFRS 16: Leases. Regulatory South West Water Limited gearing is 67.0% at 31 March 2021 (64.6% at 31 March 2020).

Group Finance Director's report continued

Sustainable and robust funding position

The Group has a strong liquidity and funding position with £3,204 million cash and committed facilities at 31 March 2021. This consists of cash of £2,919 million (including £251 million of restricted funds representing deposits with lessors against lease obligations) and £285 million of undrawn facilities. £2,496 million of the cash holdings are held at the Pennon company level.

Following the sale of Viridor, Pennon has also reduced the number of Revolving Credit Facilities (RCFs), reflecting the reduced ongoing requirement.

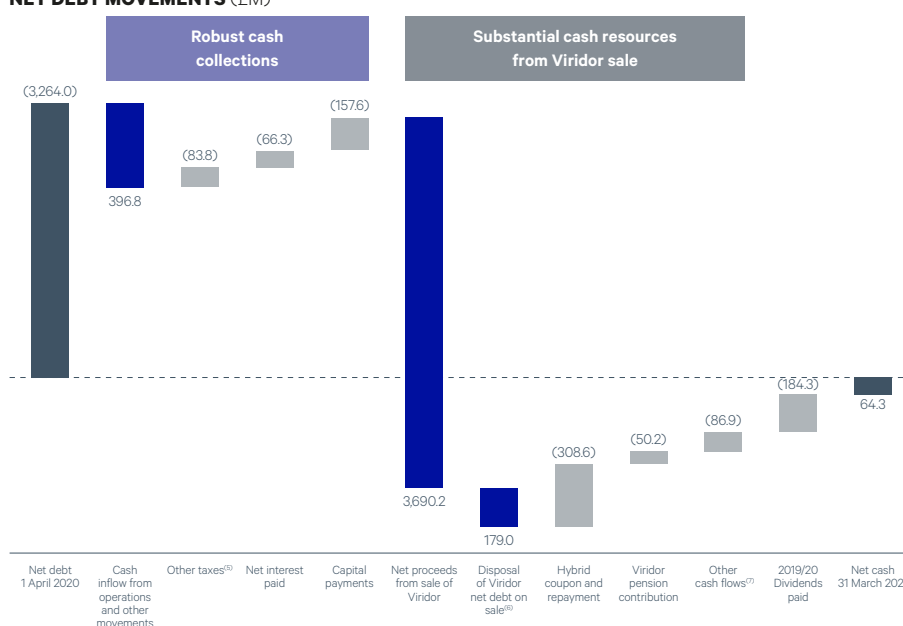
Given the current low interest rate environment, the Group's cash is being managed to provide flexibility and liquidity to meet any required cashflow needs whilst ensuring appropriate security and counterparty limits are observed.

South West Water net debt at 31 March 2021 was £2,199 million, slightly lower than the previous year (31 March 2020 £2,227 million). During the year to March 2021, South West Water signed £120 million of new and renewed facilities. Following the continued success of our Sustainable Financing Framework, a new £30 million long funding finance lease facility and our first green private placement will provide support for our sustainable projects under the Green Loan Principles. Additionally, the renewed facility extends the existing debt maturity providing additional efficient funding for South West Water in the current low rate environment.

Our 2020 Sustainable Financing Impact Report was published in October, detailing the progress we have made in this area and the allocation of funding to our sustainable projects in water and wastewater to support our communities.

In preparation for the cessation of LIBOR in December 2021, the Group is following current recommendations from regulators and progressing our transition plans. Having completed our first LIBOR to SONIA amendment for a sustainable RCF in 2020, we are engaging with our banking counterparties to ensure we are well placed for the transition. We have agreed transition language for our facilities to switch to SONIA with a number of our counterparties and are currently progressing with our hedge accounting analysis before finalising the transition.

NET DEBT MOVEMENTS (£m)



“
Cash collections have remained robust throughout the year in both South West Water and Pennon Water Services, despite the increased risks arising from the pandemic.

Post Viridor sale debt restructuring
Immediately prior to the Viridor disposal, the implied Pennon company borrowings, being Group borrowings not relating to South West Water, totalled c.£1.2 billion. The significant majority of these borrowings were originally drawn to fund the investment phase of Viridor.

The restructuring of Pennon company debt has been completed since the disposal, with c.£1.1 billion principal debt being repaid to 31 March 2021. The majority of this debt was floating rate and has therefore been repaid at par showing the flexible approach secured when financing Viridor's energy recovery facility investment phase. The swift repayment of this debt has also resulted in minimising the cost of carry on these instruments. There were a limited number of derivative transactions used to maintain our interest rate risk within the treasury policy which would no longer achieve hedge accounting and have therefore been terminated in line with the Group's policy to minimise income statement volatility.

The Group also retired certain fixed rate debt during 2020/21. Given the commitments under these fixed rate agreements, make whole costs were applicable. The debt was terminated at a value accreting basis where a discount to the full documented make whole cost was achieved. As part of this restructuring, the short-dated Pennon bond due in 2022 could not be immediately terminated in full, but the launch of a tender process successfully reduced the debt to £30 million, from £100 million, by 31 March 2021. £74.4 million of non-underlying charges have been reflected in the profit from discontinued operations in respect of the costs of debt retirement, including £17.6 million of make whole costs incurred on debt retired during the second half of the financial year.

(5) Other taxes include business rates, employers' national insurance, fuel excise duty, carbon reduction commitments, environmental payments and climate change levy.

(6) Includes disposal of £61.7 million of cash balances and £240.7 million of lease financing held by Viridor at 8 July 2020.

(7) Includes cash flows relating to retirement of Pennon company debt and cash flows from discontinued operations.

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 for other areas of the Group.

Penon Water Services funding is predominantly provided by Penon. Penon will continue to use funds to support the Group's ongoing operations as appropriate.

Taxation strategy

Transparency is a critical component of our approach, recognising that openness and honesty with our customers is essential. Optimising our tax position benefits them, for example by keeping water bills down, but we do not enter into artificial tax arrangements, use tax havens or take an aggressive stance in the interpretation of tax legislation.

We have once again been successful in maintaining the Fair Tax Mark. This is an independent UK accreditation scheme for businesses paying their fair share of corporation tax and reporting on their tax practices transparently. Achieving the Mark demonstrates that we are paying the right amount of corporation tax in the right place at the right time and apply the gold standard of transparency. Having taken the lead, we have also helped to inspire other water companies to apply for the accreditation, thereby improving the tax transparency of the sector in which we operate.

The Group's operations and subsidiaries are subject to tax in the UK. Each Group company operates in accordance with the detailed tax strategy which is published annually.

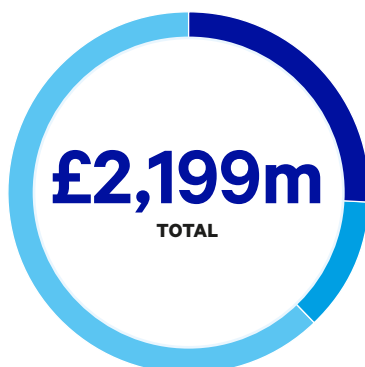
Under our tax strategy we:

- At all times consider the Group's corporate and social responsibilities in relation to its tax affairs
- 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 decisions
- Do not enter into artificial tax arrangements nor take an aggressive stance in the interpretation of tax legislation
- Do 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
- Do not have any connections with tax havens unless it is necessary for the purposes of trading within those jurisdictions.

As a long-term business with a long-term approach to financial management, there have been no changes to the tax strategy which is reviewed and reaffirmed on an annual basis.

Further details are given in the Group's tax strategy document available on the Penon Group website.

SWW NET DEBT STRUCTURE



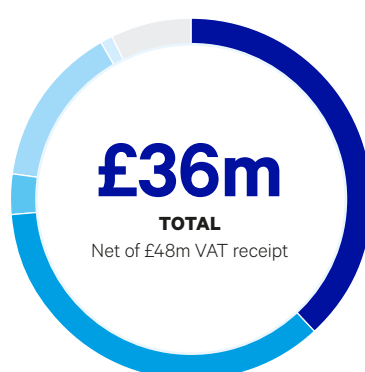
- Index-linked: **£579m**
- Floating: **£270m**
- Fixed: **£1,350m**

REGULATORY CAPITAL VALUE

£3,393m

Year	Value (£m)
2021	£3,393m ⁽⁸⁾
2020	£3,573m
2019	£3,505m
2018	£3,403m
2017	£3,291m

TAX CONTRIBUTION 2020/21 (borne/collected)



- Employment taxes: **£32m**
- Business rates: **£30m**
- Corporation tax: **£3m**
- Environmental payments: **£12m**
- Fuel excise duty: **£1m**
- Other: **£6m**

Tax contribution 2020/21 – borne/collected

The Continuing Group's total tax contribution (TTC) for 2020/21 amounted to £36 million (2019/20 £75 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 landfill tax, business rates, corporation tax and employers' National Insurance contributions (NICs). Taxes collected and recovered highlights where the business is collecting tax on behalf of HMRC.

Employment taxes totalled £32 million (2019/20 £26 million) including employees' Pay As You Earn (PAYE) and total NICs. The total amount of £32 million includes PAYE of £3 million (2019/20 £3 million) on pension payments made by the Group pension scheme. A net amount of £23 million (2019/20 £19 million) was collected on behalf of the authorities for employee payroll taxes.

Business rates of £30 million (2019/20 £29 million) were paid to local authorities. This is a direct cost to the Group and reduces profit before tax.

UK corporation tax payments to HMRC in the year were £3 million (2019/20 £52 million) in relation to 2020/21 instalment payments. This is a reduction due to a number of factors including a reduction in the number of payments due (four in 2020/21 versus six in 2019/20 as the payment on account legislation was amended and required two additional payments last year) and a reduction in taxable profits as a result of debt restructuring costs following the repayment of debt post the disposal of Viridor.

VAT of £48 million has been received (2019/20 £48 million has been received) by the Group from HMRC. VAT has no material impact on profit.

Payments to the Environment Agency and other regulatory bodies total £12 million (2019/20 £11 million). This reduces profit before tax.

Fuel excise duty of £1 million (2019/20 £1 million) related to transport costs. This reduces profit before tax.

(8) 31 March 2021 RCV reflects a reduction from prior year levels due to re-basing following midnight adjustments made at end of the K7 regulatory period.

Group Finance Director's report continued

Pensions

As part of its long-term pension strategy, the Group completed its employee consultation on plans to modernise its ongoing pension arrangements in the first half of the year.

The outcome of the consultation resulted in a decision to close Pennon's principal defined benefit scheme to future accrual with effect from 1 July 2021 with all employees transitioning to a new defined contribution scheme offered through a master trust arrangement. This has resulted in a non-underlying curtailment charge of £4.4 million.

At 31 March 2020, the Group's pension schemes showed an aggregate deficit (before deferred tax) of £8.5 million, of which a surplus of £6.6 million related to the Continuing Group and a deficit of £15.1 million related to Viridor. Post the sale of Viridor, the Group surplus at 31 March 2021 is £8.8 million reflecting the following principal movements:

- £12.2 million increase in deficit from adverse movements in financial and other actuarial assumptions (notably, corporate bond yields) increasing the liabilities by c.£72 million being offset by asset outperformance of c.£60 million
- £36.0 million additional contributions to Pennon's principal pension scheme made at the time of the Viridor disposal, over and above the scheduled deficit recovery contributions
- £21.9 million increase in net pension liabilities relating to the transfer and settlement of certain pension obligations in connection with Viridor, and the impact of closing the principal defined benefit scheme to future accrual.

The Group continues to simplify its defined benefit pension arrangements. In March 2021 residual assets and liabilities from the sections of the Citrus pension schemes were transferred into the Group's principal pension scheme, Pennon Group Pension Scheme (PGPS). This completes the consolidation of the defined benefit pension arrangements into one scheme. A contribution of £6 million was made to PGPS in April 2021 to maintain funding levels following this transfer.

The March 2019 triennial valuation of PGPS resulted in an actuarial valuation deficit of £53.0 million. Agreed deficit recovery contributions of £31.9 million and £2.9 million were made in the year to March 2020, and March 2021 respectively with an outstanding agreed payment of £0.4 million due in March 2022. Following these recovery payments and additional responsible contributions following the Viridor disposal and scheme consolidation programme, as at 31 March 2021, PGPS is approximately 103% funded under the agreed technical provisions in the 2019 valuation.

“The earnings accretive nature of the Bristol Water acquisition is also expected to deliver further dividend growth for the Group.

In connection with the proposed return of capital to shareholders, a further £17.0 million payment will be made into PGPS. Following this payment, the Company will have contributed £59.0 million into PGPS, representing approximately 2% of the proceeds, after debt retirements. Adjusting for these additional payments at 31 March 2021 PGPS would be c.106% funded against its technical provisions.

Use of residual proceeds

Following the sale of Viridor and the receipt of £3.7 billion net cash proceeds, the Board has employed a structured approach to capital allocation, ensuring the most efficient and effective use of capital in order to maximise shareholder value.

Right-size balance sheet and gearing

As detailed above, we have effectively rationalised Pennon's debt portfolio in order to lower ongoing interest charges and ensure a sustainable and appropriate level of gearing for the Group and our ring-fenced water business. We are targeting gearing (Net debt to RCV) of <65% at Group level and around 60% in our water business by the end of K7 (2025).

We have also made responsible pension contributions, ensuring appropriate levels of funding for our remaining defined benefit pension scheme, reducing risk going forward.

Investing for growth in UK Water

We have employed a highly disciplined approach to assessing opportunities for growth to ensure that any acquisition will deliver long-term value through EPS accretion and synergistic totex savings and RCV growth. In addition, capital investment in South West Water's Green Recovery Initiative will also support organic RCV growth in the longer term.

On 2 June 2021, we approved the acquisition of Bristol Water for a cash consideration of £425 million. Bristol Water is a profitable regulated water only company serving a population of approximately 1.2 million customers in the Bristol region, with an RCV of £555.9 million as at 31 March 2021. The acquisition will complete on 3 June 2021 and will be reviewed by the Competition and Markets Authority.

For the year ended 31 March 2021, the acquired businesses had combined unaudited revenues of £118 million, operating profits of £21 million and underlying profit before tax of £9 million. As part of the Acquisition £389 million of net debt as at 31 March 2021 has been assumed by Pennon.

The acquisition is expected to deliver long term value through an RCV increase of c.16%, earnings accretion and synergistic totex savings through the application of our proven integration strategy.

Return of capital to shareholders

Following the sale of Viridor, the Board has considered the balanced approach of returning £1.9 billion to shareholders, the majority by way of a proposed special dividend. The proposed special dividend of £1.5 billion, represents £3.55 per existing ordinary share. The share buy-back programme of up to £0.4 billion will start after payment of the proposed special dividend has been made and conclude by 30 September 2022. The Board considers that the proposed share buy-back enables some further return of proceeds and provides Pennon with ongoing financial flexibility.

To maintain comparability, so far as possible, of the Company's share price before and after the special dividend, Pennon intends to consolidate its Ordinary Share capital on the basis of two New Ordinary Shares in the capital of the Company for every three Existing Ordinary Shares in the capital of the Company (the Share Consolidation).

The effect of the Share Consolidation will be that the existing shares will be replaced by the new shares so as to reduce the number of shares in issue and reflect the amount of cash to be returned to shareholders, thus being economically neutral.

In connection with the proposed return of capital, the Company has committed to contribute an additional £17 million to its remaining defined benefit pension scheme, PGPS.

Dividends and retained earnings

Following the significant profit on the disposal of Viridor, the statutory net profit attributable to ordinary shareholders of £1,762.2 million has been transferred to reserves.

The proposed special dividend of £1.5 billion, which represents £3.55 per existing ordinary share, will be paid from the retained earnings arising from the Viridor disposal.

The Group previously announced its dividend policy for the period 2020-25, stating that the dividend will grow in line with CPIH + 2% per annum. The choice of indexation aligns with the regulatory inflation measure being used for K7. The dividend policy reflects the sector-leading position of the Continuing Group, consistent with sustainable cover.

Based on the current share structure at the year end, the Board recommends the payment of a final dividend of 14.97 pence per share for the year ended 31 March 2021. Together with the interim dividend of 6.77 pence per share paid on 1 April 2021 this gives a total dividend for the year of 21.74 pence. This represents an increase of 3.0% on the implied Continuing Group dividend of 21.11 pence for 2019/20. Pennon offers shareholders the opportunity to invest their dividend in a Dividend Reinvestment Plan ('DRIP').

		Pre-share consolidation	Post-share consolidation
Special dividend		355.00p	N/A
2020/21 – Continuing Group	Interim dividend	6.77p	10.15p
	Final dividend	14.97p	22.46p
	Total dividend	21.74p	32.61p
2020/21 – Bristol Water Acquisition		Total dividend	+2.00p +3.00p
Annual growth		CPIH +2%, sustainable, sector-leading dividend policy	

Proposed dividends totalling £91.8 million are covered 1.9 times* by net profit (before non-underlying items and deferred tax) (2019/20 1.4 times). Dividends are charged against retained earnings in the year in which they are paid.

If the share consolidation outlined above is approved by shareholders and progresses as proposed, the final dividend will be re-based to 22.46 pence per new ordinary share. For comparative purposes the total dividend for 2020/21 of 21.74 pence will equate to 32.61 pence post consolidation.

The earnings accretive nature of the Bristol Water acquisition is also expected to deliver further dividend growth for the Group. The Board expects that Bristol Water will deliver dividend growth on a pre-consolidation and post-consolidation basis of 2.0 pence and 3.0 pence per share, respectively.

The dividend above, including the expected uplift from Bristol Water, provided regulatory approval for the acquisition is granted, represents the sustainable dividend for the Continuing Group.



Paul Boote
Group Finance Director

2 June 2021

Managing our risks

Risk report and viability statement

The Pennon Board and Group Executive are committed to the effective management of risks and opportunities to ensure the long-term success of the Group.

Pennon operates mature and robust risk management and internal control frameworks which are aligned to the Group's strategic priorities and are embedded into our processes, culture and ways of working. These frameworks form a key part of our governance structure ensuring that there is robust review, challenge and assurance over the management of both our current and emerging risks and opportunities.



Governance of the risk management and internal control frameworks

The risk management framework encompasses both a 'top down' and 'bottom up' approach. This allows risks and opportunities to be cascaded and escalated effectively, enables a common understanding of the risks and opportunities and their potential impact on the achievement of the Group's strategic priorities and provides a multi-layered approach to the review and challenge of risk.

A consistent methodology is applied in the identification, assessment and management of the Group's risks, which considers both the likelihood of the risk occurring over a long-term period and the potential impact across a range of categories aligned with our priorities including: financial, safety, environmental and customer service. Principal and business-level risks are subject to regular review and challenge by the individual subsidiaries and functions, the Risk Committee, Group Executive and the Pennon Board.

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' model. The Group Executive and the Pennon Board obtain assurance over the effectiveness of the internal control environment through a variety of internal and external assurance providers, including an independent Group Internal Audit function.

Key responsibilities and activities

The key responsibilities and activities which encompass the Group's risk management framework are:

Oversight	Board <p>Key risk management responsibilities</p> <ul style="list-style-type: none"> Sets the Group's strategic objectives Establishes the Group's risk appetite Determines the Group's principal risks Ensures an effective internal control framework <p>Key assurance activities</p> <ul style="list-style-type: none"> Quarterly review of the Group's principal risks against the determined risk appetite Quarterly review of the Group's emerging risk log
	Audit Committee <p>Key risk management responsibilities</p> <ul style="list-style-type: none"> Reviews the effectiveness of the Group's risk management framework Reviews the adequacy of the internal control framework <p>Key assurance activities</p> <ul style="list-style-type: none"> Performs quarterly deep dive reviews on principal risks Approves the Group Internal Audit Plan Receives reports on the outcomes of key assurance activities
Third line	Group Internal Audit <p>Key risk management responsibilities</p> <ul style="list-style-type: none"> Provides independent, risk-based assurance on the effectiveness of the internal control framework Coordination of independent assurance activities <p>Key assurance activities</p> <ul style="list-style-type: none"> Regular reporting to Audit Committee and Group Executive on the effectiveness of internal controls and the outcomes of key assurance activities
Second line	Group Executive <p>Key risk management responsibilities</p> <ul style="list-style-type: none"> Day to day management of the Group's principal and operational risks Establishes the relevant Group-wide risk management processes and procedures Maintains the internal control framework <p>Key assurance activities</p> <ul style="list-style-type: none"> Performs a thorough appraisal of the Group's principal and emerging risk profile quarterly Monitors the Group's performance against KPIs and financial performance Establishes and reviews policies, procedures and delegated authorities
	Risk Committee <p>Key risk management responsibilities</p> <ul style="list-style-type: none"> Provides review and challenge over subsidiary/functional principal risks and mitigation strategies Alignment of the top down and bottom up risk management process Performs horizon scanning on emerging risks and opportunities <p>Key assurance activities</p> <ul style="list-style-type: none"> Quarterly review of Group principal risks and key subsidiary / functional risks Undertakes deep dive reviews of specific risks
	Individual subsidiaries / functions <p>Key risk management responsibilities</p> <ul style="list-style-type: none"> Identifies and assesses subsidiary / functional level risks Implements and executes appropriate risk mitigation strategies, aligned with the agreed risk appetite Monitors compliance with internal control framework Review of subsidiary / functional principal risks on a quarterly basis by senior leadership teams <p>Key assurance activities</p> <ul style="list-style-type: none"> Compliance functions provide second line assurance across regulatory, legal, health & safety and other key business processes Self-certification of compliance with the internal control framework
First line	<p>In addition, the Group also received assurances from a variety of external assessments, including by our regulators, which complements and further enhances the Group's overall assurance framework.</p>

Environmental, social and governance risk management

The nature of the Group's operations means that environmental, social and governance (ESG) considerations are inherent in how the Group operates as a responsible business and are a key focus for the Group. The identification, assessment and management of ESG risks and opportunities, including the potential impact of climate change on our business, is integrated into the Group's overall risk management framework and methodology, with the outcomes reflected within the assessment of relevant principal and business level risks. The delivery of the Group's ESG actions and commitments is monitored through our ESG framework.

More information

 **ESG framework** pages 24 to 25

South West Water technical (non-financial) data

In addition to the risk management framework detailed above which applies across the Group, recognising the importance of the regulatory ODI framework, South West Water engages an independent, third-party auditor, Jacobs, to audit the accuracy of the technical (non-financial) data reported in its annual performance report, including its performance commitments and environmental data. DNV also perform further assurance work over the Group's sustainability measures.

More information

 **Sustainability measures** pages 28 to 29

Continuous improvements to risk management and internal control

Following the refocusing of the Group as a water and wastewater business, a comprehensive review of the Group's risk management framework has been undertaken. Risk management processes have been streamlined, risk reporting has been enhanced and a reconstituted Risk Committee has been established, which includes representation from across key functional areas including operations, health and safety, finance and legal.

Additionally, the following activities have been completed during the year as part of the commitment to continuously improve the Group's risk management framework:

- The Group's risk management policy has been updated and approved by the Board and recommunicated to staff.
- Health and safety governance has been further strengthened with dedicated Board and Executive health and safety committees established during the year.
- Key risk indicators and associated metrics have been updated and aligned with the Group's revised strategic priorities, supporting the monitoring of the Group's principal risks against its risk appetite.

Horizon scanning

Emerging risks and opportunities are considered to be factors and events which could have a future impact on the achievement of the Group's strategic priorities but lack the required clarity or certainty in order to adequately assess their impact. Horizon scanning of emerging risks and opportunities is embedded within the risk and opportunity review process performed by individual subsidiaries and functions. Emerging risks are also reviewed by the Risk Committee, Group Executive and Pennon Board as part of their regular assessment of the Group's risk profile. Once there is sufficient clarity and certainty over an emerging risk, it is assessed applying the Group's methodology and appropriate mitigating actions are established. Notable emerging risks and opportunities are detailed within the table below:

RISK/ OPPORTUNITY	COMMENT	RISK CATEGORY IMPACT	TIME HORIZON
COVID-19 long-term economic implications	Uncertainty remains over the pace and scale of the long-term implications of COVID-19 on the global and UK economy, which could impact our business.	<ul style="list-style-type: none"> • Legal, regulatory and finance 	Medium-term
Micro-pollutants, plastics and micro-plastics	The continued focus on the impact of micro-pollutants and micro-plastics could present both risks and opportunities arising from changes to water treatment processes.	<ul style="list-style-type: none"> • Operating performance • Business systems and capital investment 	Medium-term
Biodiversity	Threats to the region's biodiversity, as a result of climate change, may require changes to how we interact with species and habitats in the areas that we operate in.	<ul style="list-style-type: none"> • Operating performance 	Long-term
Changes to the demographics within the South West	Increases in population migration to the South West due to the longer-term impact of COVID-19 and climate change could place further demand on our resources and assets.	<ul style="list-style-type: none"> • Operating performance 	Long-term

- An updated telematics system is being rolled out across the Group's fleet, providing improved vehicle and driver monitoring, oversight and reporting.
- A programme of second line Health and Safety assurance was delivered covering additional safety measures implemented at the Group's operational sites and offices in response to COVID-19.
- The Group has further enhanced the resilience of its 24/7 Service Support Centre which provides support to our operational sites and customer contact resolution.
- South West Water has continued to progress the replacement programme of operational technology providing further resilience to cyber related risks.

Management of South West Water within the Group's risk management framework

Pennon manages its risks in such a way that South West Water, as a 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.

Managing our risks continued

Risk appetite

The UK Corporate Governance Code requires the Group to determine the risk appetite 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 comprehensiveness of the Group's internal controls in mitigating its principal risks to an acceptable level is considered with due consideration of the relevant risk appetite. The risk appetite for each risk category is detailed below:

RISK CATEGORY	RISK APPETITE STATEMENT
Law, regulation and finance	<p>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 employees, the public and those who work with 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.</p> <p>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.</p>
Market and economic conditions	<p>The Board recognises that our activities are exposed to changes in macroeconomic and external market conditions. 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.</p>
Operating performance	<p>The Board has a low appetite for significant operational failure of our water and wastewater assets and seeks to reduce both the likelihood and impact through long-term planning and careful management of our operational assets.</p> <p>There is greater appetite for well-informed risk taking to develop further markets, subject to this not detrimentally impacting on the level of service expected of our regulators, customers and wider stakeholders.</p>
Business systems and capital investment	<p>The Board has a low risk appetite for risk associated with the delivery of capital investment within our regulated business plan. Broader investment decisions are taken on an informed basis with risks weighted against the expected level of return on a case-by-case basis.</p> <p>The Group seeks to minimise technology and security risk to the lowest possible level without detrimentally impacting on the Group's operations.</p>

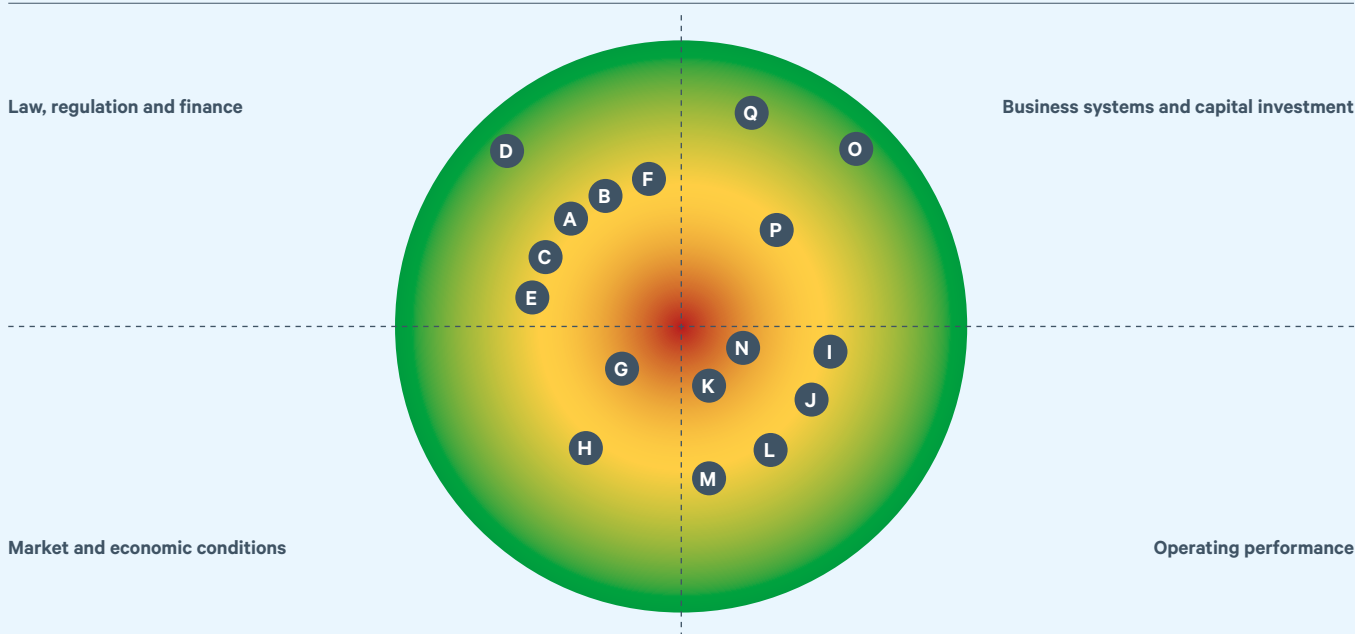
LONG-TERM PRIORITIES

- 1 Leadership in UK water
- 2 Efficient operations
- 3 Sustainable growth

RISK LEVEL

- Increasing
- Stable
- Decreasing
- High
- Medium
- Low

Overview of Pennon's principal risk profiles



CATEGORY	REF	STRATEGIC PRIORITIES	RISK DESCRIPTION	NET RISK
Law, regulation and finance	A	1 2	Changes in Government policy	Stable
	B	1 2	Regulatory reform	Stable
	C	1 2	Non-compliance with laws and regulations	Increasing
	D	2 3	Inability to secure sufficient finance and funding, within our debt covenants, to meet ongoing commitments	Decreasing
	E	1 2 3	Non-compliance or occurrence of an avoidable health and safety incident	Stable
	F	2	Failure to pay all pension obligations as they fall due and increased costs to the Group should the defined benefit pension scheme deficit increase	Stable
Market and economic conditions	G	1 2	Non-recovery of customer debt	Stable
	H	2 3	Macroeconomic risks impacting on inflation, interest rates and power prices	Stable
Operating performance	I	1 3	The Group's operations and assets are impacted as a result of climate change and extreme weather events	Increasing
	J	1 3	Failure of operational water treatment assets and processes resulting in an inability to produce or supply clean drinking water	Increasing
	K	1 3	Failure of operational wastewater assets and processes resulting in an inability to remove and treat wastewater and potential environmental impacts, including pollutions	Stable
	L	1	Failure to maintain excellent service or effectively engage with our customers and wider stakeholders	Stable
	M	1 2 3	Insufficient skills and resources to meet the current and future business needs and deliver the Group's strategic priorities	Stable
	N	1 2 3	Non-delivery of regulatory outcomes and performance commitments	Stable
Business systems and capital investment	O	1 3	Inefficient or ineffective delivery of capital projects	Decreasing
	P	1	Inadequate technological security results in a breach of the Group's assets, systems and data	Increasing
	Q	3	Failure to fully realise the strategic value arising from the acquisition of Bristol Water	Decreasing

Managing our risks continued

Principal risks and uncertainties

The Group's business model exposes the business to a variety of external and internal risks influenced by the potential impact of macro political, economic and environmental factors.

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. Following the completion of the Viridor sale, the Board has performed a comprehensive review and reassessment of the Group's principal risks to reflect the refocusing of the Group on its water and wastewater business. This has resulted in a number of changes to the Group's principal risks when compared with previous annual reports.

- **Tax compliance and contribution:** This is no longer considered a principal risk due to the lower tax risk profile of the continuing Group following the disposal of Viridor and all enquiries with HMRC being resolved.

- **Poor service and/or increased competition leading to loss of customers:** The commercial exposure arising from the potential loss of customers significantly decreased following the disposal of Viridor and is no longer considered a principal risk for the Group. A new risk has been established with a broader customer and stakeholder focus covering the both Group's domestic water and water retail operations, which has both financial and reputational implications: Failure to maintain excellent service or effectively engage with our customers and wider stakeholders (risk L).
- **Business interruption or significant operational failures / incidents:** This risk has been separated into two elements to more clearly articulate the risks associated with the Group's drinking water and wastewater activities; Failure of operational water treatment assets and processes resulting in an inability to produce or supply clean drinking water (risk J) and Failure of operational wastewater assets and processes resulting in an inability to remove and treat wastewater and potential environmental impacts, including pollutions (risk K).
- **Failure to fully realise the strategic value arising from the acquisition of Bristol Water (risk Q):** This reflects the potential risks associated with the acquisition and integration of Bristol Water.

Britain's trade agreement with the European Union



On 31 December 2020 the UK's transition period from leaving the EU ended and was replaced with a new trade agreement. There has been no significant impact or disruption to the operations and activities of the Group either prior to or following the commencement of this trade agreement.

Impact of COVID-19

As a provider of critical services, the Group has continued to operate resiliently throughout the period of COVID-19 to date, demonstrating the strength of the risk management framework. Whilst the UK Government has provided a roadmap for the lifting of current restrictions, this is dependent on a number of factors and there is the potential that specific measures could remain or be reintroduced in the medium term. The Group's principal risks have been assessed giving due consideration to the estimated continued impact of COVID-19 and the mitigating actions that will remain in place.

The Directors confirm that during 2020/21 they have carried out a robust assessment of current and emerging risks facing the Group. The assessment of the Group's principal risks has considered the impact on its business model, future performance, solvency and liquidity. These principal risks have been considered in preparing the viability statement on page 80.

Law, regulation and finance

PRINCIPAL RISK	STRATEGIC IMPACT	MITIGATION	NET RISK	APPETITE
A: Changes in Government policy	Long-term priorities 1 2 Changes in Government policy may fundamentally impact our ability to deliver the Group's strategic priorities, impacting shareholder value.	The current UK Government remains supportive of the existing regulatory model and the Group continues to engage with MPs and political stakeholders, both directly and through Water UK, demonstrating the value from our operational performance and continued investment in our network infrastructure. The Group is committed to supporting the South West economy through its Green Recovery Initiative which focuses on projects that matter most to customers and those that improve public health, protect the environment and address climate change. Broader emerging changes in Government policy, including restrictions and ongoing economic support in response to COVID-19, are regularly monitored in order to assess the potential impact on the Group.		We recognise that Government policy evolves. The Group seeks to minimise the potential risk and maximise opportunities through regular engagement and robust scenario planning.
B: Regulatory reform	Long-term priorities 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.	Certainty over the regulatory framework for the 2020-25 regulatory period has been provided through South West Water's Final Determination. Ofwat have published initial discussion papers to inform the priorities for the PR24 price review. South West Water has responded to these papers and has proactively commenced planning for the next price review. Specific temporary regulatory changes, in response to COVID-19, remain in place; particularly in respect of the water retail market, including wholesaler support. The Group fully engages with regulators on these changes to minimise the potential impact on the Group's activities.		We accept that regulatory reform occurs and seek to leverage opportunities where possible and minimise the potential risks by targeting changes which are NPV neutral over the longer-term to protect customer affordability and shareholder value.

LONG-TERM PRIORITIES

- 1 Leadership in UK water
- 2 Efficient operations
- 3 Sustainable growth

RISK LEVEL

- Increasing
- Stable
- Decreasing
- High
- Medium
- Low

Law, regulation and finance continued



PRINCIPAL RISK	STRATEGIC IMPACT	MITIGATION	NET RISK	APPETITE
C: Non-compliance with laws and regulations	<p><i>Long-term priorities</i></p> <p>1 2</p> <p>The Group is required to comply with a range of regulated and non-regulated laws and regulations across our businesses. Non-compliance with one or a number of these may result in financial penalties negative impact on our ability to operate effectively and reputational damage.</p>	<p>The Group operates within robust and mature regulatory frameworks, ensuring compliance with the requirements of Ofwat, the Environment Agency and other relevant regulators. These frameworks are subject to review by South West Water, Pennon Water Services and the Group Executive as appropriate.</p> <p>The legal and regulatory landscape has become more complex increasing the potential risk within this area. This includes additional legal requirements proposed within the Environmental Bill, as well as additional requirements on water companies to reduce the use of storm overflows.</p> <p>Regular horizon scanning is undertaken to identify potential changes and, where introduced, internal processes, systems and controls are revised, as necessary, to ensure compliance.</p> <p>The Group maintains a comprehensive internal framework to ensure compliance with corporate laws and regulations. This is reinforced through key policies including the Group's Code of Conduct, Anti-Bribery and Corruption, Anti-Facilitation of Tax Evasion and Anti-Modern Slavery and Human Rights, which have been reviewed and endorsed by the Pennon Board during the year.</p> <p>The Group operates a Speak Up whistleblowing process, allowing concerns to be raised confidentially and appropriately investigated. This process has been refreshed and relaunched during the year.</p>		The Group maintains the highest standards of compliance and has no appetite for legal or regulatory breaches.
D: Inability to secure sufficient finance and funding, within our debt covenants, to meet ongoing commitments	<p><i>Long-term priorities</i></p> <p>2 3</p> <p>Failure to maintain funding requirements could lead to additional financing costs and put our growth agenda at risk. Breach of covenants could result in the requirement to repay certain debt.</p>	<p>The Group has well established treasury, funding and cash flow arrangements in place underpinned by a clear Treasury Management policy which has been endorsed by the Pennon Board. The impact of political, economic and regulatory risks on the Group's financing commitments and cash flow is regularly reviewed by the Group Executive and the Pennon Board.</p> <p>The Group retains significant cash and committed facilities of £3,189 million and has utilised c.£1 billion to efficiently reduce gross debt at the Pennon company level to circa £180 million. Additionally, South West Water is fully funded for the 2020-2025 regulatory period.</p> <p>During 2020/21 £120 million of new or renewed funding was entered into, including £90 million of funding through the Sustainable Financing Framework for South West Water.</p>		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 and safety incident	<p><i>Long-term priorities</i></p> <p>1 2 3</p> <p>A significant health and safety event could result in financial penalties, significant legal costs and damage to the Group's reputation.</p>	<p>The effective management of health and safety risks continues to be a priority for the Pennon Board and Group Executive.</p> <p>The Group's health and safety governance arrangements have been further enhanced during 2020/21 with dedicated Board and Executive Health and Safety committees established. Additionally, a new Director of Health and Safety has been appointed with significant water industry experience.</p> <p>HomeSafe training has continued to be delivered to front line and support staff and a new Group-wide Wellbeing strategy has been launched.</p> <p>Enhanced COVID-19 safety measures remain in place to enable the Group's activities to be delivered safely, stringently following the most recent Government guidelines. This includes remote working where appropriate, the provision of COVID-19 testing for those unable to work remotely, social distancing and enhanced hygiene at all of the Group's sites and appropriate personal, protective equipment (PPE).</p> <p>The continuing Group's LTIFR during the year was 1.41 with the Group targeting an LTIFR of 0.5 by 2025.</p>		The Group has no appetite for health and safety related incidents and maintains the highest standards of compliance for our staff, contractors and other third parties.

Managing our risks continued

Law, regulation and finance continued

PRINCIPAL RISK	STRATEGIC IMPACT	MITIGATION	NET RISK	APPETITE
F: Failure to pay all pension obligations as they fall due and increased costs to the Group should the defined benefit pension scheme deficit increase	Long-term priorities 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 supplemented by professional advisors to manage the scheme's investment strategy. A recovery plan remains in place to return the scheme to a fully funded position on a technical basis by March 2022. During the year £36 million of contributions have been made, partially utilising proceeds from the disposal of Viridor. Following this payment and other movements in market conditions, the scheme is 103% funded on a technical provisions basis at 31 March 2021. Following consultation, the scheme will be closed to future accrual for existing members from 30 June 2021.		The Group will ensure that all obligations are met in full but seeks to manage this without unnecessary costs to the Group.

Market and economic conditions

PRINCIPAL RISK	STRATEGIC IMPACT	MITIGATION	NET RISK	APPETITE
G: Non-recovery of customer debt	Long-term priorities 1 2 Reduced customer debt collection would adversely impact on the Group's revenue.	South West Water and Pennon Water Services have continued to review and adapt their debt collection strategies in response to changes in COVID-19 restrictions and the consequential impact on customers. These measures have enabled both South West Water and Pennon Water Services to maintain collection rates and debt exposure at levels broadly comparable with the prior year. South West Water has sought to identify those customers most in need and support them in the most appropriate ways; such as automatically extending social tariffs and payment plans. Similarly, Pennon Water Services has proactively engaged with customers from those sectors most impacted by COVID-19 restrictions and provided tailored support in line with market code requirements. The potential impact on customers arising from the gradual withdrawal of Government economic support measures means a level of risk to collection rates will remain in the medium term.		While seeking to minimise non-recoverable debt, we recognise customer affordability challenges and the inability to disconnect domestic customers results in a residual risk of uncollectable debt remaining.
H: Macro-economic risks impacting on inflation, interest rates and power prices	Long-term priorities 2 3 Lower inflation or deflation could adversely impact on the Group's revenue and significant changes in interest rates and power prices could increase the Group's cost base.	Regulatory revenue controls links the Group's revenue to CPIH. Additionally, the mix of fixed rate, floating and indexed link debt, in addition to robust procurement processes assists in mitigating the risk of inflation. The Group has a diverse portfolio of debt with a manageable debt maturity profile, enabling changes in interest rates to be managed effectively during each regulatory period. South West Water has hedged the majority of its wholesale power costs through to March 2022 and has a new energy purchasing contract in place for future hedging opportunities, to mitigate the risk of volatility in the energy markets. Energy usage is minimised and where possible on-site renewable energy schemes are implemented reducing reliance on purchasing energy from the grid. This remains an important element of the Group's strategy to achieve Net Zero by 2030.		The Group seeks to take well judged and informed decisions while ensuring plans are in place to mitigate the potential impact of macroeconomic risks.

LONG-TERM PRIORITIES

- 1 Leadership in UK water
- 2 Efficient operations
- 3 Sustainable growth

RISK LEVEL




- Increasing
- Stable
- Decreasing
- High
- Medium
- Low

Operating performance

PRINCIPAL RISK	STRATEGIC IMPACT	MITIGATION	NET RISK	APPETITE
I: The Group's operations and assets are impacted as a result of climate change and extreme weather events	<p><i>Long-term priorities</i></p> <p>1 3</p> <p>Failure of our operations to cope with short-term extreme weather or long-term implications of climate change may result in an inability to meet customer needs, environmental impacts, increased costs and reputational damage.</p>	<p>A low appetite remains amongst regulators and stakeholders for reduced performance arising from extreme weather and climate change related incidents.</p> <p>The Group has assessed the risks and opportunities associated with the transition to a low carbon scenario and the associated physical risks of the various scenarios. This is detailed further in our TCFD section on pages 74 to 79.</p> <p>Climate change impacts are mitigated through proactive and reactive mitigation strategies.</p> <p>Extensive water resource scenario planning and modelling is undertaken, as outlined in South West Water's 25-year Water Resources Strategy.</p> <p>There has also been significant capital investment to maintain the performance of our assets and pipe network. This has included enhancing the resilience of assets located on or near flood plains or at risk of rising sea levels and coastal erosion.</p> <p>The Group is also targeting Net Zero Carbon by 2030 and strategies to achieve this are being progressed.</p> <p>The Group will also be publishing an updated Climate Change Adaptation Plan later in 2021.</p>		The Group seeks to mitigate the impact of climate change and extreme weather events through long-term planning, forecasting and investment.
J: Failure of operational water treatment assets and processes resulting in an inability to produce or supply clean drinking water	<p><i>Long-term priorities</i></p> <p>1 3</p> <p>An inability to produce or supply clean drinking water could result in financial penalties, regulatory enforcement and damage to the Group's reputation.</p>	<p>The potential impact of increased tourism within the region, as a consequence of COVID-19, on water treatment assets increases the potential risk in this area.</p> <p>Additional resilience has been created through the Mayflower Water Treatment Works which replaced Crownhill in November 2020. Further water treatment capital investment is planned during the regulatory period.</p> <p>Asset health is managed through a well established programme of planned and preventative maintenance works and effective stores management.</p> <p>These actions have assisted in delivering further improvements during the year across a number of areas within the Group's drinking water operations.</p> <p>In the event of a significant incident South West Water maintains detailed contingency plans and incident management procedures which are regularly reviewed.</p>		The Group operates a low tolerance for significant operational failure of its water treatment assets and seeks to mitigate these risks where possible.
K: Failure of operational wastewater assets and processes resulting in an inability to remove and treat wastewater and potential environmental impacts, including pollutions	<p><i>Long-term priorities</i></p> <p>1 3</p> <p>An inability to remove or treat wastewater could result in adverse environment impacts, financial penalties, regulatory enforcement and damage to the Group's reputation.</p>	<p>Wastewater assets are managed through a well established programme of capital investment and planned and preventative maintenance.</p> <p>There have been significant improvements in South West Water's pollutions performance since the launch of the targeted pollutions reduction plan in summer 2020.</p> <p>Key enhancements delivered as part of this plan includes governance, training, asset health and technology and there remains continued focus on ensuring this positive trend continues in 2021/22.</p> <p>In the event of a significant incident South West Water maintains detailed contingency plans and incident management procedures which are regularly reviewed.</p>		The Group operates a low tolerance for significant operational failure of its wastewater processes and assets and maintains the highest level of environmental standards.

Managing our risks continued

Operating performance continued

PRINCIPAL RISK	STRATEGIC IMPACT	MITIGATION	NET RISK	APPETITE
L: Failure to maintain excellent service or effectively engage with our customers and wider stakeholders	<p><i>Long-term priorities</i></p> <p>1</p> <p>Failure to maintain an adequate level of service and engagement could lead to financial penalties for South West Water, the inability of Pennon Water Services to retain and grow market share and damage to the Group's reputation.</p>	<p>The Group continues to invest in training and expanded channels to interact with and support customers. South West Water holds the Institute of Customer Service's ServiceMark accreditation and during 2020/21 also achieved BS18477 accreditation; a dedicated standard for identifying and responding to customer vulnerability.</p> <p>Pennon Water Services continues to maintain high customer satisfaction scores, including a rating of 4.8 out of 5 on Trustpilot.</p> <p>Following the launch of the WaterShare+ scheme an independent WaterShare+ advisory panel has been established as a key mechanism for engaging and demonstrating to customers how South West Water is delivering its business plan and Board pledges.</p> <p>The Group also proactively engages with other key stakeholders including regulators, environmental stakeholders and community groups.</p>		The Group continually seeks to engage with and increase customer and wider stakeholder satisfaction levels.
M: Insufficient skills and resources to meet the current and future business needs and deliver the Group's strategic priorities	<p><i>Long-term priorities</i></p> <p>1 2 3</p> <p>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.</p>	<p>Throughout 2020/21, the Group did not furlough any staff or utilise Government COVID-19 support.</p> <p>The Group's HR strategy enables the Group to attract, retain and develop our employees. The Group has set targets to recruit 500 new apprentices and 100 graduates over the next five years; plus 50 Kickstart opportunities during 2021.</p> <p>There are also various engagement forums across the Group which provides opportunities for employees to regularly engage and discuss business priorities with senior management and the Group Executive.</p> <p>The impact of the Group's Employee Benefits and Reward Strategy, a focus on talent management and prioritisation of our diversity and inclusion agenda are reflected within the results of the Group's most recent Great Place to Work Best Workplace survey. We achieved our highest ever participation rate at 84% while 73% of respondents believe Pennon is a great place to work; resulting in the Group being accredited as a Great Place to Work.</p>		While turnover of employees does occur, we ensure the appropriate skills and experience are in place with succession plans providing adequate resilience.
N: Non-delivery of regulatory outcomes and performance commitments	<p><i>Long-term priorities</i></p> <p>1 2 3</p> <p>South West Water's regulatory outcomes and performance commitments cover key strategic focus areas.</p> <p>Non-delivery against these could result in financial penalties being applied as well as reputational damage to the Group.</p>	<p>Performance against ODIs is subject to regular scrutiny and review by both the Group Executive and the Pennon Board, further supplemented by a comprehensive programme of assurance.</p> <p>Fast track status awarded to South West Water by Ofwat enabled early roll out of key projects and initiatives. This has resulted in c.80% of Outcome Delivery Incentives (ODIs) being on or ahead of target.</p> <p>This includes internal and external sewer flooding and South West Water is achieving its supply interruption target two years ahead of plan.</p> <p>The net penalty position for 2020/21 is largely based on pollutions performance. As outlined in risk K above, the targeted pollutions reduction plan has delivered significant improvements since July 2020 and focus remains on ensuring this positive trend continues into 2021/22.</p>		The Group is committed to achieving all performance commitments over the length of each regulatory period. Where performance in an individual year falls below expectations, action plans and targeted intervention are implemented to ensure performance returns to committed levels.

LONG-TERM PRIORITIES

- 1 Leadership in UK water
- 2 Efficient operations
- 3 Sustainable growth

RISK LEVEL

- Increasing
- Stable
- Decreasing
- High
- Medium
- Low

Business systems and capital investment

PRINCIPAL RISK	STRATEGIC IMPACT	MITIGATION	NET RISK	APPETITE
O: Inefficient or ineffective delivery of capital projects	<p><i>Long-term priorities</i></p> <p>1 3</p> <p>Inability to successfully deliver on our capital programme may result in increased costs and delays, detrimentally impacting our ability to provide top class customer service and achieve our growth agenda.</p>	<p>Capital projects are subject to an established and robust business case process, which includes challenge and risk modelling of key assumptions. Projects are delivered utilising skilled project management resource, complemented by Executive level oversight.</p> <p>Projects to be delivered during the current regulatory period are progressing and a number of additional capital projects have been identified as part of South West Water's Green Recovery Initiative submission.</p> <p>There remains a risk that the continued impact of COVID-19 places further strain on the financial health of key contractors and supply chain partners. Regular engagement and communication is maintained with the Group's supply chain, regular monitoring of the financial health of our key partners is undertaken and early intervention is taken where necessary.</p>		The Board has a low risk appetite for risk associated with the delivery of capital investment within our regulated business plan.
P: Inadequate technological security results in a breach of the Group's assets, systems and data	<p><i>Long-term priorities</i></p> <p>1</p> <p>Failure of our technology security, 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 could have a detrimental impact on our customers and result in financial penalties and reputational damage to the Group.</p>	<p>During the period of COVID-19 external cyber threats have continued to increase in both volume and sophistication.</p> <p>While there has been an increase in remote working, which has introduced additional capacity challenges, IT systems have remained resilient and the Group has maintained a strong preventative and detective information security framework, aligned to guidance issued by the National Cyber Security Centre. South West Water also continues to hold the ISO27001 accreditation.</p> <p>South West Water has also completed a number of actions during the year as part of the roadmap to meet the requirements of the Network and Information Systems (NIS) directive, with activities aligned to priorities identified by the Drinking Water Inspectorate.</p> <p>Disaster recovery plans are in place for corporate and operational technology and are subject to regular review.</p>		The Group seeks to minimise technology and security risk to the lowest possible level without detrimentally impacting on the Group's operations.
Q: Failure to fully realise the strategic value arising from the acquisition of Bristol Water	<p><i>Long-term priorities</i></p> <p>3</p> <p>The acquisition of Bristol Water is expected to be reviewed by the CMA and a response is expected within the normal timescales.</p> <p>Additionally, the inability to effectively integrate the acquired business could result in a failure to maximise the value of this transaction, impacting on shareholder return.</p>	<p>The Group has maintained a highly disciplined approach during the acquisition process which has been subject to extensive review by the Pennon Board. This has included benchmarking the transaction against a range of metrics including earning accretion, value creation from the impact on shareholder returns (both income and growth) and the impact customers and other stakeholders. The Group has a strong track record of integration, as demonstrated through its acquisition of Bournemouth Water in 2015 which has generated significant benefits for customers and shareholder returns.</p>		Opportunities that support the Group's strategic priorities are assessed against an expected level of return adopting clearly defined factors and metrics.

Task Force on Climate-related Financial Disclosures (TCFD)

Pennon has been driven by its strategic focus to become a leader in UK water infrastructure, delivering for the benefit of our customers, communities and the environment.

TCFD recommendations

The Task Force published its recommendations in June 2017 to:

- 1. Provide a framework for climate-related risks and opportunities** within mainstream annual financial filings
- 2. Encourage proper Board and Audit Committee oversight** around the assessment and response to climate-related financial risk and opportunity, and effective disclosure to investors
- 3. Focus on the financial implications** of climate change on business
- 4. Ask organisations to describe the potential impact** that climate change will have on the future prospects of businesses by performing scenario analysis (to include a 2°C or lower scenario)



The TCFD recommendations focus on four key components: **Governance, Strategy, Risk Management and Metrics and Targets** and through this section we are providing an update to the Group's development in these areas.

As a listed group we will be required to full adopt the recommendations by 2022. We are supportive of these developments and committed to reporting our compliance to the recommendations by 2022.

The Group is focused on pursuing operational excellence and growth within the UK Water Industry. This has allowed us to reshape and set a new vision for the Continuing Group, committing to a new deal for our customers, the environment and our employees.

Our services and facilities nonetheless have carbon impacts. These include direct greenhouse gas emissions from our operations and indirect impacts through energy use, transport and those created by our supply chain.

The Group has committed to complying with the TCFD recommendations and looks to develop our reporting during the year to provide full compliance by 2022.

Within our sustainability strategy we have set a clear objective to demonstrate leadership in minimising emissions that contribute to climate change and develop climate change adaptation strategies. The Group has set some challenging targets towards a sustainable future including our Net Zero Carbon by 2030 and eliminating water poverty by 2025 commitments.

As a Group we have reported our GHG emissions since 2013. Our GHG emissions performance is disclosed through our CDP Climate change assessment in which we received a B in 2020.

More information

Directors' report page 130

Risk management

The Group operates a mature Risk Management framework 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 structure to ensure that there is robust review, challenge and assurance over the management of our key risks and opportunities. The identification and assessment of climate change related risks is integrated into this Group-wide process.

The Group completes integrated ongoing business reviews and significant planning in relation to the impact of climate change on new and existing assets, SWW is the main operating subsidiary and has published Waterfuture Our vision 2020 - 2050, which sets out the Company's long-term vision and includes the sustainability and resilience visions.

The document shows that water companies use UK climate projections to help plan investment in water and wastewater. Key findings for South West England (which incorporates both South West Water and Bournemouth Water areas) show that our climate in the 2050s is likely to be very different from today, with rises projected in average summer temperatures in the South West of at least 2.5°C. For all regions the central estimate shows a decrease in summer precipitation and an increase in winter precipitation by the 2050s. A combination of higher summer temperatures and reduced summer rainfall could see significant increases in the summer demand for water and increasing risk of droughts.

The increase in winter precipitation places additional pressure on our combined sewer network resulting in more properties at risk of sewer flooding and an increased frequency of potential storm overflows. An increase in winter rainfall also places our assets at risk of flooding. That is why we will need to adapt to climate change even as we seek to change its future course. We therefore urgently require both mitigation and adaptation related investments.

The Company is currently reviewing its climate adaptation plan which will be published later this year and all SWW planning is now based on the IPCC's Representative Concentration Pathway (RCP) using the RCP8.5 which is approximately aligned to a 4 degree warming scenario by 2100.

SWW submits a business plan to the water industry regulator every five years and at this stage Ofwat will review the plan and set revenue controls; this allows the Company to submit its capital programme for the next regulatory period, and the Company therefore has the potential to adapt as climate scenarios become more defined.

As a Group, sustainability is at the heart of our decision making, and the decisions we make today have the potential to have impacts on the business for generations to come. We have integrated our sustainability strategy into the business, and this is an important step to delivering against our targets as we develop. There is however still work to do and we are exploring appropriate carbon pricing metrics to use within our investment processes.

More information

Operational review pages 50 to 53

Governance

The Group has a strong governance structure in place to oversee the effective operation of our business with overall responsibility for climate change risk and mitigation held by the Pennon Group ESG Committee.

The Group has climate change as a principal risk on the Group's risk register and during the regulatory period planning climate change is assessed to ensure the business remains resilient to changes as it completes its capital programme. To read more, see our principal risks on pages 64 to 73.

The responsibility for sustainability is then cascaded through the business in order to meet our targets and objectives.

The ESG Committee consists of Non-Executive Directors of Pennon Group, the CEO and Group Finance Director whilst also attended by the Sustainability Director.

The Executive Directors' remuneration policy is set to incentivise the achievement of key performance objectives and for 2021/22 the element previously based on personal objectives has been replaced with ESG linked goals including targets relating to our carbon reduction goals, the working environment for our employees and diversity.

More information

ESG Committee report pages 102 and 103

The Board and its governance framework pages 92 to 97

Annual report on remuneration pages 112 to 129

Short, medium and long-term horizons

In determining our strategy, we have processes in place for identifying, assessing and responding to climate-related risks and opportunities. In shaping the strategy, we consider short, medium and long-term horizons.

Short-term – 1 to 10 years

These are designed for annual sustainability targets, budgeting and financial control. The five-year short-term horizon aligns to the water business regulated business plan period. Operational risks will be planned and budgeted for over this time frame though planning begins during this period for the next regulatory period.

Medium term – 10 to 30 years

Water and wastewater treatment assets have a typical life of up to 30 years and will therefore be reviewed during this period. Major projects and operational plans will be renewed and managed over this time frame to ensure projects meet the correct regulatory period plans.

Long-term – 30 to 100 years

Typically for longer-term strategic direction, risk and resilience planning, asset planning and capital investments requirements. These are considered over the long-term horizon for assets such as pipework and reservoirs which will be aligned to longer-term climate impact projections.



IMPACT, LIKELIHOOD AND CRITERIA

A consistent methodology is applied in the assessment of the Group's risks (including climate change related risks), which considers both the likelihood of the risk occurring and the potential impact. Risks are assessed on both a 'gross' (without the consideration of existing control measures) and 'net' (with consideration of existing control measures) basis.

Likelihood





- Probable:** more than 70% likelihood of the risk occurring
- Possible:** 30-70% likelihood of the risk occurring
- Unlikely:** 10-30% likelihood of the risk occurring
- Rare:** less than 10% likelihood of the risk occurring

Impact

-  **Minor:**
e.g. possible intermittent impact on service to customers or damage to assets requiring some repair or maintenance
-  **Moderate:**
e.g. hosepipe ban, flooding of assets
-  **Major:**
e.g. prolonged impact on service to customers in a small region
-  **Severe:**
e.g. prolonged impact on service to customers in a large region

Impact is assessed across a range of categories including financial, safety, environmental, customer and reputational impact.

Criteria

-  **Minor:**
negligible impact on revenue or <1% of profit before tax (PBT)
-  **Moderate:**
flat revenue growth or 1-3% of PBT
-  **Major:**
reduction of revenue up to 3% or 3-5% of PBT
-  **Severe:**
reduction of revenue more than 3% or more than 5% of PBT

The impact and likelihood is then multiplied and plotted on a 4x4 matrix to determine the overall Red, Amber, Green (RAG) rating. Where the net risk is considered to be Red then it is considered to have a substantive financial or strategic impact on the Group.

The RAG rating of the net risk is then used to drive the prioritisation of action.

Task Force on Climate-related Financial Disclosures (TCFD) continued

Strategy

The Group has assessed the risks and opportunities associated with both the transition to a low carbon scenario and the physical risks associated in the various scenarios.

The Group has undertaken qualitative scenario analysis considering the financial implications of the physical climate risk for SWW under two climate scenarios based on the IPCC's Representative Concentration Pathway (RCP) 2.6 and 8.5 as an approximation to a 2 degree and 4 degree warming scenario.

It is expected that even in a low carbon scenario, that there are likely to be increased physical risks such as more extreme weather events and sea level rise from the current position. The Group considers the impacts of physical climate change as a principal risk, noting climate change more broadly is a contributing factor to multiple principal risks. The following risk indicators to target mitigation activities across a number of the Group's principal risks.

RISK TYPE	EXAMPLE OF RISK TYPE	USE WITHIN RISK ASSESSMENTS
Current regulation	The Group operates in a highly regulated environment. The impact of climate change is driving Ofwat, South West Water's regulator, to introduce more challenging regulatory requirements around the resilience arrangements of water companies. In turn, this has influenced our 2020-25 business plan which determines the investment priorities of the business for the current regulatory period. This has resulted in a greater investment in resilience activities focused on those assets where climate change related incidents could have the greatest impact.	Non-compliance with laws and regulations – including climate change related regulation – is a specific organisational level principal risk for the Group and each subsidiary company. As such it is subject to review and challenge at each Group Risk Committee meeting as part of the organisation level risk management process.
Emerging regulation	The Group's Legal team perform a monthly horizon scan of potential new legislation which informs the assessment of climate change related risks. Each subsidiary and Group risk report includes an organisational level 'horizon scanning' section encompassing all relevant emerging risks and reviewed by the Group Risk Committee. Where relevant, any emerging climate-related legislation would be incorporated into this horizon scanning section.	Examples includes the UK meeting its Net Zero greenhouse gas target. This could impact operational costs and potential investment requirement to reduce or offset emissions.
Technology	Technology is primarily assessed at an asset level as this is where climate change has the greatest impact. At an organisational level, the impact of climate change is included within the Group principal risk of 'Significant IT failure', where relevant. This is considered at each Group Risk Committee.	Technology-related mitigation and adaptation strategies are being considered in response to climate change risks, for example opportunities for further renewable energy are being explored.
Legal	Ensuring that our water operations remain compliant with the Water Industry Act at all times, is a key legal risk for the business to manage. This includes the requirement to secure the long-term resilience water supply and wastewater systems, and to ensure that the long-term need for water supplies and wastewater services is met.	Non-compliance with laws and regulations – including climate change related laws – is a specific principal risk for the Group and each subsidiary company. It is therefore considered at an organisational level. As such this principal risk is subject to review and challenge at each Group Risk Committee meeting.
Market	As both a producer and consumer of power across the Group, we need to consider the potential impact of climate change on power prices and alternatives that may be available. The other market developments such as chemicals used within our operations may also be affected, these may impact our revenue and also the assets that we choose to invest in.	Climate change is typically considered as a secondary risk as part of the ongoing assessments of market-based impacts through the organisational level risk management process.
Reputation	Not being seen as a leader in sustainability and climate related action would negatively impact our reputation in the view of our customers, our investors and our regulators.	Reputational impact is considered for each risk as part of the organisational level risk assessment process. It is explicitly listed as an impact criteria category when determining the overall impact of individual risks.
Acute physical	Acute events are actively considered at the asset level of the risk assessment process as part of planned and reactive maintenance planning and capital investment business cases. They are also considered at the organisational level via the Group Risk Committee quarterly reporting on business risk.	Extreme weather events are considered to be an acute physical risk. Further analysis can be found in the table opposite. Such events could result in poor operational performance and therefore may impact the ability to meet the water demands of our customers.
Chronic physical	One example of this is the continued decline in reservoir levels over a period of time. The impact on our customers is continuously monitored by South West Water's Water Resources team. Changes in the acidity of rainfall are also considered on the impact of our assets and the water treatment processes we perform.	Chronic events are actively considered at the asset level of the risk assessment process as part of planned and reactive maintenance planning and capital investment business cases. They are also considered at the organisational level via the Group Risk Committee quarterly reporting on business risk.

The Group considers the physical risks to be the most material to the business and has undertaken further research and analysis in this area.

The financial impacts of the 2 degree scenario show:

- SWW faces material physical climate risks with significant impacts on the business, strategy and financial planning. The most significant financial impacts are considered to be on input and operating costs and capital costs. SWW's financial viability testing has demonstrated the Company's finances and business over a ten-year period remain viable, due to existing and planned risk management and mitigation actions. This is consistent with Ofwat's duty to ensure the five-yearly financial determinations are set at a level to enable the ongoing financability of the water companies.
- SWW's strategy for managing physical climate risks and financial impacts can be summarised as: adapt to climate change, enhance resilience, innovate, become more efficient, and balance investment, in order to maintain and improve the Company's performance to the year 2050. This will require significant action and investment by the Company, as well as action by supply chain partners and wider actors.
- SWW has considered climate scenarios in its strategic planning and remains on track to deliver a strategy that is resilient under the impacts of climate change to 2050, based on its current understanding of physical climate risks. Some areas remain where it will apply further focus to enhance resilience, and this is a focus for SWW in the current and future AMP periods.

In both a 2 degree and 4 degree scenario it is expected that SWW will see several physical climate related changes and the following table sets out some of the potential scenarios and impacts on the business along with some of the actions already taken and future planned mitigations.

PHYSICAL CLIMATE RISKS	KEY IMPACTS IDENTIFIED	EXAMPLES OF ACTIONS TAKEN TO MANAGE CURRENT RISKS	EXAMPLE OF ACTION PLANNED TO MANAGE FUTURE RISKS
Increasing frequency and intensity of droughts	Reduction in security of supply due to lower yields from rivers and boreholes.	Demand management and water efficiency, including PCC reductions to 127 l/h/d.	Water Resources Management Plan including demand management options i.e. increased metering, leakage reduction.
	Increased peak and daily demand from customers (e.g. watering gardens).	Leakage reduction strategy.	Drought planning beyond five years including more extreme events.
	Subsidence and pipe failures (more extreme winter soil wetting and summer drying patterns).	Investigation of regional water transfers.	Stochastic and multi-year drought analysis to test how water supply systems perform in extreme long droughts.
		Potential Abstraction Incentive Mechanism (AIM) schemes.	Collaborative water resource management planning - West Country Water Resources and Water Resources South East.
Increasing average temperatures and heatwaves	Decreased water quality.	Upstream Thinking.	Upstream Thinking expansion.
	Distribution network water storage insufficient for peaks in demand.	Granular activated carbon at WTWs.	Upgrade to granular activated carbon treatment at WTWs.
	More favourable conditions for invasive, non-native species (INNS) – impact on amenity value at reservoirs and impact on treatment works (e.g. zebra mussels blocking pipes).	Robust health and safety practices and management.	
	Increased health and safety risks with managing sludge (i.e. ignition risk and higher incidence of pathogens).		
Increasing frequency of heavy rainfall and floods	Flooding damage to assets, dam failures, service disruptions.	Upstream and Downstream Thinking.	Further sewer separation schemes in areas at risk.
	Drinking water quality impacts (contaminants enter underground storage tanks).	Asset resilience previously at 1 in 200-year level (BW). Asset flood risk assessments undertaken every five years.	Surface water drainage plans and investment in key areas.
	Difficulties disposing/recycling sludge.	Contingency planning in flood risk hotspots e.g. River Otter (SWW).	Upstream Thinking expansion.
	Combined sewer overflows (CSOs) spill more frequently.	New Mayflower WTW in Plymouth increases local flood resilience.	Enhanced operational resilience to 1 in 1,000-year fluvial flood.
	Sewer flooding.	Partnership flood schemes e.g. Countess Wear WwTW (Exeter).	Real-time monitoring and control (e.g. at all CSOs).

Task Force on Climate-related Financial Disclosures (TCFD) continued

PHYSICAL CLIMATE RISKS	KEY IMPACTS IDENTIFIED	EXAMPLES OF ACTIONS TAKEN TO MANAGE CURRENT RISKS	EXAMPLE OF ACTION PLANNED TO MANAGE FUTURE RISKS
Increasing frequency of heavy rainfall and floods continued	Mobilisation of pollutants and catchment erosion – impact on clean water quality.	Drainage & Wastewater Management Plan (DWMP).	Continue to improve incident management.
		Management of CSO spill risks/bathing water compliance – ‘Clean Sweep scheme’.	
		£2.57 million in PR19 to improve flood defences at four WTWs up to 1 in 1,000 year events.	
		Sites have temporary deployable flood protection.	
Increasing frequency of storms / extreme weather events	Service disruptions (including from power and telemetry failures).	Cold weather plan.	Real-time monitoring and control.
	Drinking water quality impacts (contaminants enter network during service disruptions).	Investment in centralised control room and alternative water supply teams.	Extend recovery plans at more WwTWs.
	Drinking water security of supply (e.g. as in ‘Beast from the East’).	Duplication of strategic water mains network.	In general, cold snaps are expected to decline with warmer conditions (but they can’t be ruled out).
		Backup power at plants to manage risks of energy supply interruption.	
Rising sea levels	Coastal flooding and erosion damages assets.	Improved flood resilience of all assets in the coastal floodplain.	Moving to 1 in 1,000 year levels of flood resilience.
	Saline intrusion deteriorates assets and reduces wastewater treatment works performance.	Protection of sites from saline intrusion/incursion (Otter Basin).	Protection of sites from saline intrusion/incursion.
	Saline intrusion contaminates boreholes and direct intakes in the Otter Valley and boreholes in the Isles of Scilly.	Partnership flood schemes e.g. Countess Wear WwTW (Exeter).	
	Coastal boreholes at risk of coastal erosion on Isles of Scilly.	Asset flood risk assessments undertaken every five years.	
Indirect impacts	Relocation of populations (i.e. moving away from floodplains) and change in tourism (i.e. increased seasonal demand arising from increased temperature), impacting supply-demand balance.	Water efficiency programme includes targeting tourists.	Regional water resources planning incorporates industry stakeholders.
	Changes in agriculture affect supply demand balance for water.	Planning for supply chain resilience for critical chemicals (e.g. access to sites during storms or icy conditions).	
	Supply chain disruptions for critical chemicals for water and wastewater treatment.		



It is expected that the physical risks will have a financial impact on the business however we are engaged with our stakeholders and plan to manage this through the regulatory cycles. We work with our customer base and stakeholders to ensure each regulatory period addresses the requirements of our customers, regulators and the business to create a sustainable and resilient asset base for generations to come whilst providing the level of service our customers expect.

Our analysis focused on key areas where financial impacts would affect the business. These were revenue, operating costs, capital costs, value of assets and cost of capital.

The impacts on revenue are likely to be limited as we encourage our customers to use less water and we continue to be more efficient offset by higher revenues through the regulatory model reflecting higher associated investment requirements. The Group will look to adapt through the regulatory cycles and there will be a number of factors affecting revenue as we progress through to 2050. The Group may also look to develop its non-regulated revenue maybe through climate related opportunities such as renewable energy and water transfer.

Operating costs are likely to increase and working with our customers during the price reviews will manage the impact on the business. The Company's adaptation plans for climate change, enhancing resilience and becoming more efficient through reducing demand and leakage should help to mitigate the costs associated with climate change.

SWW has an ongoing capital programme and planning for the next regulatory period will include a more resilient approach to climate change whether this is preparing for a 4 degree scenario or developing assets to be resilient in a 1 in 1000 year event; this will be supported with the use of new technology using innovation to develop the Group's asset planning to be more efficient and adaptable.

Following qualitative analysis SWW expects the overall value of our assets to be largely unaffected under, albeit this is the net sum of moving parts, both a 2 and 4 degree scenario. Due to ongoing actions to mitigate the impacts of climate change, further quantitative analysis will be conducted during 2022.

The cost of capital is not expected to be adversely impacted by the scenarios, the use of our Sustainable Financing Framework to access suitable funding should benefit the Company and the Group's treasury policy allows the Group to manage its associated financial risks.

Planned next steps

We have further activity planned over the coming year to further enhance our alignment with the TCFD recommendations. This includes:

- Further scenario analysis of both physical and transition climate risks and opportunities.
- Review major strategic plans to ensure they are resilient to the identified climate risks and opportunities.
- Further analysis of the financial impacts of climate change.
- Further development of appropriate metrics and targets to measure future performance and incorporate into Sustainable Finance Framework as appropriate.
- The Group will continue its work towards 100% renewable energy from 2022 increasing the production of renewable and sustainable energy.

We will continue to report progress at Board Committee and seek external scrutiny of our application of the TCFD recommendations to ensure our strategy is robust and aligned to our business purpose.

Outlook

Following the initial analysis, the Group expects whilst there will be additional costs to meeting climate change adaptation, the Group's business model together with its sustainable funding strategy provide a solid platform for the Group to meet these challenges.

Metrics and targets

During the next 12 months the Group will further enhance its disclosures including comprehensively reviewing the Group's strategy and action plans to develop our methods and practices for assessing the risks and opportunities and undertake costing impacts where appropriate.


Our Net Zero Carbon target by 2030

Net Zero

BY 2030

The Group has committed to Net Zero Carbon by 2030 and will update on its implementation progress against its targets during the year.

More information

 **Net Zero strategy** page 30

GHG Emissions

Our scope 1, 2 and 3 emissions can be found on page 131.

ESG targets

Our ESG targets can be found on pages 28 and 29 which will support our TCFD disclosures including reducing water use within our operations by 6 Megalitres/day and increasing renewable energy by 4% during 2021/22.

We will positively engage and collaborate with our customers and communities to support their own climate change response

As part of the industry's big research question: "How do we remove more carbon than we emit by 2050?", we are working with UK Water Industry Research (UKWIR) to better understand emissions related to customer behaviour. This includes related water saving opportunities and messages. We continue to support regional climate change and Net Zero Carbon plans including the Devon Carbon Plan.

South West Water to publish its Climate Change Adaptation Plan by 2021

Following the UK Government (Defra) infrastructure climate risk framework, an extensive review of climate change risks has been undertaken during 2020/21 to review and update the key physical climate change risks to our water business. This is being used to inform our updated Climate Change Adaptation Plan to be published later in 2021.

Viability statement

Period of assessment

The Board regularly considers the appropriate period for the viability assessment to be performed in line with the UK Corporate Governance Code. The Board considers the appropriate period to assess the Group's viability remains unchanged at five years, which recognises both the longer-term visibility in the regulatory environment of the South West Water business and the corporate activity, including acquisitions, undertaken by Pennon.

Assessment of viability

The assessment has been made with reference to the Group's current position and prospects, including consideration of the ongoing impacts of the COVID-19 pandemic, its longer-term strategy (including the planned use of the residual proceeds from the Viridor disposal after the retirement of debt), the Board's risk appetite and the Group's principal risks and how these are managed, as detailed on pages 64 to 73 of the risk report. The Group's principal continuing operating subsidiary is South West Water, a long-term business characterised by multi-year investment programmes, with associated revenue streams.

The Group's strategic business plan, including consideration of the ongoing COVID-19 pandemic, principal risks and Ofwat viability scenarios considered in respect of South West Water (set out in further detail below) are the 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.

MATTERS CONSIDERED BY THE AUDIT COMMITTEE

Retention and development of skills

Working practices response to COVID-19

Cyber security

Non-payment of customer debt

Brexit readiness across the Group

Pollutions management

Climate change adaptation

The Group's business plan has been stress tested. In performing this stress testing the following factors have been considered:

- Ofwat viability scenarios have been modelled and monetised
- Principal risks, which include an ongoing assessment of the COVID-19 pandemic, have been ascribed a value with reference to risk weighting, factoring in the likelihood of occurrence and financial impact
- The proposed use of the proceeds from the Viridor sale have been modelled.

The Ofwat viability scenarios are as follows:

- 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.

Through this testing, it has been determined that none of the individual principal risks or Ofwat viability scenarios would in isolation, or in aggregate, compromise the Group's viability over the five-year period.

In addition, a reverse engineered scenario that could possibly compromise the Group's viability over the five-year assessment period has been modelled. This scenario builds on the factors above and additionally assumes all the Group's principal risks incurring each year with maximum effect and no probability weightings attached.

The Board considered the likelihood of this scenario, on the Group's viability over the five-year viability period and noted the potential mitigating actions which could include reduction in capital and operational spend and dividends, concluding the Group could remain viable.

In making its assessment of the Group's viability, the Directors have taken account of the Group's robust capital solvency position, the proposed use of the Viridor proceeds, the Group's latest assessments of the ongoing impact of the COVID-19 pandemic, 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 regulated 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 pages 98 to 101, the Directors reviewed and discussed the process undertaken by management, and also reviewed the results of the stress testing performed.

Viability assessment conclusion

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.

Forward-looking statements

This Strategic Report, consisting of pages 2 to 81, 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.

Approval of strategic report

Our strategic report on pages 2 to 81 has been reviewed and approved by the Board.



Simon Pugsley
Group General Counsel and
Company Secretary

2 June 2021



An aerial view of Buckfastleigh Sewage Treatment Works

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Governance





Board of Directors

[More information](#) pages 90 to 91



ESG Committee report

[More information](#) pages 102 to 103



Remuneration Committee report

[More information](#) pages 106 to 107

Chair's letter to shareholders



Bringing water to life – supporting the lives of people and the places they love for generations to come.



Trusted



Responsible



Collaborative



Progressive

Dear Shareholder

On behalf of the Board, I am pleased to introduce the corporate governance report for 2021. This continues to be the Board's principal method of reporting to shareholders on our governance policies and on our 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, fulfilment of our purpose, the creation of value for all our stakeholders and the ongoing development of our sustainable business. As Chair of Pennon, one of my overriding responsibilities is to ensure that we continue to operate to the highest standards of corporate governance. The table on pages 88 and 89 will help you to navigate our reporting and evaluate our performance against the Principles of the UK Corporate Governance Code 2018.

One consequence of Pennon's ownership of South West Water, a regulated water and wastewater business, is that to meet the requirements of Ofwat, South West Water Limited maintains a separate board of directors and operates in the manner of a publicly listed company in its own right. Further detail of South West Water's operations and governance can be found in its annual report and accounts and its annual performance report.

Following the completion of the sale of Viridor, modifications were made to ensure our system of governance remains appropriate and continues to support the delivery of our strategy.

Our revised Board and Committee framework allows us to further streamline our decision-making process. The South West Water Board, which shares with Pennon its CEO, Chair and the four Independent 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 the Group as a whole. As is explained on page 88, processes and procedures are in place to safeguard the independence of decision making by the South West Water board.

Role of the Board and its effectiveness

My role as Chair 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 shareholders and other stakeholders.

It is my view that the Board continues to be highly effective with a good understanding of the Group's opportunities as well as the threats facing the business. This view is supported by the results of this year's Board and Committee performance evaluations, which are reported on page 105, as well as the considered approach taken by the Board in evaluating the options for the use of proceeds from the Viridor sale, including the acquisition of Bristol Water and the special dividend to shareholders. We keep under constant review the threats to the future success of the business, the most immediate being the continuing impact of the COVID-19 pandemic. Other risks identified and reviewed are contained in our risk report on pages 64 to 73.

More information

 **The Board and its governance framework** page 90

Purpose and values

Bringing water to life – supporting the lives of people and the places they love for generations to come.

Our reshaping of the Group with a focus on UK Water presented an appropriate point to reconsider our vision and purpose and the Board was keen that this should reflect the wider social contract we have with our customers and the communities we serve. Our new vision, **'Bringing water to life'**, and our purpose, 'supporting the lives of people and the places they love for generations to come', demonstrate the unique role we play in providing a vital service for the public good. These statements, together with our well-embedded core values (trusted, responsible, collaborative and progressive), guide the Board in all of its activities and decision making.

Monitoring the Group's culture

Organisations that embody a clear sense of vision and purpose deliver good results, and the most successful workplace cultures are built on trust. The Board relies on employee engagement as a way of monitoring the organisation's culture, most notably our Trust Index score. This is explained on page 35.

Stakeholder engagement

The Board understands the part the Group can play in 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 services for the benefit of all of our stakeholders.

Our section 172 statement describes in more detail how the Board regards the interests of all our stakeholders when carrying out its duties. The statement, which can be found on pages 38 and 39, should be read alongside pages 34 to 37 and the summary on page 87, of how stakeholder interests were taken into consideration by the Board in decision making during the year.

We engage and consult with employees regularly through the SWW employee engagement forum as well as the weekly Big Chat. Such forums provide employees with important and up to date information about key events and give them an opportunity to provide feedback.

We also actively engage with all our stakeholders, including our customers, our communities, our people and our suppliers, as well as with our investors. We are acutely aware that our stakeholders are struggling with the challenges posed by an uncertain future. We commit to maintaining appropriate and regular dialogue to ensure that our strategy and our performance objectives reflect their expectations. Our continuous engagement allows stakeholders to provide feedback on the matters they consider to be important and any issues which they would like to be addressed.

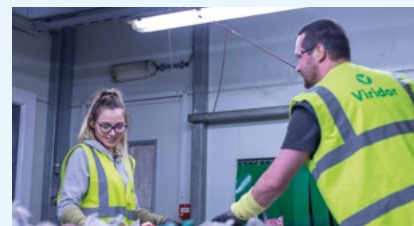
GOVERNANCE IN ACTION



Board virtual health and safety site tour

The Board was disappointed to be prevented from carrying out site visits during 2020/21 due to COVID-19. However, the Directors embraced the opportunities provided by technology and made a virtual visit to a major wastewater treatment site where the team demonstrated our health and safety approaches to the Board.

GOVERNANCE IN ACTION



Sale of Viridor

- The disposal of Viridor arose as part of the strategic review of the business that was being overseen by the Board.
- A working group was appointed by the Board to explore and then manage the sale process with reference back to the Board at all key stages of the sale process.
- The Disclosure Committee maintained constant oversight of the Viridor sale process given the potential for inside information developing and to ensure compliance with the Company's disclosure obligations.
- The Board received training by the Company's advisers on directors' duties for Class 1 transactions, including the issuance of a Class 1 circular and the holding of an extraordinary general meeting.
- Changes to the Board followed the Viridor sale and the Company's new focus on UK Water, with continuity being provided by the appointment of Gill Rider as Chair given her tenure as the Company's longest serving Board member.

Chair's letter to shareholders continued

Shareholder engagement calendar

- June 2020**
 - Announcement of Full Year Results 2019/20
 - London & Europe Roadshow
 - North America Roadshow
 - Edinburgh Roadshow
 - Morgan Stanley salesforce briefing
- July 2020**
 - Announcement of the sale of Viridor
 - PCIM⁽¹⁾ Roadshow
 - Pennon Annual General Meeting
- September 2020**
 - Citi – Utilities & Infrastructure conference
 - Analyst breakfast briefing
 - Pennon Trading Statement
- November 2020**
 - Announcement of Half Year Results 2020/21
 - London & Europe Roadshow
 - PCIM roadshow
- December 2020**
 - North America roadshow
- January 2021**
 - Citi European Utilities & Infrastructure conference
- March 2021**
 - Pennon Trading Statement

(1) Private Client Investment Manager.

Shareholder engagement

Our shareholders are one of our key stakeholder groups and we continued to manage a comprehensive engagement programme with them throughout the year despite the difficulties posed by COVID-19.

During this past year, 54% of our shareholder register met over 2020/21 and we attended 13 virtual roadshows, events and conferences in the UK, USA and mainland Europe. We also held 117 meetings and calls with both current and prospective investors. Pennon maintains a stable shareholder register with almost two-thirds of investors based in the UK. The majority of Pennon's issued share capital is held by institutions, with the remainder largely held by private client investment managers.

Our Group Finance Director continues to report to the Board regularly on major shareholders' views about the Group, and the Company's corporate brokers present frequently to the Board on equity market developments and shareholder perceptions. This helps to ensure that the Board is fully briefed on the views and aspirations of shareholders.

The Directors have always enjoyed the Annual General Meeting (AGM) and meeting shareholders in person. We were disappointed that COVID-19 restrictions prevented Pennon from holding a physical meeting last year. Given the continued uncertainty caused by the COVID-19 pandemic, we will be strongly encouraging shareholders to participate remotely in the AGM this year to ensure their safety as well as that of our Board and our employees. We will continue to monitor developments leading up to the AGM but given the changing and often unpredictable nature of this pandemic, at the time of printing we believe it is in everyone's best interests to encourage remote attendance at the AGM as much as possible.

We are very aware that the AGM provides an important forum for shareholders to engage with the Board and raise questions, and we are keen to ensure that such shareholder engagement is maintained. We will therefore provide facilities to allow for full shareholder participation remotely if appropriate. Further details will be made available in the Notice of AGM.

Compliance with the UK Corporate Governance Code 2018 and other requirements

Details of how we have applied the Principles that form the UK Corporate Governance Code 2018 (the UK Code) are provided throughout this annual report and the table on pages 88 to 89 provides some useful signposting. Underpinning our application of the Principles is our compliance with the UK Code's Provisions throughout the year; I am pleased to say that we have no exceptions to report. The UK Code is published on the Financial Reporting Council (FRC) website, www.frc.org.uk

My introduction to this corporate governance report and the following sections have been made in accordance 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 cover the work of our Board and its Committees, our internal control systems and procedures including risk management, our statements relating to share capital and control, our confirmation of the Company as a going concern and our Directors' responsibility statements. Finally, in accordance with reporting requirements, on page 135 the Board is able to confirm to shareholders that the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary to assess the Company's position, performance, business model and strategy.



Gill Rider
Chair
Pennon Group plc

2 June 2021

STAKEHOLDERS



Our customers



Our employees



Our communities



Our environment



Our suppliers



Our investors



Our regulators

The following table sets out some of the most significant decisions taken by the Board during the year and how stakeholder interests were taken into account:

KEY DECISION	STAKEHOLDERS AFFECTED	STRATEGIC FACTORS TAKEN INTO CONSIDERATION	OUTCOME
Sale of Viridor		<ul style="list-style-type: none"> Realisation of significant strategic value for shareholders Positioning for potential future growth opportunities Smooth transition for employees 	Board decision to publish a circular to shareholders seeking shareholder approval of sale
Board changes and governance framework for the Continuing Group		<ul style="list-style-type: none"> Maintaining continuity and effective leadership to facilitate refocus on UK Water Smooth transition following sale of Viridor Ensuring strong adherence to corporate governance and conflicts of interest process 	Pennon and SWW boards strengthened with mutual focus on UK Water
Use of proceeds from Viridor sale		<ul style="list-style-type: none"> Delivery of shareholder value Positioning for potential future growth opportunities Management of pension scheme deficit 	Board approval of use of proceeds in line with Strategic Review
COVID-19 response		<ul style="list-style-type: none"> Health, safety and wellbeing of employees and customers Continued delivery of essential services Helping vulnerable customers Financial security for employees Maintaining a solid funding and liquidity position 	Strong Board support for measures introduced by the management team and maintained throughout the year
Green Recovery		<ul style="list-style-type: none"> Generating new jobs in the South West Investing in the largest environmental programme in 15 years Improving public health Protecting the environment Addressing climate change 	Board approval of Green Recovery Initiative
Pollution Incident Reduction Plan		<ul style="list-style-type: none"> Financial and regulatory impact of pollution incidents Impact of pollution incidents on customers, communities and the environment Reputational matters 	Board approval of Pollution Incident Reduction Plan and monitoring progress of Plan
Net Zero strategy		<ul style="list-style-type: none"> Government commitment to Net Zero by 2050 UK-wide water sector and Water UK commitment to Net Zero by 2030 Positive impact on the environment Regulatory and environmental compliance 	Board approval of strategic plan and roadmap agreed
Upstream Thinking – further investment		<ul style="list-style-type: none"> Positive environmental impact Improving water quality and catchment predictability Regulatory compliance Return of value from further investment Reputational matters 	Board approval of further investment in Upstream Thinking project
WaterShare+		<ul style="list-style-type: none"> Delivery of outperformance value to customers Giving customers a greater say in business Enabling customers to become shareholders in the business Delivery of commitment in PR19 business plan 	Board approval of WaterShare+ Scheme
Dividend policy		<ul style="list-style-type: none"> Delivery of shareholder value 	Board approval of Dividend Policy and payment of dividend
New Group borrowings		<ul style="list-style-type: none"> Maintaining a sustainable and solid funding and liquidity position Delivery of shareholder value Continued delivery of high standards of service to customers 	Entry into new funding facilities
Tax Strategy		<ul style="list-style-type: none"> Maintaining Fair Tax Mark status Group's corporate and social responsibilities in relation to its tax affairs Legal and regulatory compliance 	Board approval of annually published Tax Strategy
Modern Slavery Statement		<ul style="list-style-type: none"> Health, safety and wellbeing of our employees and the workers in our supply chain Reputational matters Legal compliance 	Board approval of Modern Slavery Statement published on website

Chair's letter to shareholders continued

How we have performed against the Principles of the UK Code

Information about how we follow the Code's Principles can be found in the following sections of the annual report.

	UK CODE PRINCIPLES	WHERE
Board leadership and company purpose	<ul style="list-style-type: none"> • An effective and entrepreneurial Board • Promoting the long-term sustainable success of the Company • Generating value for shareholders • Contributing to wider society 	<ul style="list-style-type: none"> • Board of Directors (pages 90 to 91) • Business model (page 12 to 13) • ESG strategy and performance (pages 24 to 29)
	<ul style="list-style-type: none"> • Company's purpose, values and strategy are aligned with its culture • Directors act with integrity, lead by example and promote the desired culture 	<ul style="list-style-type: none"> • Business model (page 12 to 13) and throughout the annual report • Our people (pages 42 to 47)
	<ul style="list-style-type: none"> • Resources, internal controls, risk management 	<ul style="list-style-type: none"> • Group Finance Director's report (pages 56 to 63) • Risk report (pages 64 to 73)
	<ul style="list-style-type: none"> • Shareholder and stakeholder engagement 	<ul style="list-style-type: none"> • Our stakeholders (pages 34 to 37) • Our people (pages 42 to 47)
	<ul style="list-style-type: none"> • Workforce policies and practices are consistent with the Company's values and support its long-term sustainable success • Workforce is able to raise any matters of concern 	<ul style="list-style-type: none"> • Business model (pages 12 and 13) • Our people (pages 42 to 47) • The Board and its governance framework (pages 92 to 97)
Division of responsibilities	<p>The role of the Chair is to:</p> <ul style="list-style-type: none"> • Demonstrate objective judgement • Promote a culture of openness and debate • Facilitate constructive Board relations and the effective contribution of all Non-Executive Directors • Ensure the Directors receive timely, accurate and clear information 	<ul style="list-style-type: none"> • The Board and its governance framework (pages 92 to 97) • Nomination Committee report (pages 104 to 105)
	<ul style="list-style-type: none"> • Board composition – balance of Executive/Non-Executive • Clear division of responsibilities between the Chair and CEO 	<ul style="list-style-type: none"> • The Board and its governance framework (pages 92 to 97)
	<ul style="list-style-type: none"> • Non-Executive Director time commitment • Non-Executive Director roles – to provide constructive challenge, strategic guidance, offer specialist advice and hold management to account 	<ul style="list-style-type: none"> • Board of Directors (pages 90 to 91) • The Board and its governance framework (pages 92 to 97)
	<ul style="list-style-type: none"> • The Board, supported by the Company Secretary, has the policies, processes, information, time and resources it needs to function effectively and efficiently 	<ul style="list-style-type: none"> • The Board and its governance framework (pages 92 to 97)
Composition, succession and evaluation	<ul style="list-style-type: none"> • Board appointments are subject to a formal, rigorous and transparent procedure • An effective succession plan is maintained for Board and senior management • Appointments and succession plans are based on merit and objective criteria, and should promote diversity 	<ul style="list-style-type: none"> • Nomination Committee report (pages 104 to 105)
	<ul style="list-style-type: none"> • The Board and Committees have a combination of skills, experience and knowledge • Consideration is given to the length of service of the Board as a whole and membership regularly refreshed 	<ul style="list-style-type: none"> • Board of Directors (pages 90 to 91) • The Board and its governance framework (pages 92 to 97)
	<ul style="list-style-type: none"> • Annual evaluation of the Board considers its composition, diversity and how effectively members work together to achieve objectives • Individual evaluation demonstrates that each Director continues to contribute effectively 	<ul style="list-style-type: none"> • Nomination Committee report (pages 104 to 105)

	UK CODE PRINCIPLES	WHERE
Audit, risk and internal control	<ul style="list-style-type: none"> The Board has established policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of the financial and narrative statements 	<ul style="list-style-type: none"> Audit Committee report (pages 98 to 101)
	<ul style="list-style-type: none"> The Board presents a fair, balanced and understandable assessment of the Company's position and prospects 	<ul style="list-style-type: none"> Audit Committee report (pages 98 to 101) Directors' report (pages 130 to 135)
	<ul style="list-style-type: none"> The Board has established procedures to manage risk, oversee the internal control framework and determine the nature and extent of the principal risks the Company is willing to take in order to achieve its long-term strategic objectives 	<ul style="list-style-type: none"> Risk report (pages 64 to 73)
Remuneration	<ul style="list-style-type: none"> Remuneration policies and practices are designed to support strategy and promote long-term sustainable success Executive remuneration is aligned to the Company's purpose and values, and is clearly linked to the successful delivery of the long-term strategy. 	<ul style="list-style-type: none"> Directors' remuneration report (pages 108 to 129)
	<ul style="list-style-type: none"> There is a formal and transparent procedure for developing policy on executive remuneration and determining Director and senior management remuneration No Director is involved in deciding their own remuneration outcome 	<ul style="list-style-type: none"> Directors' remuneration report (pages 108 to 129)
	<p>Directors:</p> <ul style="list-style-type: none"> Exercise independent judgement and discretion when authorising remuneration outcomes Take account of Company and individual performance, and wider circumstances 	<ul style="list-style-type: none"> Directors' remuneration report (pages 108 to 129)

Board of Directors

A refreshed Board



Gill Rider
Chair



CB, PhD, CCIIPD

Appointed

Gill was appointed to the Board on 1 September 2012 and became Chair on 31 July 2020.

Skills and experience

- Gill has a wealth of experience in leadership and governance across a broad range of sectors including professional services, education, not for profit and government.
- Gill was the senior independent director of Charles Taylor plc until its sale in January 2020.
- 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 chair of the council of the University of Southampton.

Other appointments

- Gill is currently a non-executive director of Intertek Group plc where she is also chair of their remuneration committee. In addition to her PLC roles, Gill is also the President of the Marine Biological Association.



Susan Davy
Chief Executive Officer



BSc Hons, ACA

Appointed

Susan was appointed Chief Executive Officer on 31 July 2020. She was appointed to the Board in February 2015 as Chief Financial Officer, having joined the Group as Finance Director of South West Water in 2007.

Skills and experience

- Susan's knowledge of the industry, coupled with her financial and regulatory expertise, has underpinned the development of Pennon's strategy which has included the value creating acquisition of Bournemouth Water in 2015 and the successful Viridor disposal process, both of which she has led. In her 25 years' experience in the utility sector, Susan has also held a number of other senior roles in the water sector, including at Yorkshire Water.
- Under her guidance South West Water is the only water company to have achieved fast-track status for two consecutive business plans – the first in 2014, the second in 2019.
- Susan is highly respected in the City and has been instrumental in building Pennon's reputation.

Other appointments

- She is a Non-Executive Director and Audit Chair of Restore Plc, a member of the CBI President's Committee, deputy Chair of the CBI South West, having served as Chair from 2018–2021, a Water UK Board member, member of the Energy & Utilities Skills Partnership Council and was previously a member of the A4S (Accounting for Sustainability) CFO leadership network.



Paul Boote
Group Finance Director



BSc, FCA

Appointed

Paul was appointed to the Board on 8 July 2020.

Skills and experience

- Paul is a chartered accountant with over 20 years' experience. Prior to joining Pennon ten years ago, he held senior finance roles at companies operating in the sport, construction and environmental infrastructure industries.
- Paul has held a number of senior roles at Pennon, most recently as Pennon's Director of Treasury, Tax and Group Finance. During this time, he was responsible for the development of Pennon's sector-leading sustainable debt portfolio, ensuring the Group maintains a responsible approach to tax, as well as leading on financial reporting matters.
- Over the past year, Paul has been instrumental in the development and successful implementation of the Group's recent strategic review.
- Paul holds a number of directorships with Group subsidiary companies and is a key member of the executive Finance Committee which he now chairs.
- Paul's knowledge of the Group and relationships with key external stakeholders, coupled with his corporate finance and financial reporting experience, provides continuity to the Board as the Group evolves through this strategic review period.

Other appointments

None.



Neil Cooper
Senior Independent
Director (Non-Executive)



BSc Hons, FCMA

Appointed

Neil was appointed to the Board on 1 September 2014 and became Senior Independent Director on 31 July 2020.

Skills and experience

- Neil brings to the Board extensive experience in a wide variety of corporate and financial matters.
- 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 chair 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.

Other appointments

- He is currently the chief financial officer of Currencies Direct, a foreign exchange broker and international payment provider.



Iain Evans ●▲●●●
Independent Director
(Non-Executive)

CBE, BSc Hons, FCA, MBA

Appointed

Iain was appointed to the Board on 1 September 2018.

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 years as chair.
- As chair of the ESG Committee, Iain is leading Pennon's development of a sustainability programme that underpins the delivery of Pennon's strategy.

Other appointments

- Iain is a non-executive director of Bologna Topco Limited and continues to act as an independent corporate strategy consultant.



Claire Ighodaro ●●●●▲
Independent Director
(Non-Executive)

CBE, BSc Hons, FCMA, DUUniv (Hon)

Appointed

Claire was appointed to the Board on 1 September 2019.

Skills and experience

- Claire has held a number of senior roles and directorships of UK and international organisations and has extensive board experience, serving on audit, remuneration and governance committees.
- In May 2019, she stepped down from Bank of America's Merrill Lynch International Board as chair of the governance committee 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. She 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.
- As chair of the Remuneration Committee, Claire continues to steer Pennon's approach on executive remuneration, ensuring that it is aligned with and supports the Group's strategy.

Other appointments

- Claire is non-executive Chair of the Board and the Governance Committee for Axa XL - UK entities and non-executive director of Flood Re, where she is also Audit Committee Chair and a member of the Remuneration Committee.



Jon Butterworth ●●●▲●●
Independent Director
(Non-Executive)

MBE, MSc, Flod

Appointed

Jon was appointed to the Board on 8 July 2020.

Skills and experience

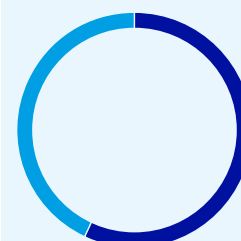
- Jon is the independent scrutineer of health and safety processes across the Group to help ensure that these are robust and effective. He chairs the Health and Safety Committee.
- Jon has a distinguished track record within the utility industry, having started his career over 40 years ago in British Gas as an apprentice technician.
- Jon was Managing Director of North West Gas and subsequently the National Operations Director in National Grid, before taking on the role of Global Director of Safety, Sustainability & Resilience.
- Jon's utility background provides him with an immense depth of knowledge and experience of the importance of maintaining a balance between profit and safety and constructively challenges the Board and management to constantly raise the bar in this area.

Other appointments

- Jon is currently the Chief Executive Officer of National Grid Ventures (NGV) and a member of the National Grid Plc executive committee.
- Jon is a Fellow of the Institute of Directors and is also chair of North Sea Link, NEMO Link, BritNed Netherlands, Interconnectors Holding Ltd, National Grid Metering, Ex-Chair of CORGI Board, Ex-Ambassador of the HM Young Offenders Programme and a trustee of the National Gas Museums Trust.

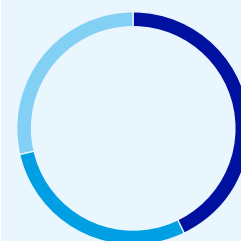
Our Board

BOARD COMPOSITION



● Male (4)
● Female (3)

TENURE



● 0-2 years (3)
● 3-5 years (2)
● 5+ years (2)

More information

📖 **The Board and its governance framework page 93**

COMMITTEE MEMBERSHIP KEY

- Pennon Executive
- Audit Committee
- ESG Committee
- Health and Safety Committee
- Nomination Committee
- Remuneration Committee
- △ Chair of Committee
- Member of Committee

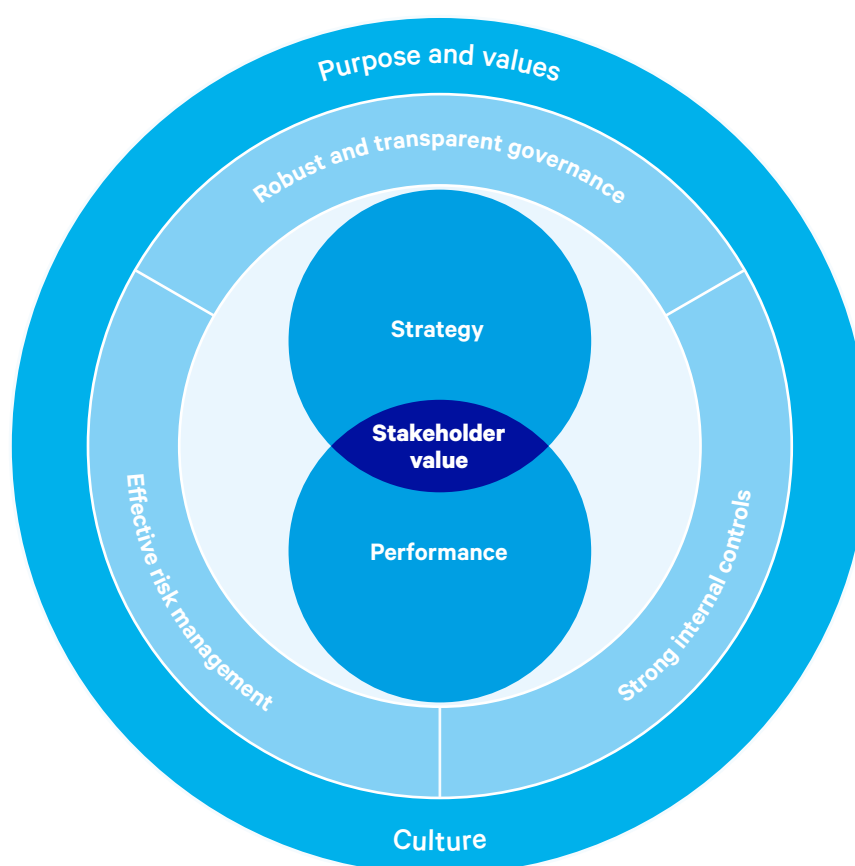
The Board and its governance framework

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.

More information

 **Business model** on pages 12 and 13



GOVERNANCE FRAMEWORK

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 wastewater 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.

Purpose and values

Our purpose – bringing water to life, supporting people and the places they love for generations to come – and its supporting values of trusted, collaborative, responsible and progressive, will help drive our strategic priorities over the long term.

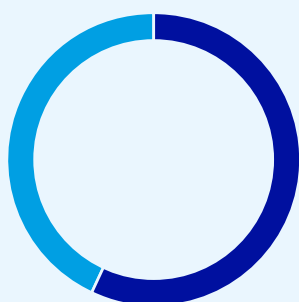
Culture

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.

Pennon Board composition, independence and experience

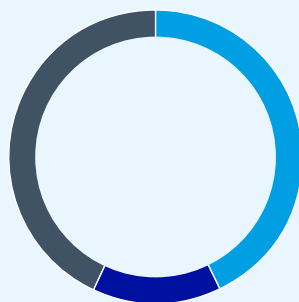
The Board continued to maintain its target of 33% female representation throughout the year; at year end it was 42.9%.

GENDER DIVERSITY



Male: 57.1% (2020: 57.1% and 2019: 66.6%)
Female: 42.9% (2020: 42.9% and 2019: 33.3%)

TENURE



0-3 years: 43% (2020: 28.6% and 2019: 16.7%)
4-6 years: 14% (2020: 42.9% and 2019: 50%)
7-10+ years: 43% (2020: 28.6% and 2019: 33.3%)

All of the Non-Executive Directors are considered by the Board to be independent. None of the relationships or circumstances set out in the UK Corporate Governance Code (the UK Code) applied to the Non-Executive Directors listed on the following page.

Given the longer service of Gill Rider and Neil Cooper, a particularly rigorous review was undertaken in respect of their respective re-elections. The Board remains satisfied that, based on their participation at meetings and their contribution outside of the boardroom, both Gill Rider and Neil Cooper continue to demonstrate independence of character and judgement in the performance of their role.

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 90 to 91 demonstrate collectively a broad range of business, financial and other relevant experience.

GILL RIDER – CHAIR

Gill was first appointed to Pennon's Board on 1 September 2012 and was appointed Chair in July 2020. Her tenure as a Non-Executive Director of Pennon will accordingly exceed nine years during the current financial year and therefore will be a consideration for the 2022 AGM. The Senior Independent Director therefore led an independent review in relation to the extension of Gill's term as Chair. Following a thorough review and after consulting with shareholders, the Board is satisfied that an extension of no more than three years from July 2021 is appropriate.

As the Company is currently undergoing a continued period of strategic business review and adjustment which included last year's sale of Viridor, a very significant transaction for the Group, the Board believes that continuity of leadership and strategic direction at this time is especially important to the successful conclusion of these processes.

The Board is also keen to ensure that the current work being undertaken to embed new Group governance and control structures following the sale of Viridor continues to be carried out under Gill's stewardship, noting her close involvement in the strategic review process.

In addition, the Board considered that the extension of Gill's term as Chair both facilitates effective succession planning as well as the development and continuation of a diverse Board. For these reasons, and mindful of the requirements of the UK Code, the Board believes it to be in the best interests of the Company and its shareholders, for Gill to remain as Chair.

Neil Cooper

Neil Cooper has served in excess of six years and the Board agreed that his term be extended for a further three years, subject to annual re-election at each AGM.

Susan Davy

Susan Davy continued as a non-executive director of Restore plc throughout 2020/21. The Board is of the opinion that the experience gained from external appointments provides additional and different business experience and a fresh insight into the role of an Executive Director.

The Board and its governance framework continued

Directors' roles

Neil Cooper is chair of the Audit Committee and in accordance with the UK Code and FCA Disclosure Guidance and Transparency Rule 7.1.1 he has recent and relevant financial and accounting experience (as set out in his biography on page 90). The Board is satisfied that the Audit Committee as a whole has competence relevant to the sector in which the Group operates.

There is a clear separation of responsibilities between the Chair and the Chief Executive Officer, divided between managing the Board and the business, while maintaining a close working relationship.

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

DIRECTORS' ROLES AND ACCOUNTABILITY

Chair

Gill Rider

- 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

Susan Davy

- 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 Chair 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.

Group Finance Director

Paul Boote

- 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
- Leading the Pennon strategic review, including the proposed use of proceeds from the sale of Viridor
- Managing specific business responsibilities
- Managing investor relations including financing and treasury activities.

Senior Independent Director

Neil Cooper

- Assisting the Chair with shareholder communications and being available as an additional point of contact for shareholders
- Acting as a sounding board for the Chair
- Being available to other Non-Executive Directors if they have any concerns that are not satisfactorily resolved by the Chair
- Responsible for ensuring an annual performance evaluation of the Chair, with the support of the other Non-Executive Directors.

Non-Executive Directors

Iain Evans
Claire Ighodaro
Jon Butterworth

- 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.

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 (SWW Board) continues to operate as a separate independent board in accordance with Ofwat's principles on board leadership, transparency and governance. Although all but one of the SWW Board members serve on the Pennon Board, the refocus of the Group on UK Water means that the interests of the non-regulated and regulated businesses are more closely aligned and provide for more effective leadership and governance. Because the two Boards are run concurrently, the Directors are well-positioned to assess matters holistically and provide continuity to the Group as it shifts to a water-only enterprise. Despite this concurrency the Group's rigorous conflicts of interest process safeguards the SWW Board's ability to set and have accountability for all aspects of the regulated business' strategy thereby strengthening South West Water's regulatory ringfence.

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
- Pennon's dividend policy
- 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 SWW 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 remains compatible with Ofwat's principles on board leadership, transparency and governance because such decisions are ultimately reviewed by the SWW Board. Approval of South West Water's dividend policy and the declaration of dividends to be paid by South West Water to Pennon also remain reserved to the SWW Board.

Board meetings and attendance

The Directors and their attendance at the six scheduled meetings of the Board during 2020/21 are shown below:

Position	Member	Appointment date	Attendance
Chair	Gill Rider ⁽ⁱ⁾	September 2012	6/6
	Sir John Parker ⁽ⁱⁱ⁾	April 2015	2/2
Non-Executive Directors	Neil Cooper	September 2014	6/6
	Iain Evans	September 2018	6/6
	Claire Ighodaro	September 2019	6/6
	Jon Butterworth ⁽ⁱⁱⁱ⁾	July 2020	5/5
Executive Directors	Susan Davy ^(iv)	February 2015	6/6
	Paul Boote ⁽ⁱⁱⁱ⁾	July 2020	5/5
	Chris Loughlin ⁽ⁱ⁾	August 2006	2/2

(i) Appointed as Chair with effect from 31 July 2020.

(ii) Stepped down from the Board on 31 July 2020.

(iii) Appointed to the Board on 8 July 2020.

(iv) Appointed as CEO with effect from 31 July 2020.

The Group Executive team, comprising executives of Pennon and South West Water, meets 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 to the six scheduled Board meetings, a strategy day is held in September each year, and extra ad hoc Board meetings are arranged as required. Conference calls were held regularly regarding the sale of Viridor as the transaction progressed to completion on 8 July 2020.

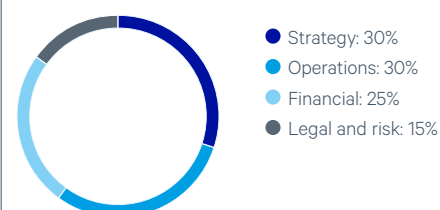
A number of unscheduled Board meetings were convened during the year, allowing the Directors to receive reports and recommendations from the sub-committee charged with overseeing the strategic review process and disposal of Viridor, and presentations from the Company's advisers. More information on the governance arrangements for the Viridor sale can be found on page 85.

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. In light of the COVID-19 restrictions in place during the year, no physical site visits took place; instead the Directors participated in a virtual tour of Brokenbury Wastewater Treatment Works in Torbay in March 2021. Further details are provided on page 85.

Under the guidance of the Chair, all matters placed before the Board are discussed openly. Presentations and advice are received frequently from 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 30% of its time has been taken up in discussions around strategy, 30% in operations of the Group, including that of both main operating subsidiaries, 25% on financial aspects of the Group and 15% on legal and risk matters. In compliance with COVID-19 restrictions, Board and Committee meetings were held online throughout the year. Although this approach presented challenges, it enabled the Group's usual high standards of governance to be maintained.

HOW THE BOARD SPENT ITS TIME



Members of the Executive

Susan Davy	Chief Executive Officer
Paul Boote	Group Finance Director
Simon Pugsley	Group General Counsel and Company Secretary
Adele Barker	Group Chief People Officer

The Board and its governance framework continued

Executive management

The role of the Executive is to define and drive the business priorities that will achieve delivery of the Group's 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 Executive meets regularly to receive reports from the management committees and to review and refine recommendations to be presented to the Board.

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 information flows effectively between the Directors, the Board and the Committees.

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 employees in order to better understand key processes and systems. Paul Boote and Jon Butterworth both received such a tailored induction programme, following their appointment in July 2020, and Gill Rider received a specific induction covering her duties as Chair of Pennon Group plc, with a separate session dealing with her duties as Chair of South West Water and a refresher on specific ringfenced arrangements.

The training needs of Directors are reviewed as part of the Board's performance evaluation process each year. Training may include attendance at external courses organised by professional advisers and also internal presentations from senior management. During 2020/21, refresher training was provided to the Board on directors' duties and listing rule obligations (including the Market Abuse Regulation, Class 1 transactions and related party transactions) and the Audit Committee received a technical briefing from the external auditor, which included an update on IFRS changes and an update on financial reporting.

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 98 to 107 of this governance report.

The terms of reference of each of the Board's Committees are set out on the Company's website <http://www.pennon-group.co.uk/about-us/board-committees> 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 and updated during the year to ensure that they remain 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.

Each Director has a duty under the Companies Act 2006 to avoid a situation in which they have or may have a direct or indirect interest that conflicts or might conflict with the interests of the Company. This duty is in addition to the existing duty owed to the Company to disclose to the Board any interest in a transaction or arrangement under consideration by the Company.

A register of Directors' conflicts is maintained and reviewed at each Board meeting. Authorised conflicts disclosed on the register currently involve cross-directorships with Pennon Water Services Limited and the trustee board of the Group's defined benefit scheme. No other conflicts of interest arose during the year.

Related parties

The processes outlined above in relation to conflicts of interest, together with the commissioning of frequent share register analysis, enable the Board to monitor the Group's related parties so that any related party transactions may be quickly identified and compliance with the Listing Rules ensured.

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 2020/21 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 Internal Control Guidance, which brings together elements of best practice for risk management and internal control by companies. The Group's internal audit function undertakes specific risk assessments to identify vulnerable risk areas in the Group. The Board's risk framework described on page 64 of 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 and safety, climate change and tax compliance. Details of the key risks affecting the Group are set out in the strategic report on pages 64 to 73.

Key performance indicators are in place to enable the Board to measure the Company's ESG performance on page 26 and a number of these are linked to remuneration incentives on page 108.

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.

More information

 **Risk management** page 64

Code of Conduct and policies

The Group's Code of Conduct was reviewed and refreshed during the year. The Code of Conduct and related policies set out Pennon's commitment to promoting and maintaining the highest ethical standards. Areas covered in the Code of Conduct and related policies 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 strictly prohibits employees from offering or accepting bribes, facilitation payments and kickbacks. The policy requires proper due diligence checks of third party suppliers and contractors doing business with the Group, including a corruption risk assessment to examine the nature of the proposed work or transaction. The policy provides a framework that requires everyone who works with or for the Group to act honestly and with integrity at all times. The policy has been rolled out comprehensively into all parts of the Group, with training provided by the legal compliance team. The Group ensures compliance with the policy by conducting planned and ad hoc checks, providing specific training, and carrying out detailed investigations into allegations of potential wrongdoing (whistleblows) received from employees, customers and suppliers.

In order to mitigate risk, targeted authorisation and oversight processes are applied to the areas that have been identified as being more vulnerable and additional training is provided.

The legal compliance team likewise actively assesses high risk areas based on information gained through their close working relationship with the Group internal audit function. Assessments are undertaken using a number of entry points, including using the output of reviews with the executive teams, during and following face-to-face training, and analysing whistleblowing reports. Foreign trading operations, procurement activities, business development and back-office functions continue to be specifically reviewed for compliance with anti-bribery and anti-corruption requirements. Comprehensive operating procedures are in place to address risks in those areas, with regular reviews taking place to ensure the assessment of risk remains up to date.

The anti-corruption and anti-bribery policy also sets out the employment consequences for its breach and potential legal sanctions under bribery laws. Any breaches or failure to adhere to the Group's strict standards of integrity and honesty will be subject to disciplinary action, up to and including dismissal from the Company. All employees are required to read, understand and comply with the policy and report any circumstances or any suspicions of fraud, bribery, corruption or other irregularities, either to a line manager or by using the Group's confidential whistleblowing service Speak Up. There were no confirmed cases of bribery or corruption or business ethics violations during the year.

SPEAK UP

The Speak Up service encourages employees to raise concerns about suspected wrongdoing or unlawful or unethical conduct, explains how this should be done and ensures that they are able to do so without fear of reprisals. The Group's whistleblowing policy specifically includes and encourages reporting of:

- Bribery or corruption
- Stealing or fraud
- Corrupt or dishonest activity
- Anything else contrary to the law.

The Speak Up service comprises telephone and web-based reporting channels operated for Pennon by independent provider Navex Global. Following receipt of a report, the allegation will be assessed and an investigation started promptly. The investigation process will be undertaken fairly, impartially and thoroughly, and strict confidentiality will be maintained at all stages of the investigation and while any subsequent action is taken.

Allegations of bribery or corruption are reported to the Audit Committee together with investigation outcomes and details of any action taken, which are disclosed to our external auditors. To date there have been no fines, penalties or significant issues reported or found in relation to bribery, corruption or fraud.

In March 2021, the Board approved an updated version of the Group's Code of Conduct and associated policies following an extensive review and refresh. A comprehensive programme of training and internal communications is now underway with targeted messaging and interactive training sessions. This programme addresses the business's key compliance and principal risk areas and has been designed to increase resilience, heighten awareness and promote a culture of doing the right thing.






The Group also has policies in place covering the acceptance of gifts and hospitality, anti-facilitation of tax evasion and conflicts of interest, which requires our people to disclose any situation which may conflict with their responsibilities as Pennon employees. Our Code of Conduct and our policies are available on our website at www.pennon-group.co.uk/about-us/policies.

Audit Committee report

Ensuring sound financial management and robust controls



AUDIT COMMITTEE COMPOSITION AND MEETINGS

Position	Director	Date of appointment to Audit Committee	Attendance
Committee Chair	Neil Cooper	September 2014	 5/5
Committee members	Gill Rider ⁽¹⁾	September 2012	 2/2
	Iain Evans	September 2018	 5/5
	Claire Ighodaro	September 2019	 5/5
	Jon Butterworth ⁽²⁾	July 2020	 2/3

(1) Gill Rider stood down as a member of the Audit Committee upon her appointment as Chair of the Board on 31 July 2020. She has attended all Audit Committee meetings since that date as an invitee.

(2) Appointed to the Committee with effect from 31 July 2020.

PRIORITIES AS COMMITTEE CHAIR

As Audit Committee Chair, it is my responsibility to ensure the Committee supports the Board in fulfilling its responsibilities by monitoring the quality and integrity of Group financial reporting, the adequacy of its risk management and its internal controls processes. The year has been particularly significant for the Group in terms of the successful divestment of its Viridor business as well as in the need for it to respond to the COVID-19 pandemic. This led to these two key areas being a particular area of focus for the Committee through 2021/22 as follows:

COVID-19 pandemic

Through the year, the Committee closely monitored the impact of COVID-19 on the finance and internal audit functions themselves, on the financial control environment and on Group financial results. We considered and noted required changes to control processes as the Group adapted to remote working while continuing to provide the essential services of the provision of safe clean drinking water and reliable wastewater services.

Viridor disposal

A further priority for the Committee arose from the implications of the disposal of Viridor, which required specific consideration in a number of areas, including:

- Recommending the shareholder circular proposing the sale to the Board
- Considering and reviewing disposal accounting and disclosures
- Reviewing and approving consequential changes to financial and accounting policies
- Reviewing and assessing the impact of the sale on the Group's principal risks.

Dear Shareholder

I am pleased to introduce the Audit Committee's report on its activities and key areas of focus during 2020/21.

As in previous years, the principal responsibilities of the Committee continue to be focused on three key areas:

- Ensuring the quality and integrity of the Group's financial reporting; an activity that includes the assessment of the application of accounting policies given underlying standards, probing and 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 encompasses 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 a schedule of business reflecting the annual reporting cycle of the Group, which is designed to allow sufficient time for their consideration while also permitting time to be spent on related key accounting matters. The scheduling of activities has also allowed for ad-hoc work on events as they have arisen. 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 the recruitment and retention of staff, cyber security, our response to the COVID-19 pandemic, the processes around payment of customer debt, our performance in relation to pollution and our response to climate change. More detail on our risk management processes, principal risks and their associated mitigations can be found on pages 64 to 73.

Alongside the risk-orientated activities, we continue to review the output of the Group's financial resilience and health assessments; over a 12-month period through our assessment of the Group's going concern status and over a period of five years to assess the Group's continuing viability. This year, the viability assessment has considered a range of financial projections arising from the complex environment including the ongoing and potential future impacts of the COVID-19 pandemic and the different scenarios relating to the deployment of the Group's current cash resources. While the Group maintains a five-year viability assessment period, being appropriate for an acquisitive group, South West Water has continued to use 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 80.

As part of the half-year and year-end reporting review process, we reviewed, probed and challenged the key financial reporting judgements of management as set out on page 100. 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.

Looking ahead to 2021/22, as we better understand the impact of the COVID-19 pandemic, the Committee will remain vigilant and continue to monitor developments and adapt its approach – where necessary – to best support the Group's stakeholders.



Neil Cooper
Audit Committee Chair

2 June 2021

Audit Committee composition

Jon Butterworth was appointed to the Committee on 8 July 2020, following his appointment to the Board. All other members of the Committee served for the full year, other than Gill Ryder who formally stepped down from the Committee on her accession to the role of Chair. She continues to attend the Committee by invitation.

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

In accordance with the UK Code, the Board is satisfied that Neil Cooper, Iain Evans and Claire Ighodaro have recent and relevant financial experience and also, in accordance with FCA Rule 71.1R 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 90 to 91.

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

Significant matters considered by the Committee

A calendar of business sets in place a framework for ensuring that the Committee 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 overleaf.

SIGNIFICANT MATTERS CONSIDERED BY THE COMMITTEE

Financial reporting	<ul style="list-style-type: none"> 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, as outlined later in this report Reviewing the internal assessment of going concern and longer-term viability on behalf of the Board After a detailed review in accordance with its established process, advised the Board that the presentation of the Annual Report and Accounts is fair, balanced and understandable in accordance with reporting requirements and recommended their approval for publication Internal control processes, systems and levels of compliance Review of internal audit reports on core systems and processes across the Group.
External auditor	<ul style="list-style-type: none"> Considered the 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 the 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 31 March 2020, which did not identify any significant deficiencies Recommended to the Board the reappointment of Ernst & Young LLP (EY) as senior statutory auditor following a thorough review and benchmarking of their operation following the conclusion of the 2019/20 audit Considered the timeframe for the Group's re-tender for its statutory auditor.
Risk management	<ul style="list-style-type: none"> 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 Group risk appetite, noting in particular the sale of Viridor and consequential impact on the risk profile of the Group Reviewed the Group risk register and considered appropriate areas of focus and prioritisation for the audit work programme for the financial year Assessment of information security across the Group in mitigating key IT risks As part of the risk management review, considered the annual report on whistleblowing Carried out deep dives at Committee meetings on principal risk areas.
Governance	<ul style="list-style-type: none"> Considered and approved Group accounting policies used in the preparation of the financial statements Considered and approved updated internal financial policies following the sale of Viridor Confirmed compliance with the UK Code Held regular meetings with the external auditor and the Group director of Risk and Assurance without members of management being present.

Audit Committee report continued

Significant matters considered by the Committee continued

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 2021, its May 2020 shareholder circular and its September 2020 prospectus 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 138 to 145. In addition to the significant matters set out in the table below, the Committee considered presentational disclosure matters including the use of non-underlying performance metrics disclosure and ensuring a fair presentation of statutory and non-statutory performance and financial measures.

During the year, the Committee's areas of focus included:

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 and Pennon Water Services continue to be in respect of revenue recognition relating to income from measured water services. Whilst the Committee relied on South West Water's and Pennon Water Services' evolving processes for assessment of water into supply, it scrutinised their track record of accuracy looking back at actual outturns versus accruals at previous year ends. 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.
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 across the Group against historical standards and as compared to the track records of other companies in the relevant sectors. The Committee was particularly mindful of the ongoing impacts of the COVID-19 pandemic on the assessment of expected credit losses in determining the bad debt provision, noting that the full impacts of the pandemic on the water businesses customer bases are unlikely to be fully seen until the UK Government's economic support packages are withdrawn. 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 and its provisions for expected credit losses was reasonable.
Going concern basis for the preparation of the financial statements and viability statement	A report from the Group Finance Director 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 the application of scenarios to enable the Committee to better understand the potential range of outcomes. At the end of each six-month period the Group Finance Director 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 report for 2020/21 included a scenario for the potential impact of the COVID-19 pandemic. The Committee also reviewed a report from the Group Finance Director on the Group's financial viability over an appropriate period, in connection with the UK Corporate Governance Code requirement for a viability statement to be given by the Board. The Board considers the appropriate period to assess the Group's viability remains unchanged at five years which recognises both the longer-term visibility in the regulatory environment of the South West Water business and the corporate activity, including acquisitions, undertaken by Pennon. Similarly, this report also considered the viability of the Group considering the potential ongoing impacts of the COVID-19 pandemic alongside the potential manifestation of other adverse events modelled from the Group's principal risks and using Ofwat's mandated sensitivities for water companies. South West Water 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 80.
Profit from discontinued operations including fair value of deferred consideration	The Committee considered the appropriateness of the accounting for Viridor's financial performance from 1 April 2020 up to the date of disposal on 8 July 2020 and the profit on disposal arising on completion of the sale on that date. In reviewing the financial performance up to 8 July 2020, we considered the areas of judgement in Viridor's performance notably in respect of revenue recognition on its long-term concession arrangements. In connection with the calculation and disclosure of the profit on disposal, we considered management's assessment of the fair value of the deferred consideration that may be received under the terms of the Share Purchase Agreement based on an assessment of the range of possible outcomes and the probability weightings for each of those outcomes. In arriving at our conclusions, we considered management's ongoing assessment of the range of possible outcomes noting that the fair value initially estimated in the half year results at 30 September 2020 had been revised, as required under IFRS.
Preparation of shareholder circular in relation to the sale of Viridor and prospectus for the WaterShare+ customer share offer	The Group issued a Circular to shareholders in May 2020 in respect of the proposed sale of Viridor and in September 2020 a Prospectus for the offer of shares to its water businesses' customers. In support of the preparation of the Circular and the Prospectus Committee members scrutinised management's near-term working capital projections, the accountants report thereon, prepared by EY in May 2020 and, in respect of the Prospectus, an appropriately updated working capital analysis prepared in September 2020. These projections included a reasonable worst-case scenario that considered the cumulative impact of the Group's principal risks, Ofwat mandated viability sensitivities and a downside assessment of the potential impact of the COVID-19 pandemic. These working capital assessments indicated that the continuing Group had adequate headroom for the period assessed.

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 their independence, whilst recognising 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 2020 Annual General Meeting. Christabel Cowling is the audit partner and has been in that role since 2019.

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 and financial statements and which was shared with, and discussed by, the Committee in advance.

The effectiveness review of the external auditor is considered as part of the Committee's annual performance evaluation, which also examines the relationship and communications between the Committee and the external auditor. Further details of the Committee evaluation are provided on page 105. No issues were raised during that review. The Committee concluded that the auditor was effective during the year and that the relationship and communications were open and constructive.

The Committee considered that it is appropriate that the external auditor be reappointed and has made this recommendation to the Board. The Committee chair has also met privately, via telephone, 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 are fully safeguarded.

The external auditor reported on their independence during the year and again since the year end, confirming to the Committee that, based on their assessment, they were independent of the Group.

Provision of non-audit services

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 chair to approve all non-audit work performed by the statutory auditor. The policy uses the average of the last three years' audit fees disclosed in the accounts and certain non-audit fees that are required to be performed by the auditors are excluded from the assessment. 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 66% of the three-year average audit fee, which is within the Group's 70% non-audit fee limit. Whilst below the limit, the proportion of fees for non-audit services is higher than in previous years, as the Committee considered it was most appropriate to utilise EY's skills and experience in connection with the review of working capital projections required for preparation of the shareholder circular for the sale of Viridor. The Committee was satisfied that this would not impact the auditor's independence and objectivity.

The Group Finance Director 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 167.

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.

Following the establishment in 2019 of a new directorate of Risk and Assurance encompassing Group risk reporting and internal audit, the Group's internal audit function has continued to operate effectively. The 2020/21 Group internal audit plan was approved in May 2020, following a thorough review to ensure that it was appropriate for the Continuing Group post Viridor disposal and was sufficiently flexible to respond to emerging risks, including the impact of COVID-19 and the ongoing strategic review. In developing the plan, account is taken 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 chair.

The Committee's annual internal assessment of the internal audit function was completed in March 2021 and considered conformance with the Code of Ethics, International Standards and Code of Practice published by the Institute of Internal Auditors, as well as the outputs from stakeholder satisfaction surveys and the resources, skills and experience within the team. The Committee concluded that the Group Internal Audit function continues to be effective. The next cyclical external review of the internal audit function will be undertaken in 2021/22.

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 and Accounts is fair, balanced and understandable (FBU) on page 135, the Committee 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 and 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 138 to 145.

In preparing and finalising the 2021 Annual Report and 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 Penon 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 and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position, performance, business model and strategy.

Statement of compliance with CMA order

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 no later than the year ending March 2024. This allows for any potential new audit firm to take up the role no later than 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, while receiving continued challenge from a senior statutory auditor.

Environmental, Social and Governance Committee report

Ensuring responsible business practice



Dear Shareholder

I am pleased to report on the Environmental, Social and Governance (ESG) Committee's activities during the year.

The role of the ESG Committee is to ensure robust scrutiny of key aspects of environmental, social and governance (ESG) performance and to oversee Pennon's performance against its strategic sustainability objectives.

Over the past year we have re-focused our Group ESG strategy, establishing a new capitals framework. This unique approach allows clear links between the ESG targets and the impact and benefits of the established six core capitals; natural, social, human, manufactured, intellectual and financial.

Alongside our re-focused ESG strategy we have updated our 2021/22 targets and associated targets to ensure greater alignment to our emerging capitals strategy and driving ESG assessment improvements. 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.

The Committee's calendar of business now reflects a focus on performance in each of the capitals in turn and we look forward to reviewing progress against the Group's ambition to be the leader across the South West and the Water Industry. In particular, we are developing how our capitals approach will drive decision making.

Finally, in terms of governance we welcome the enhanced disclosure and alignment to the TCFD recommendations and strong performance against Sustainable Financing Framework targets, and progress in our Net Zero strategy.

A strong performance against our identified 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, 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
ESG Committee Chair

2 June 2021

ESG COMMITTEE COMPOSITION AND MEETINGS

Position	Director	Date of appointment to ESG Committee	Attendance
Committee Chair	Iain Evans	September 2018	4/4
Committee members	Chris Loughlin ⁽²⁾	November 2006	1/1
	Gill Rider	September 2012	4/4
	Susan Davy	March 2018	4/4
	Claire Ighodaro	September 2019	4/4
	Jon Butterworth ⁽¹⁾	July 2020	2/3
	Neil Cooper ⁽¹⁾	July 2020	3/3
	Paul Boote ⁽¹⁾	July 2020	3/3

(1) Appointed to the Committee with effect from 31 July 2020.

(2) Stepped down from the Board on 31 July 2020.

ESG Committee composition

Neil Cooper, Jon Butterworth and Paul Boote were appointed to the Committee on 31 July 2020 and Chris Loughlin stepped down on the same date. All other members of the Committee served throughout the year.

Committee remit and activities

During the year, the Committee reviewed its remit and responsibilities and agreed that oversight of health, safety and wellbeing be transferred to a new Health and Safety Committee, with membership comprising all of the Non-Executive Directors and chaired by Jon Butterworth. The Health and Safety Committee provides a 'review and challenge' function to support the Board and the Executive on all matters connected to health and safety including the deployment of the health and safety strategy, resilience and process safety. It also reviews the extent and effectiveness of the Group's reporting of health and safety performance, as well as comparisons to external benchmarks.

At the same time, it was agreed that the name Environmental, Social and Governance Committee would be a better reflection of the nature and breadth of the Committee's responsibilities.

In its new guise, the ESG Committee continues to assess performance against a range of approved targets for the Group, set as part of the business planning process. Progress is reported to the Committee throughout the year.

In addition, the South West Water ESG committee provides assessment and oversight of South West Water's performance against sustainability targets that are core to the successful delivery of its 2020-25 business plan. 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 2021, Pennon achieved or is on track for 10 of the 12 targets, apart from the number of Category 2 pollution incidents and an increase in our lost time injury frequency rate (LTIFR). We continue to target significant improvements in these areas.

The ESG Committee continues to aim 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 Group in the areas of 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 2020/21, the Committee considered a wide range of matters in the course of fulfilling its duties in accordance with its terms of reference:

- The evolution of the Group's previous sustainability strategy to a new ESG strategy, driven by a new approach to capitals
- The continued relevance of the sustainability focus areas, objectives and targets to the Group following the sale of Viridor

- Prior to the establishment of the Health and Safety Committee in November 2020, the Group's health and safety performance and the effectiveness of health and safety policies and procedures, including the continued roll-out of the HomeSafe programme
- Environmental leadership, climate change and carbon management
- The Group's biodiversity programme and performance
- Service quality and customer satisfaction
- The Group's approach to community relations, community benefit and investment
- Sustainable supply chain procurement and practices
- Progress against the sustainability targets for 2020/21 and establishing an updated set of targets for 2021/22 aligned with our refocused ESG strategy
- Sustainability reporting and disclosures for 2020 and the associated verifier's reports and recommendations
- ESG index positions and ratings for 2020
- Approval of the Sustainable Financing Framework Impact Report 2020 and allocation of funds for 2021.

Reporting and assurance

Pennon's sustainability performance and reporting has been assured by DNV, an independent management consultancy specialising in technical assurance in the utility sector. DNV's method of assurance 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. DNV's independent limited assurance report is available at www.pennon-group.co.uk/sustainability.

Certain disclosures within this annual report that relate to the sustainability performance of South West Water and Bournemouth Water have been subject to an independent audit of regulatory data conducted by Jacobs. DNV has reviewed the consolidation of these into total Pennon data, but not their preparation.

Jacobs are engaged by South West Water to independently audit South West Water's technical (non-financial) data published in its Annual Performance Report. This includes all South West Water's regulatory targets, including the suite of environmental performance indicators. Jacobs provide a report on this audit within South West Water's Annual Performance Report.

Benchmarking

Pennon is a constituent within the FTSE4Good Index, Sustainability Index, CDP Climate Change, Dow Jones Sustainability Index and a number of other leading external ESG assessments. FTSE4Good and similar leading indices are designed to facilitate investment in companies that meet globally recognised corporate responsibility standards. These leading indices assess companies on their disclosures relating to stringent environmental, social and governance criteria, and their position 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:

- Chair's letter, pages 10 to 11
- Chief Executive Officer's review, pages 20 to 23
- Business model, pages 12 to 13
- Key performance indicators, pages 16 to 17
- ESG strategy and performance, pages 24 to 31
- Our stakeholders, pages 34 to 37
- Our people, pages 42 to 47
- Our operations, pages 50 to 55

South West Water sustainability report

While this is a fully integrated annual report, South West Water continues to produce its own sustainability reporting. South West Water's company Annual Performance Report and regulatory reporting, to be published in July 2021, will incorporate its sustainability reporting. South West Water's report will be available to view at www.pennon-group.co.uk/sustainability and will also be published on the South West Water website.

HEALTH AND SAFETY COMMITTEE



An introduction from Jon Butterworth

I believe the key to ensuring we keep employees safe and well in the workplace, is through empowering everyone to take responsibility for the health, safety and wellbeing of each other and for themselves. Simply put, it's about culture, leadership and accountability.

Establishing a new Board Committee focused purely on Health and Safety in 2020 is an important step forward in Pennon's journey as part of our HomeSafe strategy towards zero harm. We aim to be a leader of Health and Safety by 2025, and leadership from the top is critical. The Board now has dedicated time to discuss, review performance, offer support, encourage learning and meet leaders and employees from across the business.

Importantly, the Board also reviews deep dives of High Potential Incidents with a particular focus on lessons learned and in getting to the root cause, encouraging a learning mindset. We have also reviewed external benchmarking of our performance against water peers, the results from our Engagement survey and employees' perception of Health and Safety and share good practice.

Nomination Committee report

Promoting diversity and ensuring ongoing leadership effectiveness and stewardship



Dear Shareholder

There has never been a more important time for a responsible business to ensure outstanding leadership and stewardship and to promote diversity.

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

Only the members of the Committee are entitled to attend the Nomination Committee meetings of the Committee. Other regular invitees to Committee meetings during the year included the Group Chief Executive Officer, the Group Chief People Officer and the General Counsel and Company Secretary. Committee members are excluded from participating in Committee discussions where their own positions are under discussion.

Matters considered by the Committee during the year included:

- Overseeing the enactment and implementation of the Board's internal succession plan ensuring an orderly handover and transition of Board and senior executive appointments following the successful sale of Viridor
- Undertaking a review of the Committee structure of the Continuing Group, including Non-Executive Committee membership
- Approving revised terms of reference for the Committee in light of changes to the structure and review of the Group's governance framework
- Approval of a succession plan for Board members, following changes made to the Board
- The annual review and approval of the Group policy on Diversity, Respect and Inclusion and the Group's progress on diversity, including the outcome of the Hampton-Alexander Review, the Group position on gender pay, and achievement of the Parker Review target for ethnic diversity on boards ahead of the 2021 target date
- Consideration and approval of the Board becoming a signatory of the Change the Race Ratio to drive improvements in ethnic diversity
- The key themes emerging from a review of the Group Executive Leadership Review and ongoing development, including a review of the succession plan and flight risk analysis.

The key appointments approved by the Nomination Committee included:

- The appointment of Gill Rider as Chair of the Board and Nomination Committee (previously Senior Independent Director and Chair of the Remuneration Committee) following Sir John Parker's decision to step down at the Annual General Meeting on 31 July 2020
- The appointment of Susan Davy (previously Pennon's Chief Financial Officer) as Group Chief Executive Officer, following the decision by Chris Loughlin to step down from the Board on 31 July 2020
- The appointment of Paul Boote, as Group Finance Director, previously Pennon's Director of Treasury, Tax and Group Finance
- The appointment of Neil Cooper as the Senior Independent Director, in place of Gill Rider following her appointment as Chair

NOMINATION COMMITTEE COMPOSITION AND MEETINGS

Position	Director	Date of appointment to Nomination Committee	Attendance
Committee Chair	Gill Rider ⁽²⁾ Sir John Parker ⁽¹⁾	September 2012 April 2015	 4/4  1/1
Committee members	Neil Cooper Iain Evans Jon Butterworth ⁽³⁾ Claire Ighodaro ⁽³⁾	September 2014 September 2018 August 2020 August 2020	 4/4  4/4  2/3  3/3

(1) Stepped down from the Board on 31 July 2020.

(2) Appointed as Chair on 31 July 2020.

(3) Appointed to the Committee on 31 July 2020.

- Claire Ighodaro's appointment as chair of the Remuneration Committee, in place of Gill Rider following her appointment as Chair
- The appointment of Jon Butterworth, an independent non-executive director of South West Water, to the Pennon Board and as lead Non-Executive Director for Health & Safety matters.

The Committee also considered the extension of the Chair's term led by the Senior Independent Director. Gill was first appointed to the Pennon Board on 1 September 2012 and to Chair of the Board in July 2020. The Committee is strongly of the view that continuity of leadership and strategic direction is important to the ongoing success of the Group for a further period of up to three years. This will ensure the successful continuation of the strategic review, and allow for effect an orderly succession plan.

It is the usual practice of the Committee to appoint an external search consultancy to assist in non-executive appointments to ensure that an extensive and robust search can be made for suitable candidates. Given the strength and depth of experience of the Board, the Committee concluded that the enactment of the internal succession plan, would best serve the interests of the Continuing Group.

No member of the Committee took part in the discussions around their own role.

Further information on the Board leadership biographies, can be found on pages 90 to 91.

Board effectiveness review

The Board undertakes a formal and rigorous review of its performance and that of its Committees and Directors each year. This ensures that they continue to operate effectively and are identifying opportunities for improvement and best practice, as well as helping to inform future agenda items and areas of focus.

Last year's evaluation was externally facilitated with the following actions implemented:

- The finalisation of succession plans in preparation for the expected outcome of the strategic review
- Appointment of a lead Non-Executive Director for Health & Safety matters
- The importance of the Board in championing diversity
- A focus on Directors' training and development, further details of which can be found on page 96.

This year the evaluation was carried out in March 2021 via an online questionnaire created internally by the Group General Counsel and Company Secretary in consultation with the Chair and respective Committee Chairs.

The questionnaire focused on the ongoing effectiveness of the Board during the year in setting the Group's strategy, promoting Pennon's culture and values, ensuring that the Group's obligations to its shareholders and other stakeholders were understood and met, overseeing the use of the Group's resources, managing the risks inherent in the strategy, plans and the operating environment, and ensuring that the Pennon Executive had managed all the activities of the Company well.

The outcomes of the review concluded that the Board, its Committees and individual Directors continue to demonstrate a high degree of effectiveness and collaboration, and that the Board had a good understanding of opportunities for growth and risks facing the business. Areas which received positive feedback included the open and cooperative nature of the relationship between the Executive and Non-Executive Directors, the enhanced focus on health and safety and ESG matters respectively, good information flows and the smooth running of remote meetings in the difficult circumstances caused by the COVID-19 pandemic.

Areas identified as meriting ongoing focus included reorientation of the Group's strategic direction following the sale of Viridor, delivering on our commitments, particularly around public value, social purpose and progressing ESG for the benefit of all stakeholders, succession planning, the Directors' training and development needs, and delivery of diversity policy objectives. All of these matters will be included in the respective forward-looking agendas.

Talent management and succession planning

During 2020/21, a review was carried out of the capability and potential of the members of the revised Group Executive, supported by leadership advisory firm Heidrick and Struggles.

The Committee, supported by the Group Chief People Officer, reviews both the executive and non-executive leadership as part of a regular agenda, including flight risks and mitigation plans. Horizon scanning externally has also become a more frequent activity, to ensure that the Board remains flexible to respond to any changing priorities.

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 whilst promoting diversity of gender, social and ethnic backgrounds. In this context, 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.
- 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.

There has never been a more important time for responsible businesses to promote the widest level of diversity in the boardroom and beyond and the Board takes it leadership of this important topic very seriously. Pennon is only one of a few FTSE businesses in the UK to have both a female Chief Executive and Chair. As at the 31 March 2021, the Board's gender diversity stood at 43%, with Pennon Executive gender diversity at 50% and 40% in ExCo minus 1. This focus on diversity positioned us 23rd in the recent Hampton Alexander report. As advocates of Sir John Parker's review for ethnic board diversity, and in meeting the target ahead of 2021, we were also early signatories of the Change the Race Ratio. Alongside this, we have continued our membership of the 30% Club, and SWW has once again contributed to the industry's Women in Water initiative. The Group's wider workforce diversity is currently 29%. Championing Diversity and Inclusion will remain an important priority of the Nomination Committee.



Gill Rider
Chair

2 June 2021

Remuneration Committee report

Ensuring executive reward supports the Group's long-term sustainable success



Dear Shareholder

The Committee met five 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, considers shareholder views 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 Chair, the Executive Directors and senior executives of the Group
- Approving the design and determining targets for any performance-related pay schemes, and approving the payments made, having applied discretion and consideration of the wider circumstances
- Reviewing the wider workforce remuneration, taking these into account when setting the remuneration policy for Executive Directors.

The Committee's activities during the financial year

The Committee engaged in the following activities during the year:

- Undertook comprehensive engagement activity with shareholders in advance of releasing our updated remuneration policy, achieving shareholder approval at the 2020 AGM
- Monitored external developments in remuneration
- Considered the remuneration arrangements for the outgoing CEO
- Considered the remuneration arrangements in respect of the appointment of the new Chair, Chief Executive Officer and Group Financial Director and senior appointments within the Group Executive
- Considered the approach to separation for the Group following the sale of Viridor and the appropriate treatment of LTIP and annual bonus awards for impacted employees
- Ensured executive remuneration in SWW was aligned to PR19 deliverables
- Completed a review of the structure of the fees for the Non-Executive Directors
- Reviewed drafts of the Directors' annual remuneration report and recommended it to the Board for approval for inclusion in the annual report
- Determined performance targets in respect of the Annual Incentive Bonus Plan for 2021/22, reflecting the change in Group composition

REMUNERATION COMMITTEE COMPOSITION AND MEETINGS

Position	Director	Date of appointment to Remuneration Committee	Attendance
Committee Chair	Claire Ighodaro ⁽¹⁾	July 2020	 3/3
Committee members	Gill Rider ⁽²⁾	September 2012	 5/5
	Neil Cooper	September 2014	 5/5
	Iain Evans	September 2018	 5/5
	Jon Butterworth ⁽³⁾	July 2020	 3/3

(1) Appointed as Chair of the Remuneration Committee on 31 July 2020.

(2) Gill Rider stood down as Chair of the Remuneration Committee upon her appointment as Chair of the Board on 31 July 2020. She has attended all Remuneration Committee meetings since that date as a member of the Remuneration Committee. Prior to the announcement on 8 July 2020 of her appointment as Chair of the Board, Gill Rider was Chair of the Remuneration Committee.

(3) Appointed to the Committee on 31 July 2020.

- Determined bonuses and deferred bonus awards pursuant to the Company's Annual Incentive Bonus Plan in respect of the year 2020/21
- Approved updates to the rules for the long-term incentive plan (LTIP), the Annual Incentive Bonus Plan and the all-employee Sharesave Scheme, to incorporate latest best practice
- Approved the LTIP awards for the year
- Reviewed the Group's gender pay gap report
- Approved the release of the 2017 deferred bonus share awards and the vesting outcome of the 2017 LTIP awards
- Reviewed the Committee's terms of reference and undertook a review of the Committee's performance in the year.

The Committee's focus for 2021/22

- Ensure that targets are stretching, so that they act to retain, motivate and incentivise the executive to deliver the Group's strategic goals and PR19 regulatory commitments (including those relating to public value, social purpose and ESG), live the Group's values creating 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 wider workforce remuneration, taking this into account when setting the remuneration policy for Executive Directors
- Monitoring the updated remuneration policy to ensure that it is delivering as intended, and continues to meet best practice.

I was appointed to the Remuneration Committee in July 2020, following the announcement of Gill Rider's appointment as Board Chair. Jon Butterworth was also appointed to the Remuneration Committee in July 2020. All other Committee members served throughout the year.

In accordance with the Code, all of the Committee members are independent Non-Executive Directors. The Chief Executive Officer also attends meetings when invited except for such part of a meeting when matters concerning her own remuneration are to be discussed.

The Committee is advised by Deloitte, an independent remuneration consultant, to ensure remuneration is determined impartially. Aside from the provision of tax services to the Group, Deloitte has no other connection with the Company or any Director. The Committee is also supported by the Group Chief People Officer and the Group General Counsel and Company Secretary.



Claire Ighodaro
Remuneration Committee Chair

2 June 2021

GOVERNANCE IN ACTION

Remuneration approach for the wider workforce

Consistent with best practice, the Remuneration Committee spends considerable time on matters relating to remuneration arrangements across the wider organisation.

Details of remuneration 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.

To provide greater transparency of remuneration we have introduced additional information. The Remuneration Committee is kept informed of wider workforce remuneration through the Pennon pay dashboard which is reviewed twice a year.

This has evolved during 2020/21 to provide oversight of how the Group Reward framework is being implemented.

Our well-established People Strategy is centred around talented people doing great things for customers and each other, and creating the best place to work. Responsible and trusted businesses today have a duty to make a positive societal contribution – whether that's through promoting social mobility, addressing racial and gender inequality, or in providing secure and meaningful employment where all employees are paid fairly for the work they do.

During 2020 a specific Reward framework was created for the Group to complement the People Strategy with three aims:

- To communicate to stakeholders our approach to rewarding and recognising employees and their contribution
- To ensure that reward decisions support business delivery and promote long-term wealth creation, in line with our People Strategy and values
- To deliver a fair reward package to engage and motivate employees to want to perform at their best.

A critical aspect of the design work was in understanding employees' views of reward, the benefits most valued and what aspects could be improved. Listening sessions and focus groups were held during this process as well as incorporating themes from the engagement survey.

The Reward framework is centred around four key pillars which build into a Total Reward proposition, and more information can be found on page 114.

Directors' remuneration report

2020/21 performance highlights and outcomes

Group performance

- Underlying profit before tax £157.0 million
- 2020/21 dividend per share up 3.0% to 21.74 pence per share from 21.11 pence (re-based 2020)
- Completion of Viridor sale delivering £3.7 billion net cash proceeds
- £1.1 billion debt repayment.
- £100 million investment in Green Recovery.

ANNUAL BONUS 2020/21 OUTTURN (% OF MAXIMUM)

SUSAN DAVY

Chief Executive Officer⁽¹⁾

78.1%

PAUL BOOTE

Group Finance Director⁽²⁾

78.1%

LONG-TERM INCENTIVE PLAN (LTIP) OUTTURN (2018 GRANT) (% OF MAXIMUM)

2018 GRANT

89.9%

2020/21 SINGLE FIGURE OUTCOME (£'000)

SUSAN DAVY

Chief Executive Officer⁽¹⁾

565

1159

PAUL BOOTE

Group Finance Director⁽²⁾

256

399

● Fixed ● Variable

(1) Appointed as CEO on 31 July 2020 – previously CFO. Figure shown is aggregate total for the year in respect of both positions.

(2) Appointed 8 July 2020.

Link between strategy and remuneration

Group KPIs

Link to variable remuneration

LONG-TERM	ANNUAL BONUS	LTIP
Earnings per share (EPS) Link to strategy 1 2 3		✓
Dividend per share Link to strategy 1 2 3		✓
Return on capital employment (RoCE) Link to strategy 2 3		✓
ANNUAL	ANNUAL BONUS	LTIP
Profit before tax (PBT) Link to strategy 1 2 3	✓	
Return on regulated equity (RoRE) Link to strategy 1 2 3	✓	
ODI* net rewards and ERF availability** Link to strategy 1 3	✓	
SUSTAINABLE BUSINESS	ANNUAL BONUS	LTIP
Customer satisfaction with overall service Link to strategy 1 3	✓	
Employee engagement and Health and Safety Link to strategy 1 3	✓	
ESG Link to strategy 1 3	✓	

* Reflected in bonus operational and individual metrics.

** Prior to sale of Viridor

REMINDER OF OUR STRATEGY

1

Leadership in UK water

2

Efficient operations

3

Sustainable growth

Principles used to develop remuneration policy



Link to customers

Pay linked to underlying performance	<ul style="list-style-type: none"> Significant portion of executive remuneration linked to performance of the business
Performance pay – appropriately aligned with customer interests	<ul style="list-style-type: none"> Annual bonus includes customer and operational measures linked to metrics assessed by the water industry regulator, customers, communities and wider stakeholders
Bonus and long-term incentives – substantial link to stretching performance delivery for customers	<ul style="list-style-type: none"> Stretching targets – motivate management to deliver sustainable performance Safeguard mechanisms in place to ensure outcomes reflect underlying performance.

Annual statement from the Chair of the Remuneration Committee

“
During a year of transition, the Group has delivered another year of robust performance, and this is reflected in our executive remuneration.

Dear Shareholder

I am pleased to present the Directors' remuneration report for the year ending 31 March 2021. This is my first report as Chair of the Pennon Remuneration Committee, having succeeded Gill Rider, following her appointment as Chair of the Board. I would like to thank Gill, on behalf of the Committee, for her invaluable contribution and her continued support. We also welcomed to the Committee Jon Butterworth, who was appointed to the Board in July 2020.

This has been a significant year for the Group, which saw the completion of the sale of Viridor net cash proceeds of £3.7 billion which accelerated the realisation of significant value for our shareholders. The Group has increased our focus on UK Water whilst seeking further opportunities to deliver value for our shareholders.

Operationally, we have continued to maintain our focus on, and commitment to supporting the environment, customers and colleagues. Our New Deal for the K7 period is seeing us deliver sector leading returns, driving efficiency through innovation and sustainability whilst delivering more of what matters for our communities, with around 80% of ODIs either on track or ahead of target. Year on year we are able to report on improving water quality, reduced customer supply interruptions and a more resilient service.

We have prioritised environmental leadership with our largest environmental programme in 15 years, and a commitment to reduce pollutions by 80% by 2025 alongside our pledge to become Net Zero by 2030.

During the year we also launched our pioneering WaterShare+ share scheme, a key feature of South West Water's 'New Deal' business plan for 2020-25, marking a new relationship between the Company and its customers. This saw 1 in 16 households become shareholders, with the remainder receiving their share of South West Water's £20 million of outperformance as a reduction in their bill. We have also helped circa 67,000 customers with our affordability toolkit, representing an 11% increase compared to last year.

The Group has continued to support employees during the pandemic without utilising any Government support. We were pleased to announce improvements in benefits arrangements for all employees, which included enhanced income protection terms. Within the continuing Group, we have increased employment levels extending our graduate, apprentice and Kickstart placements, in addition to ongoing recruitment. The Group also undertook a review of Reward which applies to our wider workforce. Further details of our approach are set out in the main body of the report. We were proud to have been named Britain's Most Admired utility and officially a Great Place to Work as we continue to support our colleagues through COVID-19 and ensure Pennon is a diverse and inclusive place to thrive.

Following the sale of Viridor, the Board announced it would be seeking reinvestment opportunities in the UK Water Industry with some of the proceeds from the sale to ensure the Group continued to deliver value for shareholders.

Executive changes

During the year the Committee considered the remuneration of the incoming Chief Executive Officer and the new Group Finance Director. The Committee sought to adopt a measured approach when setting salary levels for both Executive Directors. The salary levels for both have been set at the low-end of FTSE market practice. The salary for the Chief Executive Officer is more than 10% below that of the previous incumbent. Retirement benefits for both Executive Directors were reduced to 10% of salary on appointment, which aligns with the benefit levels available to the wider workforce. In future years, the Committee will keep arrangements for both Directors under review to ensure they suitably reflect their role and experience, as well as any changes to the Group structure which may arise at the conclusion of the strategic review.

Chris Loughlin stepped down from the post of Chief Executive Officer with effect from 31 July 2020. As previously disclosed, his departure terms were determined in line with Pennon's remuneration policy. Details of Chris Loughlin's departure terms are provided on page 122.

Incentive outcomes

Following the sale of Viridor the Board announced it would be seeking reinvestment opportunities in the UK Water Industry with some of the proceeds from the sale to ensure the Group continued to deliver value for shareholders.

In line with the plan rules, certain adjustments were required to the performance criteria for outstanding awards to reflect the sale of Viridor. The principle applied by the Committee was to broadly assess performance up to the point of sale, using the original targets, with adjusted targets applied for the remaining portion of the performance period to reflect the nature of the Continuing Group. The Committee has sought to maintain the stretch of the original objectives, taking into account the differing dynamics of the ongoing water business from the previous Group structure. Further details are set out on pages 117 to 120.

The performance of the Executive Directors has been carefully considered, noting the robust performance despite the pandemic. The progress against financial and operational objectives is reflected in the outcomes against the bonus scorecard and individual objectives. Modest negative discretion was applied when approving the overall bonus outturn for the year.

Overall, the annual bonus outturn awarded in respect of the year is 78.1% for both the Chief Executive Officer and the Group Finance Director. The Committee is satisfied that the bonus outcomes are fully supported by performance in the year. Careful consideration has been given to the wider context in confirming the level of bonus.

Half of the bonus earned is deferred into shares which affirms Executive Directors' commitment to creating a long-term, sustainable business.

Share awards granted under the long-term incentive plan (LTIP) in 2018 will be eligible for vesting in 2021. This award was based on EPS growth (40%), dividend growth and cover (40%) and RoCE (20%), as well as an 'underpin' evaluation, including consideration of safety, ESG factors and financial performance.

Awards are expected to vest at 89.9% of maximum, as shown on page 120. This is reflective of financial and operating performance over the performance period. We have delivered dividends of £519 million to our shareholders over the last three financial years while also making significant investments and the Committee is satisfied that the outcomes are fully warranted based on performance.

Vested shares for Executive Directors will remain subject to an additional two-year holding period.

Policy review

Our current remuneration policy was approved at the 2020 AGM, receiving support of 91.5%. We are not proposing to make any changes in the coming year, and will therefore continue to operate under this policy.

Base salary levels for Executive Directors will be frozen for the coming year, with incentive levels remaining at the levels set out in the remuneration policy.

For 2021/22, annual bonus targets have been refined to incorporate ESG goals and to ensure alignment with the UK Water sector. In light of the ongoing strategic review, the Committee has determined that it would be prudent to delay target setting for 2021 LTIP awards until there is further clarity regarding the future Group structure. We would seek to consult with our major shareholders regarding any material changes in approach from prior years. Once finalised, we intend to publish the targets for these awards on our website.

Further detail on pay arrangements are provided in the main body of the remuneration report. I trust that our shareholders continue to support our approach.



Claire Ighodaro
Remuneration Committee Chair

2 June 2021

Annual report on remuneration

Summary of Directors' remuneration policy and implementation in 2021/22

The current Directors' remuneration policy was approved by shareholders at the Company's AGM held on 31 July 2020. The full policy 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 2021/22.

ELEMENT	OPERATION	IMPLEMENTATION IN 2021/22				
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 were set on appointment in 2020 and no increases were made in 2021/22: <table><tr><td>Chief Executive Officer</td><td>£475,000</td></tr><tr><td>Group Finance Director</td><td>£300,000</td></tr></table>	Chief Executive Officer	£475,000	Group Finance Director	£300,000
Chief Executive Officer	£475,000					
Group Finance Director	£300,000					
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.	Income protection was introduced for all employees during the year, including Executive Directors.				
Pension-related benefits						
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 in line with the contribution available to the wider population.	The Chief Executive Officer and Group Finance Director receive benefits of 10% of salary, which is aligned with the maximum rate available to the wider workforce.				
Annual bonus						
Incentivises the achievement of key performance objectives aligned to the strategy of the Company.	The maximum bonus potential is 125% of 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.	Maximum opportunity of 125% of salary for both Executive Directors. Deferral of 50% of any bonus into shares for three years. For 2021/22, the bonus will be based on a combination of measures: financial metrics (50% weighting), customer and operational metrics (30% weighting) and ESG metrics (20% weighting). Consistent with prior years, a portion of the bonus will be linked to measurable goals that are key to meeting the needs of our customers, our regulator and wider stakeholders. These include measures relating to customer service scores, bathing water failures, leakage and wastewater pollution incidents, interruptions to supply and asset reliability. The element previously based on personal objectives has been removed for 2021/22 and has been replaced with an element linked to specific ESG goals. This will include targets relating to our carbon emissions reduction goals, the working environment for our employees and diversity. The detail of bonus targets are closely aligned to the strategy and are therefore considered to be commercially sensitive. However, we intend to provide further disclosure of targets, on a retrospective basis, in next year's remuneration report.				

ELEMENT	OPERATION	IMPLEMENTATION IN 2021/22														
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.	<p>The maximum annual award is 150% of base salary.</p> <p>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.</p> <p>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.</p> <p>Malus and clawback provisions apply.</p>	<p>Maximum award of 150% of salary for both Executive Directors.</p> <p>The target setting process for the 2021 LTIP grants has been delayed in light of the ongoing strategic review. The Committee is keen to ensure that the targets for the 2021 award reflect the future Group structure and align with the strategic priorities for the three-year period ending 31 March 2024.</p> <p>Once finalised, we intend to publish the performance measures and targets for the 2021 LTIP awards on our website. To the extent that there is a material change in approach, the Committee would seek to engage with major shareholders prior to the finalisation of the targets.</p>														
Discretion																
<p>In line with the 2018 Corporate Governance Code, the Remuneration Committee has ensured that it 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).</p> <p>The Committee will disclose the use of any such discretion.</p>																
Shareholding requirements																
Create alignment between executives and shareholders and promote long-term stewardship.	<p>During the course of their tenure, Executive Directors are expected to build up a shareholding equivalent to 200% of salary.</p> <p>Departing Executive Directors will normally be expected to hold 200% of salary (or actual relevant holding, if lower) on departure, with the guideline reducing to 100% of salary after 12 months. This guideline applies to all share awards vesting after the adoption of this remuneration policy after the 2020 AGM.</p>	Shareholding guidelines will remain unchanged.														
All-employee share plans																
Align the interests of all employees with Company share performance.	<p>Executive Directors may participate in HMRC approved all-employee plans on the same basis as employees.</p> <p>The maximum is as prescribed under the relevant HMRC legislation governing the plans.</p>	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.	<p>Non-Executive Directors normally receive a basic fee and an additional fee for any specific Board responsibility such as chair of a Committee or occupying the role of Senior Independent Director.</p> <p>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 Chair's benefits include the provision of a driver and vehicle, when appropriate for the efficient carrying out of her duties.</p>	<p>The fee policy was reviewed during 2020 as a result of the sale of Viridor. For 2021/22 no change to fees were made, set out below:</p> <table><tr><td>Chair fee</td><td>£225,000</td></tr><tr><td>Basic Non-Executive Director fee</td><td>£60,550</td></tr></table> <p>Additional fees</p> <table><tr><td>Senior Independent Director</td><td>£10,000</td></tr><tr><td>Chair of Audit Committee</td><td>£15,000</td></tr><tr><td>Chair of Remuneration Committee</td><td>£13,000</td></tr><tr><td>Chair of ESG Committee⁽ⁱ⁾</td><td>£13,000</td></tr><tr><td>Chair of Health and Safety Committee⁽ⁱⁱ⁾</td><td>£5,000</td></tr></table> <p><small>(i) The ESG Committee used to be called the Sustainability Committee.</small></p> <p><small>(ii) The Health and Safety Committee was introduced in 2020. This Committee typically holds a minimum of two meetings per annum.</small></p>	Chair fee	£225,000	Basic Non-Executive Director fee	£60,550	Senior Independent Director	£10,000	Chair of Audit Committee	£15,000	Chair of Remuneration Committee	£13,000	Chair of ESG Committee ⁽ⁱ⁾	£13,000	Chair of Health and Safety Committee ⁽ⁱⁱ⁾	£5,000
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Chair of Health and Safety Committee ⁽ⁱⁱ⁾	£5,000															

Annual report on remuneration continued

Remuneration approach for wider employees

Consistent with best practice, the Remuneration Committee spends considerable time on matters relating to remuneration arrangements across the wider workforce. This provides important context when making decisions regarding remuneration for the Executive Directors as well as ensuring that consistent approaches are being adopted across the organisation. To provide greater transparency of remuneration for the wider workforce we have provided expanded disclosure, through the Pennon pay dashboard which is reviewed twice a year. This has evolved during 2020/21 to provide oversight of how the Group Reward framework is being implemented.

Our well-established People Strategy is centred around talented people doing great things for customers and each other, and creating the best place to work. Responsible and trusted businesses today have a duty to make a positive societal contribution – whether that's through promoting social mobility, addressing racial and gender inequality, or in providing secure and meaningful employment where all employees are paid fairly for the work they do.

During 2020 a specific Reward framework was created for the Group to complement the People Strategy with three aims:

- To communicate to stakeholders our approach to rewarding and recognising employees and their contribution
- To ensure that reward decisions support business delivery and promote long-term wealth creation, in line with our People Strategy and values
- To deliver a fair reward package to engage and motivate employees to want to perform at their best.

A critical aspect of the design work was in understanding employees' views of reward, the benefits most valued and what aspects could be improved. Listening sessions and focus groups were held during this process as well as incorporating themes from the engagement survey.

The Reward framework is centred around four key pillars which build into a Total Reward proposition, ensuring a mix for employees at every stage of their career lifecycle.

The framework was reviewed and endorsed by the Pennon People Committee and Remuneration Committee and the success of the strategy measured through the engagement survey and employees' feedback. This is regularly reviewed and shared with the Remuneration Committee.

As part of creating the strategy, a new online cloud-based Reward Hub, enabling employees to access their reward and benefit options virtually, has been implemented. The Hub also provides the functionality of Total Reward statements, paving the way for the Group to move towards an even more flexible benefits approach. The Reward Hub is an invaluable tool for directly communicating reward elements, helping employees understand and maximise their package.

Reward framework

Our Reward framework is centred around four key pillars building into a view of Total Reward with a series of principles as follows:



UNDERPINNED BY THE PENNON VALUES



Trusted



Responsible



Collaborative



Progressive

Supported by: Strategy & Governance, Job Evaluation & Benchmarking, Systems & Data

PILLAR	PROGRESS
 <p>Base pay</p>	<p>Importantly, the Group has formalised its approach to adopting the Living Wage Foundation standards by becoming an accredited employer in April 2021.</p> <p>The Group's overarching principles for basic pay are that it should:</p> <ul style="list-style-type: none"> • Reflect the market and region in which the role operates • Be competitive to support attraction and retention • Be fair, meeting all legislative requirements • Be reviewed annually – we engage with employee forums and trades unions as appropriate. <p>The percentage change in salary for Executive Directors in 2021 was 0% compared with general increases of 1% across the Group.</p>
 <p>Variable pay</p>	<p>The Group operates a number of variable pay schemes and all employees and temporary workers are eligible to participate. Throughout the main bonus schemes, there is strong correlation in the targets, to align the whole organisation on customer, quality and service.</p> <p>All employees across the Pennon Group are entitled to participate in annual bonus arrangements. The maximum bonus levels are based on seniority and level of responsibility.</p> <p>In January 2021, we made an exceptional award of £500 to all employees, to recognise the challenges of the COVID-19 pandemic and our employees' dedication and fortitude in maintaining essential services to customers.</p> <p>Our Company bonus arrangements for employees have a strong focus on customer service. We are revising these for 2021/22 providing colleagues with an increased bonus opportunity of 5% of basic salary.</p>
 <p>Saving for the future</p>	<p>Modernisation of our pension arrangements</p> <p>In 2020 the Group consulted with employees on modernising the pension arrangements. The aim of this consultation was:</p> <ul style="list-style-type: none"> • To create a sustainable pension plan for all employees for the future, balancing the cost to employer and employee • To provide greater flexibility for employees to access their pension savings, following the introduction of pensions freedom • To increase the benefit levels within the Defined Contribution (DC) arrangements and reduce scheme administration charges. <p>The proposed changes included increasing the level of employer contributions, providing greater flexibility for employees to choose the most appropriate employee contribution for them, as well being able to make the most of pension freedoms.</p> <p>The Group managed an extensive consultation programme through Director led, face to face presentations, individual one to ones with pension advisors and dialogue with union representatives and pension trustees. Directors listened closely to the feedback and the new scheme was introduced in July 2020.</p> <p>Importantly these changes have lifted the lowest pension tier to a matching level of twice employee contribution. All tiers have had an increase, with a maximum 10% contribution from Pennon. At the same time, Executive Director pension arrangements were aligned to reflect the wider workforce.</p> <p>As part of our Saving for the future, all employees are able to participate in our HMRC approved Sharesave and Share Incentive Plan, with a strong emphasis on employee buy-in and ownership.</p>
 <p>Benefits</p>	<p>The fourth pillar of our framework covers the benefits available to employees. This year, the Group has carefully considered the value individuals place on financial wellbeing during this difficult year and have implemented the following changes as part of our aspirations to become the Best Place to Work:</p> <ul style="list-style-type: none"> • We have extended our Employee Assistance Programme to immediate family members of our employees during the pandemic, providing independent, confidential support • We increased our life assurance plan so that beneficiaries would receive 6x salary • We launched an additional income protection scheme providing greater financial security during long-term sickness absence, for up to three years in addition to the first six months of contractual sick pay. • We are launching our Simply Recognise online tool to allow managers and employees to provide positive feedback and thanks to their teams and peers.

Annual report on remuneration continued

Remuneration approach for wider employees continued

As noted on the previous page, in accordance with the 2018 UK Corporate Governance Code, the Committee also reviews the level of information provided on pay matters across the wider workforce. The Remuneration Committee is provided with an overview through the Pennon Pay Dashboard.

Pennon pay dashboard	<ul style="list-style-type: none"> • We have established a pay dashboard to help support the Committee in reviewing workforce remuneration and related policies and this has been developed to provide greater insight for 2021 • The dashboard provided an overview of pay arrangements across the business and provides key statistics on pay in different areas of the business and progress on our Reward framework implementation • The dashboard covers information on workforce demographics, employee engagement, 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.
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Gender pay gap

The aggregated gender pay gap for the Group in 2020 stood at 5.7%, a slight increase from 2019 and still significantly below the national average. The legal entities that we are required to report on have seen improvements in their gender pay gaps – with SWW at 4.92% and Source reporting a negative pay gap for the first time at -1.4%. The Group recognises the need to develop greater gender alignment in middle manager and senior positions and is seeing strong progress in this area. Pennon is an active supporter of the Women in Water initiative.

In early 2021, Pennon was recognised in the Bloomberg Gender Equality Index. The index measures gender equality across five key areas. The report showed Pennon Group performed particularly strongly on gender pay (87%) and disclosure (89%). We were also positioned at 24th in the Hampton Alexander report released in February. This was our first listing in the FTSE 100 report.

The results for 2020 also showed a negative gap on mean bonus pay. This reflects the increase in senior female postholders, where higher bonus payments are typical. The full Gender Pay Gap report can be found on the Group website.

Employee engagement

Across Pennon we endorse the principle of strengthening opportunities for employees to engage in two-way dialogue at all levels. The South West Water Employee Engagement Forum has become a well-established forum which meets regularly to create a two-way communication between senior managers of the Group and employees and this year has been chaired by the Group Chief Executive Officer.

Over the course of the year, we have evolved our Big Chat to become Your Big Chat, moving from a conference call to a video facility enabling all employees access to the Group Executive and creating opportunities to ask questions and suggest topics that employees would like to hear more about. The frequency was also increased to weekly to ensure regular and timely updates are provided to employees. We continued to receive positive feedback from employees who welcome the opportunity to hear from the Directors and ask them questions on key business matters.

We have been keen to ensure we are able to measure the progress made in this area and were pleased that we achieved our highest ever participation rate of 84% in our annual engagement survey and have officially passed the threshold to become accredited as a Great Place to Work with our Trust Index® score increasing to 68%. This is significantly higher than the national average of 53%.

We have welcomed the feedback that has been provided through these routes and employees' openness in participating in these activities.

Given there was no salary increase for the Group Chief Executive Officer and the Group Finance Director in April 2021, no employee feedback was sought on this issue.

EMPLOYEE ENGAGEMENT PARTICIPATION

84%

PARTICIPATION RATE

+18%

ON OUR 2019 SURVEY

Improvement in employees who support the view that we have special and unique benefits here

+12%

ON OUR 2019 SURVEY

Improvement in rating of our overall Reward Category

Looking ahead

We plan to develop our employee incentive scheme with increased bonus opportunity retaining our strong alignment to customer service. For 2021/22 we will continue to review and refine our approach to reward, continuing our development of our online Reward Hub with the roll out of Total Reward Statements in the summer and enhancing the Simply Recognise platform functionality.

Single total figure of remuneration table (audited information)

	Susan Davy ^(iv) (£000)		Paul Boote ^(v) (£000)		Chris Loughlin ^(vi) (£000)	
	2020/21	2019/20	2020/21	2019/20	2020/21	2019/20
Base salary	456	412	219	–	182	539
Benefits⁽ⁱ⁾ (including Sharesave)	29	29	12	–	9	37
Pension-related benefits⁽ⁱⁱ⁾	80	117	25	–	55	162
Total fixed pay	565	558	256	–	246	738
Annual bonus (cash and deferred shares)	437	324	208	–	144	420
Long-term incentive plan⁽ⁱⁱⁱ⁾	722	747	191	–	737	977
Total variable pay	1,159	1,071	399	–	881	1,397
Total remuneration	1,724	1,629	655	–	1,127	2,135

(i) Benefits comprise a car allowance, fuel allowance, medical insurance and income protection.

(ii) See page 124 for further information on pensions.

(iii) For 2020/21, the 2018/19 LTIP has been valued based on the average share price during the three-month period to 31 March 2021 of 946.1 pence and a vesting outcome of 89.9%, as referred to on page 120, together with an estimate of the accrued dividends payable on the vesting shares. Of the vested amount, 16.49% relates to share price appreciation over the performance period. The award granted to Paul Boote relates to his previous role, prior to his appointment to the Board, but is included in the table above for transparency. For 2019/20, the 2017/18 LTIP value reflects the share price at the date of vesting of 1,008.5 pence and a vesting outcome of 86.6%. The value includes accrued dividends over the vesting period. The Committee did not exercise any discretion in relation to share price changes. Both LTIP awards are subject to a two-year holding period.

(iv) Susan Davy was appointed as Chief Executive Officer as of 31 July 2020. She had previously been the Chief Financial Officer. Remuneration is the aggregate total in the year in respect of both positions.

(v) Paul Boote was appointed to the Board as Group Finance Director as of 8 July 2020. The pension benefits total includes arrears of £2,950 made in respect of his previous role.

(vi) Chris Loughlin stepped down from the Board as Chief Executive Officer on 31 July 2020. The bonus and LTIP awards for the year have been pro-rated to the date of departure.

Notes to the single figure table

Fixed pay

During 2020/21, Susan Davy was appointed as Chief Executive Officer with effect from 1 August 2020. On appointment Susan's salary was set at £475,000, which is lower than the annual salary for Chris Loughlin (£546,625). Susan previously held the post of Chief Financial Officer. Susan's annual salary as Chief Financial Officer was £417,975.

Paul Boote was also appointed to the Board as Group Finance Director on 8 July 2020, having previously held the role of Director of Group Finance, Tax and Treasury. Paul's annual salary from appointment is £300,000.

Although no salary increase has been awarded in respect of 2021, the Remuneration Committee recognises the market positioning against FTSE peers and intends to keep salary levels for both Executive Directors under review in future years, to ensure that they suitably reflect both development and experience in the role and the evolving size and nature of the Group's operations.

Retirement benefits for both Executive Directors were set at 10% of salary on appointment to their new role. This is aligned to the rate of the wider workforce. Previously, Susan received an overall pension benefit of 25% of salary. Further detail on pension arrangements is set out on page 120.

Annual bonus outturn for 2020/21

For 2020/21, both Executive Directors participated in the annual bonus plan which was based on a combination of financial, operational and personal objectives.

During the year, the Group was pleased to announce the successful sale of Viridor which was completed on 8 July 2020. Due to the timing of this transaction, performance for the first three months of the financial year was based on the previous Group structure (including Viridor), while the performance for the remainder of the year was based on the Continuing Group only. The financial targets for the latter period were simply adjusted to reflect the sale of Viridor.

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. The performance targets set and performance achieved have been set out below. The Committee elected to apply discretion to the outturn of the annual bonus, taking into account the performance of the basket of service measures and greater focus on Water UK. This resulted in an overall reduction to the formulaic outturn of 4.65%.

Annual report on remuneration continued

Notes to the single figure table continued

Annual bonus outturn for 2020/21 continued

Group financial measures – 60% weighting

Measure		Threshold	Target	Maximum	Actual outturn	Bonus outturn (% of max)
Underlying PBT (50% weighting)	Group including Viridor (Q1 only)	£179.9m	£183.6m	£192.7m	£200.3m	100%
	Continuing Group (Q2 to Q4)	£145.4m	£148.4m	£155.8m	£157.0m	
RoRE (10% weighting)	Group including Viridor (Q1 only)	7%	7%	8%	7.8%	90%
	Continuing Group (Q2 to Q4)	7%	7%	8%	7.8%	

Customer and operational measures – 20% weighting

Measures	Target	Actual outturn	Target achieved	Bonus outturn (% of max)	
Water metrics – applicable for full financial year (i.e. 87.5% of element)					
Customer Service Metric (C-MeX)	Median	Below Median	No	44%	
Bathing water quality improvements	0	4	Yes		
Wastewater pollution incidents, per 10,000km sewer	24.51	130.87	No		
Internal Sewer Flooding, per 10,000 connections	1.68	1.34	Yes		
Leakage (3yr rolling average)	120.5 megalitres per day	126.8 megalitres per day	No		
Environment Agency EPA	3 star	2 star	No		
Water Quality Score	2	2.06	No		
Interruptions to supply	6 mins 30 seconds per property	5 mins 38 seconds per property	Yes		
PWS Trust Pilot Score	4.5	4.8	Yes	56%	
Waste metrics – applicable for Q1 only (i.e. 12.5% of element)					
ERF availability ⁽⁶⁾	87%	93%	Yes		
ERF gate fee (£/T)	*	*	Yes		
ERF volume inputs (mT)	0.5	0.5	Yes		
ERF electricity revenue (£m)	*	*	No		
ERF power output (million MWh)	0.33	0.34	Yes		
Landfill volumes traded (mT)	0.32	0.19	No		
Landfill gas power output (million MWh)	97.2	110.9	Yes		
Recyclate revenue (£/T)	*	*	No		
Recycling volumes traded (mT)	0.21	0.19	No		

(i) In light of the sale of Viridor, waste metrics were only relevant for the Q1 period of the performance period. This measure therefore only makes up 12.5% of this element, i.e. half of Q1.

(ii) These measures are weighted by capacity. Due to different technology, joint ventures are included at 100%.

* Target and outturn not disclosed for reasons of commercial confidentiality.

Individual objectives – 20% weighting

Objectives	Achievements	Bonus outturn
CEO and GFD – joint objectives		
Complete the Pennon Strategic Review and ensure the use of proceeds is value enhancing for shareholders.	<ul style="list-style-type: none"> Completed the sale of Viridor realising £3.7 billion net cash proceeds Efficient de-gearing (£1 billion) Maintained a consistent share price Continued evaluation of potential growth opportunities and a disciplined approach to use of proceeds. 	5/6%
Drive HomeSafe improvements towards Pennon becoming the UK's leader in the water industry for H&S. Ensure robust COVID-19 measures in place to protect employees.	<ul style="list-style-type: none"> Adapted working practices and site arrangements to ensure the health and safety of all employees throughout COVID-19, including extending EAP support. Increased mental health awareness and roll out of lateral flow testing. LTIFR rates for the Continuing Group were higher than planned but still on track for 2025 target to achieve Best in Class. 	3.5/4%
Create a Great Place to Work where employees and teams are empowered to deliver for customers, communities and each other. Improve the Group's Trust Index.	<ul style="list-style-type: none"> Achieved accreditation as a Great Place to Work Developing the capabilities of the Executive and wider leadership team Nurturing talent and diversity through our apprenticeship, Kickstart and graduate schemes 	5/6%
Redefine our relationship with customers, the environment and people through the K7 New Deal business plan delivery.	<ul style="list-style-type: none"> Delivered 80% of our commitments in the K7 business plan Developed a Green Recovery Proposal Launch of the pioneering WaterShare+ share scheme 	3/4%

Summary of bonus outcome

When reviewing performance in the year, the Committee noted the strong set of results delivered in a year of significant transition following the sale of Viridor and the appointment of a new management team. The Group also responded to the challenges presented by the COVID-19 pandemic and successfully maintained operations, without utilising the Government's Job Retention Scheme. During the year we also made an exceptional award of £500 to all employees, to recognise the challenges of the pandemic and our colleagues' dedication and fortitude in maintaining essential services to customers.

Notwithstanding these achievements, in light of the ambitious nature of the Group's operational objectives, the Chief Executive proposed a reduction to the overall payout from the element linked to customer and operational measures from 7.25% to 2.6% and the Committee supported this amendment when approving bonus outcomes for the Executive Directors.

Bonus outturn

	Weighting	Chief Executive Officer	Group Finance Director
Group financial measures	60%	59.0%	59.0%
Customer and operational measures	20%	7.25%	7.25%
Individual objectives	20%	16.5%	16.5%
Sub-total	100%	82.75%	82.75%
Outturn after exercise of discretion	100%	78.1%	78.1%

Malus and clawback provisions apply in relation to the bonus awards in respect of the year.

Annual report on remuneration continued

Long-term incentive outturn for 2020/21

The awards in the single figure table relate to the 2018/19 share awards granted on 2 July 2018, which are due to vest on 1 July 2021. These share awards were subject to performance targets relating to Earnings per Share (EPS), a sustainable dividend measure and Return on Capital Employed.

In light of the completion of the Viridor sale in 2020, the Remuneration Committee considered the impact of the transaction on the performance criteria applicable to this award. The Committee recognised that the basis of assessment would need to vary to reflect the nature of the Group prior to and after the transaction. The performance period was therefore split, with the first two years based on the previous Group structure and the final year based on new Group structure.

The Remuneration Committee concluded that the sustainable dividends and Return on Capital Employed targets could be largely maintained, with consistent targets applied across the full performance period. However, the EPS targets needed to be adjusted to reflect the shift to a water only business. To simplify the assessment, the underlying EPS growth targets were converted into absolute EPS values, with the period following the sale of Viridor based on targets which reflected the new structure of the Group and the regulated nature of the business. While adjustments of this nature are naturally complex, the Remuneration Committee is satisfied that the approach adopted is consistent with the nature of the targets that were originally set.

Measures		Threshold (25% of maximum vests) ⁽²⁾	Maximum (100% of maximum vests)	Achievement ⁽³⁾	Vesting outcome (% of max)
EPS growth (40% of award)	Combined Group (Period to FY 20)	57.2p	61.6p	61.7p	100%
	Continuing Group (FY21)	29.6p	30.2p	31.9p	
Sustainable dividend measure (dividend growth and dividend cover) (40% of award)	Combined Group (Period to FY 20)			3.3x	84.9%
	Continuing Group (FY21)	2.6x	3.6x	3.7x	
RoCE (average) ⁽¹⁾ (20% of award)	Combined Group (Period to FY 20)			9.7%	79.6%
	Continuing Group (FY21)	8%	10%	8.1%	
Total					89.9%

(1) Average of opening and closing capital employed.

(2) For below threshold performance for any of the performance conditions, 0% vests in respect of that performance condition.

(3) Straight-line vesting between points.

Vesting of the award is subject to an 'underpin' relating to overall Group performance including environmental, social and governance factors and safety performance, as well as financial performance. The Committee has determined, to the date of this report, that this underpin has been satisfied.

Over the last three financial years, the Group has delivered a strong set of financial results. The operational success of Viridor culminated in its sale for net proceeds of £3.7 billion in 2020, allowing our shareholders to realise significant value. Taking into account the significant capital investment in the Group's operations and the value returned to shareholders via both regular and special dividends, the Remuneration Committee is satisfied that the vesting outcomes fairly reflect underlying performance over the last three years.

The awards are subject to a two-year holding period during which clawback may be applied if the Committee considers it appropriate in certain circumstances. The holding period is due to end on 1 July 2023.

Retirement benefits and entitlements (audited information)

Details of the Directors' pension entitlements and pension-related benefits during the year are as follows. Effective from 1 August 2021, the maximum pension contribution made by the Company is 10% of salary.

	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)	Age and date of retirement (for pension purposes)	Accrued pension at 31 March 2021 ⁽ⁱⁱ⁾ (£000)
Susan Davy	29	–	50	80	65 (17 May 2034)	29
Paul Boote ⁽ⁱⁱⁱ⁾	–	10	15	25	65 (29 June 2043)	–
Chris Loughlin	–	–	55	55	67 (20 August 2019)	–

(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.

(iii) Value of total Defined Contribution scheme contributions since 31 July 2020.

Chris Loughlin was not a member of any of the Pennon Group's pension schemes during his tenure and received a sum in lieu of pension entitlement equivalent to 30% of salary.

Susan Davy received an overall pension benefit from the Company equivalent to 25% of her salary for the period 1 April to 31 July 2020, which reduced to 10% of salary from 1 August 2020 on appointment as Chief Executive Officer. For 2020/21 this comprised an employer's contribution of £29,884 and a cash sum of £50,352. 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. Accrual in this scheme will cease from 1 July 2021.

The employer's contribution to the pension for Susan Davy is deducted from the overall pension allowance.

Paul Boote received a pension contribution of 10% of his salary. This comprised an employer's contribution of £10,296 to the Group's Defined Contribution pension scheme and a cash sum of £14,540, of which £2,950 was a payment in arrears, in respect of his previous role. He is entitled to access the retirement fund in the Master Trust from age 55.

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.

Non-Executive Directors' remuneration

Single figure of remuneration (audited)

	2020/21			2019/20		
	Fees (£000)	Taxable benefits (£000)	Total fees (£000)	Fees (£000)	Taxable benefits (£000)	Total fees (£000)
Gill Rider ⁽ⁱ⁾	176	0	176	78	0	78
Sir John Parker ⁽ⁱⁱ⁾	94	1	95	276	0	276
Neil Cooper ⁽ⁱⁱⁱ⁾	80	0	80	69	0	69
Iain Evans	73	0	73	70	0	70
Claire Ighodaro ^(iv)	68	0	68	35	0	35
Jon Butterworth ^(v)	49	0	49	–	–	–

(i) Gill Rider was appointed as Chair on 31 July 2020.

(ii) Sir John Parker stepped down as Chair on 31 July 2020.

(iii) Neil Cooper became Senior Independent Director with effect from 31 July 2020, in addition to his role as Chair of the Audit Committee.

(iv) Claire Ighodaro became Remuneration Chair with effect from 31 July 2020.

(v) Jon Butterworth was appointed as a Non-Executive Director as of 8 July 2020. Mr Butterworth was appointed to the South West Water board in 2017.

Non-Executive Directors' fees and benefits

During the year, Sir John Parker stepped down from the Board on 31 July 2020 following five years as Chair of the Pennon Group. No payments were made for loss of office. Sir John's fee prior to his departure was £279,850.

Gill Rider was appointed Chair of the Board, having served eight years on the Pennon Board, latterly as Chair of the Remuneration Committee and Senior Independent Director. Her fee was set at £225,000. When appropriate for the efficient carrying out of her duties, she is provided with a driver and vehicle. She is entitled to expenses on the same basis as for other Non-Executive Directors.

Fees for Non-Executive Directors were initially increased by 1.5% at the start of the financial year. In light of the sale of Viridor, the Non-Executive Director fees were further reviewed. In recognition of the new Board structure, the Committee fees were consolidated into the base fees for Non-Executive Directors (increased from £49,850 to £60,550). The additional fees for the Chairs of committees were also reviewed. The revised fee structure is set out in full on page 113.

There is no proposed increase to Non-Executive Director fees for 2021/22.

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
Susan Davy	1 August 2020 ⁽ⁱ⁾	12 months
Paul Boote	1 August 2020	12 months
Chris Loughlin	1 January 2016	12 months ⁽ⁱⁱ⁾

(i) A previous service contract dated 1 February 2015 was held by Susan Davy in respect of her appointment as Chief Financial Officer.

(ii) Stepped down from the Board on 31 July 2020 and received payment in lieu of notice, as disclosed on page 120.

Non-Executive Directors	Date of initial letter of appointment	Expiry date of appointment
Gill Rider	22 June 2012	31 August 2024 ⁽ⁱ⁾
Sir John Parker	19 March 2015	31 March 2021 ⁽ⁱⁱ⁾
Neil Cooper	17 July 2014	31 August 2023
Iain Evans	16 June 2018	31 August 2021
Claire Ighodaro	28 May 2019	31 August 2022
Jon Butterworth	1 August 2020	31 July 2023

(i) Gill Rider was appointed as Chair of the Board as of 31 July 2020 and as such is providing ongoing strategic support and continuity of the Board for up to three years.

(ii) Sir John Parker stepped down from the Board on 31 July 2020.

The policy is for Executive Directors' service contracts to provide for 12 months' notice from either side.

The policy is for Non-Executive Directors' letters of appointment to contain a three-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.

Copies of Executive Directors' service contracts and Non-Executive Directors' letters of appointment are available for inspection at the Company's registered office.

Annual report on remuneration continued

Remuneration for outgoing Chief Executive Officer (audited information)

Chris Loughlin retired on 31 July 2020, following 14 years of service with the Company and four years as Chief Executive Officer. Details of his departure terms were disclosed in July 2020. The following provides further detail on his remuneration arrangements:

- Payment in lieu of notice, including benefits, would be paid for 12 months reflecting the contractual notice period commencing from 8 July 2020 of £700k. A payment of £49k was made for accrued holiday.
- In respect of the annual bonus for 2020/21 a pro-rated bonus was paid. The annual bonus was calculated based on financial (75%) and customer and operational (25%) measures.
- Outstanding Long-Term Incentive Plan awards will be subject to time pro-rating, with performance outcomes assessed at the end of the normal performance period. Deferred bonus awards and fully performance-tested LTIP awards will be eligible for release at the earlier of the normal release date and second anniversary of his departure.
- Although the new post employment shareholding guidelines only came in effect after Chris' departure, Chris will also be expected to retain sufficient shares to meet the guideline for two years following departure.

Outside appointments

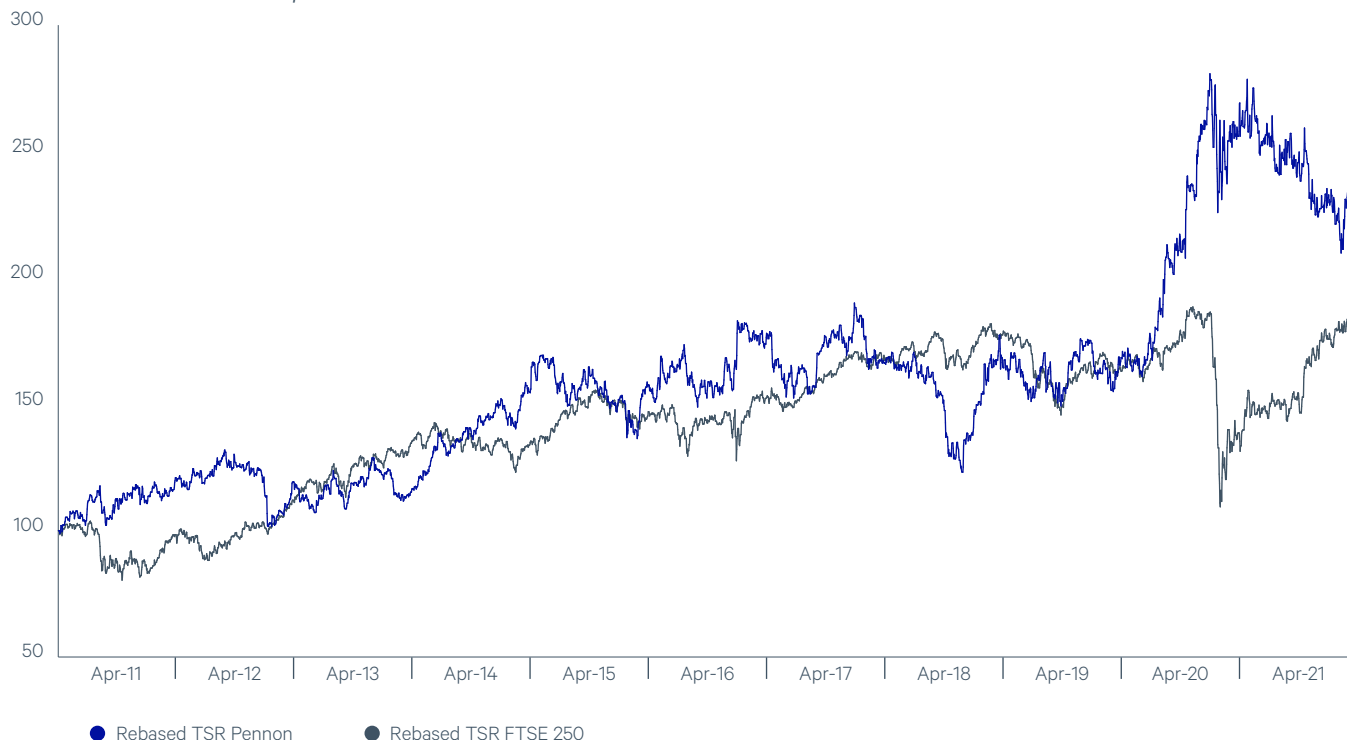
Executive Directors may accept one board appointment in another company. Board approval must be sought before accepting an appointment. Fees may be retained by the Director. Chris Loughlin continued in his appointment as a non-executive director of Mears Group PLC through the year and Susan Davy remained a non-executive director of Restore plc throughout 2020/21. No other outside company appointments are held by the Executive Directors other than with industry bodies or governmental or quasi-governmental agencies.

Additional contextual information

Historical TSR

The graph below shows the value, over the 10-year period ended on 31 March 2021, of £100 invested in Pennon Group on 1 April 2011 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 was a constituent until the end of the period.

Total shareholder return – Since April 2011



Historical Chief Executive Officer remuneration

As the Company did not have a Chief Executive Officer until 1 January 2016, the table below provides historical 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.

	2011/12	2012/13	2013/14	2014/15	2015/16 ⁽ⁱ⁾	2016/17	2017/18	2018/19	2019/20	2020/21 ⁽ⁱⁱ⁾	
	Average Executive Director	Average Executive Director	Average Executive Director	Average Executive Director	Chris Loughlin	Chris Loughlin	Chris Loughlin	Chris Loughlin	Chris Loughlin	Chris Loughlin	Susan Davy
Single figure of remuneration (£000)	1,221	894	962	762	1,119	1,318	1,153	1,351	2,135	1,127	1,724
Annual bonus payout (% of maximum)	72.87	47.00	67.56	68.20	83.98	84.05	87.00	91.00	78.0	79.2	78.1
LTIP vesting (% of maximum)	79.30	50.00	30.20	0.00	37.90	20.40	0.00	32.00	86.6	89.9	89.9

(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) Chris Loughlin stepped down as Chief Executive Officer on 31 July 2020 and was succeeded by Susan Davy. Consistent with the single figure, the figures for Susan Davy relate to the whole of 2020/21, including the portion of the year when she was Chief Financial Officer. The LTIP award for Chris Loughlin will be pro-rated to reflect service within the performance period.

Percentage change in Directors' remuneration

Comparison of Directors' remuneration to employee remuneration

The table below shows the percentage change between 2019/20 and 2020/21 in base salary, benefits and annual bonus of all Directors, including both Executive Directors and Non-Executive Directors, and all employees.

During 2020/21 circa 30% of the Group corporate functions were transferred with the sale of Viridor. This resulted in a headcount reduction and corresponding reduction in annual pay spend and bonus expenditure. The Executive Committee was reduced reflecting the more focused operations of the Continuing Group, resulting in lower bonus costs.

As Pennon Group plc has a relatively small number of employees, we have also shown below the percentage change against our employees. For comparison purposes, this is considered to be a more relative peer group than the Pennon Group plc entity.

	Percentage change in salary/fees	Percentage change in benefits	Percentage change in annual bonus
Executive Directors			
Susan Davy ⁽ⁱ⁾	10.7%	0%	34.8%
Paul Boote ⁽ⁱⁱ⁾	–	–	–
Chris Loughlin ⁽ⁱⁱⁱ⁾	-66.4%	-76%	-65.7%
Non-Executive Directors			
Gill Rider ^(iv)	126%	0%	–
Sir John Parker ^(v)	-66%	100%	–
Neil Cooper ^(vi)	16%	0%	–
Iain Evans	4%	0%	–
Claire Ighodaro ^(vii)	97%	0%	–
Jon Butterworth ^(viii)	–	–	–
All employees			
Pennon Group plc	-11.8%	3.08%	-10.7%
All employees	1.22%	5.7%	-17.8%

(i) Susan Davy appointed as Chief Executive 31 July 2020. Change in remuneration and bonus reflect her appointment.

(ii) Paul Boote appointed to the Board as Group Finance Director 8 July 2020.

(iii) Chris Loughlin stepped down from the Board as Chief Executive Officer 31 July 2020 leading to a change in remuneration for the year.

(iv) Gill Rider appointed as Chair 31 July 2020 and received an increase in fees.

(v) Sir John Parker stepped down from the Board as Chair 31 July 2020 leading to a change in fees for the year.

(vi) Neil Cooper was appointed as Senior Independent Director 31 July 2020 with an increase in fees.

(vii) Claire Ighodaro's fees for 2019/20 reflected her service period of seven months. Her appointment to Chair of the Remuneration Committee 31 July 2020 led to an increase in fees.

(viii) John Butterworth was appointed to the Pennon Board on 31 July 2021 and fees reflect the service period on the Pennon Board for 2020/21.

Annual report on remuneration continued

Additional contextual information continued

Percentage change in Directors' remuneration continued

Relative importance of spend on pay

	2020/21 (£ million)	2019/20 (£ million)	Percentage change
Overall expenditure on pay ⁽ⁱ⁾	750	700	7.1%
Distributions to ordinary shareholders	184.3	172.6	6.8%
Distributions to perpetual capital security holders	0	8.6	(100%)
Purchase of property, plant and equipment (cash flow) ⁽ⁱⁱ⁾	157.6	163.8	(3.8%)

(i) Excludes non-underlying items.

(ii) Relates to continuing Group.

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. Where relevant the numbers have been provided for the continuing Group to enable year on year comparability.

Chief Executive Officer pay ratio

Our CEO pay ratio stands at 69:1 for the median employee. This is not dissimilar to the ratio in 2020 – the demographics of the business have changed considerably with a much larger percentage of apprentices and career entry roles in the Group. We have also supported the Kickstart programme leading to 25 new entrants increasing our population at the lower end of our pay scales.

Year	Method	25 th percentile (P25) pay ratio	Median (P50) pay ratio	75 th percentile pay ratio
2020/21	A	95:1	69:1	55:1
2019/20	A	87:1	68:1	50:1

Option A has been used for the calculations as per the disclosure regulations. The employees at the lower quartile, median and upper quartile (P25, P50 and P75 respectively) have been determined based on a calculation of total remuneration for the financial year 1 April 2020 to 31 March 2021.

- Base salary for part-time employees and new joiners within the applicable period has been converted to full-time equivalents for the purpose of the calculations.
- Estimated values for employee P11D data have been used to establish the ordering of employees, given the timing of publication. This will be validated and amended in due course to account for any variances.

The validated P11D data for 2019/20 did not lead to any change in the published ratios for P25, P50 or P75.

For 2020/21 the total remuneration for the employees identified at P25, P50 and P75 is £24,803, £33,794 and £42,843 respectively. The base salary of 2020/21 for the employees identified at P25, P50 and P75 is £18,635, £27,827 and £38,207 respectively. All three employees' roles have a high component of variable pay (either shift premium, call-out or overtime), relative to other employees at a similar level. For 2020/21 the level of variable pay has increased with the additional one-off COVID-19 related bonus paid to all employees. The salary of the employee at P75 is higher than in 2019/20 reflecting the smaller population of the Group since the sale of Viridor. The role at P75 therefore sits at a more senior level in the organisation than P75 of the 2019/20 calculations. For 2020/21, the Total Single Figure calculation used to derive the CEO pay is a combination of the two CEOs in post during the year. Appropriate pro-rating of salary, variable pay and benefits has been applied.

As the Committee spends a considerable amount of time on matters relating to remuneration arrangements for the wider workforce, we are comfortable that the median pay ratio is consistent with our wider policies on pay, reward and progression and reward for the Group as a whole.

Share awards and shareholding disclosures (audited information)

Share awards granted during 2020/21

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
Susan Davy	LTIP	150% of salary	684	25% of maximum	2 August 2023
Paul Boote			450		
Susan Davy	Deferred bonus	50% of bonus awarded	162	n/a	13 July 2023
Paul Boote			54 ⁽ⁱ⁾		
Chris Loughlin			210		

(i) This award was made to Paul Boote in his previous position with the Group as Director of Group Treasury, Tax and Group Finance.

LTIP awards were calculated using the share price of £10.719 being the average closing price over the five dealing days preceding the date of grant, which was 3 August 2020. 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 10 July 2020 in order to satisfy the award, which was £10.7947.

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 of 200% of salary for both the Chief Executive Officer and Group Finance Director. In line with best practice guidelines, deferred bonuses and LTIP awards subject to a holding period only may count towards the guidelines on a net of tax basis. As noted on page 113, a new post employment shareholding requirement will come into effect following the AGM.

The beneficial interests of the Executive Directors in the ordinary shares (40.7 pence each) of the Company as at 31 March 2021 and 31 March 2020 together with their shareholding guideline obligation and interest are shown in the table below:

	Share interests (including connected parties) at 31 March 2021	Share interests (including connected parties) at 31 March 2020	Vested LTIP awards in holding period ⁽ⁱ⁾	Deferred bonus shares ⁽ⁱ⁾	SAYE	Performance shares (subject to performance conditions)	Shareholding guideline	Shareholding guideline met?
Susan Davy	90,010	78,834	89,602	62,206	2,834	222,527	200%	Yes
Paul Boote ⁽ⁱⁱ⁾	10,807	–	19,550	21,287	2,834	78,493	200%	No
Chris Loughlin ⁽ⁱⁱⁱ⁾	400,405	394,102	117,172	80,829	2,196	125,662	200% ^(iv)	Yes

(i) These share awards are not subject to further performance criteria and may therefore count towards the guideline on a net-of-tax basis.

(ii) Paul Boote's share awards are those he received in his previous position on a lower percentage and it will take him time to build up his shareholding as Group Finance Director.

(iii) Chris Loughlin's share interests are shown as at 31 July 2020, being the date he stepped down from the Board. Following his stepping down from the Board, Chris Loughlin's continuing interest in performance shares has been pro-rated to the period he was employed during each performance period. No LTIP award was granted to Chris Loughlin in 2020.

(iv) Shareholding guideline reduces to 100% 31 July 2021.

Since 31 March 2021, 12 and 14 additional ordinary shares in the Company have been acquired by Susan Davy and Paul Boote respectively as a result of their participation in the Company's Share Incentive Plan. Susan Davy has acquired 26 additional ordinary shares through the Dividend Reinvestment Plan (DRIP). 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 2021 and 1 June 2021.

Annual report on remuneration continued

Share awards and shareholding disclosures (audited information) continued

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 (40.7 pence) of the Company are shown in the table below:

Director	Shares held at 31 March 2021	Shares held at 31 March 2020
Sir John Parker ⁽¹⁾	27,027	27,027
Gill Rider	3,612	2,500
Neil Cooper	–	–
Iain Evans	–	–
Claire Ighodaro	–	–
Jon Butterworth	–	–

(1) Stepped down from the Board on 31 July 2020.

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 2021 and 1 June 2021.

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 1 June 2021 is as set out below:

	Awarded	Headroom	Total
Discretionary schemes	1.4%	3.6%	5%
All schemes	3.46%	6.54%	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 40.7 pence 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	Vested awards held at 1 April 2020 ⁽ⁱ⁾	Conditional awards held at 1 April 2020	Conditional awards made in year	Market price upon award in year	Vesting in year ⁽ⁱⁱ⁾	Value of shares upon vesting (before tax) £000	Vested awards held at 31 March 2021 ⁽ⁱⁱⁱ⁾	Conditional awards held at 31 March 2021	Date of end of period for qualifying conditions to be fulfilled	Expected date of release ^(iv)
Susan Davy										
01/07/16	15,557	–	–	920.00p	–	115	15,557	–	30/06/19	30/06/21
25/08/17	–	73,972	–	802.70p	74,045	747	74,045	–	24/08/20	24/08/22
02/07/18	–	76,653	–	790.12p	–	–	–	76,653	01/07/21	01/07/23
04/07/19	–	82,062	–	752.72p	–	–	–	82,062	03/07/22	03/07/24
03/08/20	–	–	63,812	1071.9p	–	–	–	63,812	02/08/23	02/08/25
Paul Boote^(v)										
01/07/16	3,589	–	–	920.00p	–	27	3,589	–	30/06/19	30/06/21
25/08/17	–	15,946	–	802.70p	15,961	161	15,961	–	24/08/20	24/08/22
02/07/18	–	20,250	–	790.12p	–	–	–	20,250	01/07/21	01/07/23
04/07/19	–	16,261	–	752.72p	–	–	–	16,261	03/07/22	03/07/24
03/08/20	–	–	41,982	1071.9p	–	–	–	41,982	02/08/23	02/08/25
Chris Loughlin										
01/07/16	20,343	–	–	920.00p	–	151	20,343	–	30/06/19	30/06/21
25/08/17	–	96,733	–	802.70p	96,829	977	96,829	–	24/08/20	24/08/22
02/07/18	–	100,239	–	790.12p	–	–	–	77,964 ^(vi)	01/07/21	01/07/23
04/07/19	–	107,321	–	752.72p	–	–	–	47,698 ^(vi)	03/07/22	03/07/24

(i) 32% of the award shares granted on 1 July 2016 vested on 1 July 2019 at a market price of £7412 per share.

(ii) 866% of the award shares granted on 25 August 2017 vested on 25 August 2020 at a market price of £10.085 per share.

In respect of (i) and (ii) above, the total number of shares that vested included additional shares equivalent in value to such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on the vested shares during the three-year performance period. The balance of the award lapsed.

(iii) Vested award; no longer subject to performance conditions.

(iv) Awards granted from 2015 onwards are subject to a two-year holding period following vesting.

(v) Paul Boote's LTIP awards include those he received in his previous position as Director of Treasury, Tax and Group Finance, in which he will retain an interest following his appointment to the Board as Group Finance Director on 8 July 2020.

(vi) Following his stepping down from the Board on 31 July 2020, Chris Loughlin's continuing interest in performance shares has been pro-rated to the period he was employed during each performance period.

Annual report on remuneration continued

Share awards and shareholding disclosures (audited information) continued

Details of share awards 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 (40.7 pence 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 restricted period:

Director and date of award	Restricted awards held at 1 April 2020	Restricted awards made in year	Market price of each share upon award in year	Released in year	Value of shares upon release (before tax) £000	Restricted awards held at 31 March 2021	Date of end of restricted period
Susan Davy							
30/08/17	20,503	–	808.691p	20,503 ⁽ⁱ⁾	205	–	29/08/20
25/07/18	22,746	–	761.36p	–	–	22,746	24/07/21
24/07/19	24,449	–	755.5386p	–	–	24,449	23/07/22
14/07/20	–	15,011	1079.47p	–	–	15,011	13/07/23
Paul Boote⁽ⁱⁱ⁾							
30/08/17	5,379	–	808.691p	5,379 ⁽ⁱ⁾	54	–	29/08/20
25/07/18	7,228	–	761.36p	–	–	7,228	24/07/21
24/07/19	9,033	–	755.5386p	–	–	9,033	23/07/22
14/07/20	–	5,026	1079.47p	–	–	5,026	13/07/23
Chris Loughlin							
30/08/17	26,504	–	808.691p	26,504 ⁽ⁱ⁾	265	–	29/08/20
25/07/18	29,575	–	761.36p	–	–	29,575	24/07/21
24/07/19	31,797	–	755.5386p	–	–	31,797	23/07/22
14/07/20	–	19,457	1079.47p	–	–	19,457	31/07/22 ⁽ⁱⁱⁱ⁾

(i) These shares were released on 1 September 2020 at 1000.5 pence per share.

(ii) Paul Boote's deferred bonus share awards include those he received in his previous position as Director of Treasury, Tax and Group Finance, in which he will retain an interest following his appointment as Group Finance Director on 8 July 2020.

(iii) The shares awarded to Chris Loughlin in 2020 will be released at the end of the shareholding requirements on the second anniversary of stepping down from the Board.

During the year the Directors received dividends on the above shares in accordance with the conditions of the bonus plan as follows: Susan Davy £29,631; Paul Boote £9,472; Chris Loughlin £38,463*.

* Chris Loughlin received his dividend in the form of ordinary shares (40.7 pence each) in the Company as a result of participation in the Company's DRIP. These shares are included in the figure given for the additional ordinary shares (40.7 pence each) in the Company that he acquired since 31 March 2021 given on page 125.

(c) Sharesave Scheme

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

Date of award	Options held at 1 April 2020	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 2021	Options held at 31 March 2021	Exercise period/ maturity date
Chris Loughlin								
24/06/15	2,196	–	2,196	683.00p	1040.50p	–	–	–
Susan Davy								
03/07/18	2,834	–	–	635.00p	–	975.0p	2,834	01/09/21-28/02/22
Paul Boote								
03/07/18	2,834	–	–	635.00p	–	975.0p	2,834	01/09/21-28/02/22

The Remuneration Committee and its advisers

Claire Ighodaro replaced Gill Rider as Chair of the Remuneration Committee on 31 July 2020. Gill Rider continued to serve as a member of the Committee. Neil Cooper and Iain Evans were members of the Remuneration Committee throughout the year. Jon Butterworth joined the Committee from 31 July 2020.

During the year the Committee received advice or services which materially assisted the Committee in the consideration of remuneration matters from Sir John Parker (Chair of the Board), Adele Barker (Group Chief People Officer) and from Deloitte LLP.

During 2018/19, 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 2020/21 were £120k (arrived at from an hourly rate basis of charging). During the year, Deloitte LLP also provided tax 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 the Annual 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 2020 AGM and the remuneration policy at the 2020 AGM, including votes for, against and withheld.

Annual report on remuneration (2020 AGM)

For % (including votes at the Chair's discretion)	96.85
Against %	3.15
Withheld number	1,069,039

Remuneration policy (2020 AGM)

For % (including votes at the Chair's discretion)	91.50
Against %	8.50
Withheld number	407,344

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 138 and the audited sections of the annual report on remuneration are identified in this report.

On behalf of the Board



Claire Ighodaro
Chair of Remuneration Committee

2 June 2021

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 84 to 107 and 130 to 135 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:

- Particulars of important events affecting the Company and/or its subsidiaries which have occurred since the year end (page 10 of the strategic report)
- Likely future developments of the Company (pages 11 and 22 of the strategic report)
- Risk management systems (pages 64 to 66 of the strategic report)
- Certain employee and employee engagement matters (pages 42 to 47 of the strategic report and pages 84 to 89 of the governance statement), as well as the disclosures below
- Business relationships/engagement with suppliers, customers and others (pages 34 to 37 of the strategic report and pages 84 to 89 of the governance statement).

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 56 to 63 of the strategic report and notes 2 (n) 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 90 to 91. In addition, Sir John Parker, the previous Chair, and Chris Loughlin, the previous Chief Executive Officer, served during the year until their retirement from the Board on 31 July 2020.

Final dividend

The Directors recommend a final dividend of 14.97 pence per ordinary share to be paid on 2 September 2021 to shareholders on the register on 23 July 2021, making a total dividend for the year of 21.74 pence per share (excluding the proposed special dividend which will be announced on 3 June 2021, as referenced in the circular to shareholders of the same date). The aggregate cost of the final dividend will be £91.8 million, resulting in a transfer from reserves of £1,670.4 million. The strategic report on pages 2 to 81 analyses the Group's financial results in more detail and sets out other financial information. Subject to approval of the proposed special dividend and associated share consolidation at a general meeting of shareholders convened for 28 June 2021, the recommended final dividend of 14.97 pence, per existing ordinary share, as of the date of this document, will be rebased to 22.46p per new ordinary share, following the share consolidation.

Directors' insurance and indemnities

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. Further detail of the contents of the diversity and inclusion policy are set out in the report of the Nomination Committee on page 105. Also, information regarding the diversity of the workforce is provided on pages 44 and 45.

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. 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 details of workforce engagement and employment matters relating to the Group are set out on pages 42 to 47 of the strategic report.

The Group encourages share ownership among its employees by operating an HMRC approved Sharesave Scheme and Share Incentive Plan. Following shareholder approval at the 2014 AGM, this scheme and plan were amended to provide for the increased savings limits approved by the Government. At 31 March 2021, around 53% (2020 36%) of the Group's employees were participating in these plans.

Modern Slavery Act

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 are completed to ensure compliance with the Modern Slavery Act across the Group and our anti-slavery and human trafficking web-based statement is available at www.pennon-group.co.uk/modern-slavery.

Greenhouse gas emissions

Methodology and approach

Our approach follows the UK Government's Environmental Reporting Guidelines: including streamlined energy and carbon reporting guidance and the Greenhouse Gas Protocol Corporate Standard (collectively referred to here as the reporting guidelines). In calculating our emissions, we have used the 2020 UK Government conversion factors for greenhouse gas (GHG) reporting. Additional guidance on renewable energy reporting is taken from Defra's 2009 GHG reporting Guidance.

Organisational boundary

The GHG emissions listed here cover the Pennon Group of companies, each of which uses the financial control approach, whereby the emissions are reported on the basis of the equity share held by the Pennon Group of companies in a company. This means that GHG emissions from joint venture operations can be accurately attributed to the company in proportion to the percentage of Pennon Group of companies' holding.

Operational scopes

We report our Scope 1, 2 and 3 GHG emissions where relevant.

Market and location-based methodology

The reporting guidelines allow for the reporting of both 'market-based' and 'location-based' Scope 2 GHG emissions from imported energy. For some of our supply we purchased and retired Renewable Energy Guarantees of Origin (REGOs) allowing this to qualify as zero carbon market-based emissions. We report our market-based GHG emissions separately from the location-based supply. For 2020/21 in accordance with the latest accounting guidance we have used our electricity suppliers' specific published Fuel Mix Disclosure emissions factors to report our Scope 2 market-based emissions and where Fuel Mix Disclosure emissions factors are not available we have used the 'residual grid mix' emissions factor.

Self-generated renewable energy export

In accordance with the 2009 Defra Guidance, we may report an emissions reduction in our reported net CO₂e figure for any renewable electricity we have generated and exported to the national grid or a third party.

Significant change in GHG emissions and energy use during reporting period

In July 2020 we sold our waste business, Viridor. In 2019/20 Viridor Scope 1 and 2 emissions accounted for around 96% of total Group emissions and around 50% of energy use. The sale therefore has a significant impact on our reported values. For transparency and completeness we have reported the Viridor (waste business) Scope 1 and 2 emissions and energy use here up to the point of sale (8 July 2020). For clarity and comparison with previous and future reporting we report here, where appropriate, Group GHG emissions/energy use for the 'Continuing Group' (i.e. excluding Viridor data from 2020/21 reported data) and for the Total Group including Viridor ('Group (including discontinued business)' up to the point of sale).

Targets

As part of a world first, national sector-wide commitment, along with our industry body, Water UK, we have made a commitment to Net Zero Carbon by 2030. As part of our Net Zero strategy we are committed to 100% renewable power from 2022/23 (which will be reflected in 2022/23 GHG reporting). The scope of our target includes Scope 1 and 2 (market based) GHG emissions as well as certain Scope 3 GHG emissions where a core activity is outsourced. For further details, see our Net Zero strategy on page 30.

Base year

For GHG reporting we compare the current financial year against the previous financial-year performance however due to the significant change to the Group described above, 2020/21 GHG emissions performance is not directly comparable to 2019/20. Our new Net Zero Carbon 2030 target uses a 2018/19 emissions baseline (from previously stated 2019/20 baseline) to align to agreed Water UK baseline.

Intensity measurement

We report an intensity measure of Scope 1 and 2 gross GHG emissions in tCO₂e per £100,000 revenue. In addition, we provide operational intensity measures for our water utility business in terms of tCO₂e per megalitre supplied or treated.

External assurance statement

Scope 1 and Scope 2 GHG emissions for our discontinued business (Viridor) and the consolidation of these into a Group Total has been independently assured by DNV together with selected Scope 3 GHG emissions. GHG emissions that relate to the disclosure of emissions from South West Water have been subject to a separate and 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's statement can be found at www.pennon-group.co.uk/sustainability.

Pennon Group plc GHG emissions

	2020/21				2019/20	
	Continuing Group (including discontinued business)		Group (including discontinued business)		Group (including discontinued business)	
	market-based	location-based	market-based	location-based	market-based	location-based
Scope 1 GHG emissions (tCO ₂ e) ⁽¹⁾	21,080	21,080	492,857	492,857	2,042,672	2,042,672
Scope 2 GHG emissions (tCO ₂ e)	65,685	72,436	68,949	75,700	83,535	96,846
Total gross Scope 1 & 2 GHG emissions (tCO₂e)	86,765	93,516	561,806	568,557⁽⁴⁾	2,126,207	2,139,518
Scope 3 GHG emissions (estimated) ⁽²⁾	147,392	147,392			617,132	617,132
Total gross Scope 1, 2 & 3 GHG emissions (tCO₂e)	234,157	240,908			2,743,339	2,756,650
GHG emissions removals through purchases of Renewable Energy Guarantees of Origin (tCO ₂ e)	Included in Scope 2 above	–	Not calculated for discontinued business		Included in Scope 2 above	(13,311)
GHG emissions saved by exporting self-generated electricity (tCO ₂ e)	(2,277)	(1,903)			(2,218)	(2,218)
Total annual net GHG emissions (tCO₂e)	231,880	239,005			2,741,121	2,741,121
Energy consumption used to calculate Scope 1 and 2 GHG emissions (MWh) (see Energy usage section)	357,232	357,232	421,014	421,014	620,409	620,409
GHG emissions intensity measure: tCO ₂ e (gross Scope 1+2/£100,000 revenue) ⁽³⁾	13.5	14.5	67.1	67.9	152.8	153.8
Operational intensity measure (kgCO ₂ e/MI*) – Water	198.7	211.3	n/a		Not reported	
Operational intensity measure (kgCO ₂ e/MI*) – Wastewater	216.2	234.5				
Biogenic GHG emissions outside of Scopes (tCO ₂ e)	2,583	2,583	466,685	466,685	1,756,029	1,769,365

Notes:

(1) GHG emission figures expressed in tonnes of carbon dioxide equivalents (tCO₂e) whereby emissions of carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), the fluorinated gases (HFC, PFC, SF₆) are shown in terms of the equivalent emissions from CO₂. A breakdown of emissions by GHG is available at www.pennon-group.co.uk/sustainability/greenhouse-gas-emissions.

(2) n/a Scope 3 GHG emissions not calculated for discontinued business.

(3) Based on relevant Group revenue for 2020/21. e.g. revenue for Continuing Group only where related to Continuing Group GHG emissions.

(4) Group including discontinued business includes Viridor GHG emissions for Scope 1 (471,777 tCO₂e) and Scope 2 (3,263 tCO₂e). These figures have been independently assured by DNV.

* For 'Water' measure MI = measured water into supply. For 'Wastewater' measure MI = full measured flow to treatment

Scope 1 (direct GHG emissions) GHG activities owned or controlled by our organisation that release emissions straight into the atmosphere. For Pennon, primary Scope 1 GHG emission sources during 2020/21 include GHG emissions from stationary plant, fugitive emissions from air conditioning plant and wastewater treatment and transport related GHG emissions from our own vehicles and fleet and for the discontinued business combustion related emissions from ERFs and fugitive emissions from landfill.

Scope 2 (indirect GHG emissions) GHG emissions released into the atmosphere associated with our consumption of imported electricity.

Scope 3 (other GHG indirect emissions) GHG emissions that are a consequence of our actions, which occur at sources which we do not own or control. Further details of our 2020/21 Scope 3 GHG emissions estimates are provided below.

Directors' report – other statutory disclosures continued

Operational Pennon Group plc GHG emissions by business

	Waste (discontinued business)	Water (South West Water and Bournemouth Water)	Group total
Scope 1 GHG emissions	471,777	20,920	492,857
Scope 2 GHG emissions (market based)	3,263	65,660	68,949
Total gross Scope 1 & Scope 2 GHG emissions (tCO₂e)	475,040	86,580	561,806

Note:

Waste business (Viridor) GHG emissions to point of sale 8 July 2020. 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. Group total includes 186 tCO₂e from Pennon Water Services and Group shared services.

Change in GHG emissions

Operational (Scope 1 and 2 marked-based) GHG emissions for the Group including our discontinued business decreased by 74% from 2019/20. This was as a result of the sale of our waste business in July 2020. For our continuing Group, operational (Scope 1 and 2) GHG emissions decreased (-5%) compared to 2019/20, when using a location-based approach, but increased marginally (+2%) when using a market-based approach. Scope 1 emissions were higher (+12%) in either case as a result of using an updated methodology for accounting wastewater process and fugitive emissions. The higher reported Scope 1 emissions were offset somewhat by reduced Scope 2 (location-based) emission where the continued reduction in the UK's average electricity grid emissions conversion factor, which fell by 9% from 0.2556 to 0.23314 kgCO₂e/kWh over the reporting period contributed to the emissions reduction. Scope 2 (market-based) emissions reduced primarily as a result of South West Water's purchase of REGO certificates from third parties. Our generation and export of renewable power resulted in further GHG emissions reductions.

The revenue based intensity metric has significantly reduced for the Group both with market-based (67.1), located based (67.9) and without (13.5-14.5) including our discontinued business compared to 2019/20 (152.8). This reflects the significant reduction in overall Group emissions as a result of the sale of our waste business relative to the revenue earned. We have included further operations focused intensity metrics for water and wastewater use this year which we will be additionally tracking and reporting performance against in future.

Scope 3 GHG emissions

Scope 3 categories were evaluated for relevant categories in line with the GHG Protocol Scope 3 Calculation Guidance. Further information on our Scope 3 GHG emissions and explanation of our reporting methodology including those assessed as 'not relevant' can be found in our CDP disclosure (<https://www.cdp.net/en>). The assessment is based on 2020/21 activity data for the Continuing Group only. In light of COVID-19, certain activities, namely business travel (Category 6) have seen reductions compared to previous years, and as such performance may not be representative of typical years. For commuting (Category 7), we reflected the impact of increased homeworking during lockdown with an estimate of the GHG emissions associated with homeworking. However, for the most significant categories we anticipate similar activity levels and hence 2020/21 data will be representative.

In addition, we have obtained and included for the first-time data on our downstream transportation and distribution (Category 9) associated with our water business. Note distribution here concerns transport of goods by third party contractors on our behalf e.g. recycled sludge (biosolids) to land, as opposed to water distribution, the emissions for which are included in our Scope 2 reporting.

Our estimated Scope 3 footprint for 2020/21 for the Continuing Group is 147,392 tCO₂e compared to the equivalent figure in 2019/20 of 163,026. This decrease is in part due to exclusion estimated GHG emissions from sludge recycled to land as the emissions are excluded from our Net Zero strategy boundary. We are committed to better understanding our Scope 3 GHG emissions and investigating opportunities to reduce these emissions. This includes working with our suppliers to help them understand and manage their GHG emissions.

Estimated Scope 3 GHG emissions breakdown

Sources of Scope 3 GHG emissions	Evaluation status (2020/21)	2020/21 Continuing Group~ (tCO ₂ e)	2019/20 Continuing Group (tCO ₂ e)	2019/20 Discontinued business (tCO ₂ e)
Category 1 – Purchased goods and services	Material, calculated	62,460	51,204	60,975
Category 2 – Capital goods	Material, calculated	54,791	70,478	30,699
Category 3 – Fuel- and energy-related (not Scope 1&2)*~	Material, calculated	18,511	19,834	17,386
Category 4 – Upstream transportation and distribution	Material, calculated	2,831	7,979	177,398
Category 5 – Waste generated in operations	Not material, calculated	619	9,102	9,400
Category 6 – Business travel*~	Not material, calculated	50	334	1,390
Category 7 – Employee commuting~	Material, calculated	2,657	4,095 (reported as Group total only)	–
Category 9 – Downstream transportation and distribution	Material, calculated	5,473	–	133,314
Category 12 – End of life treatment of sold products	Not relevant for Continuing Group	–	–	23,437
Total estimated Scope 3 GHG emissions		147,392	163,026	453,999

Scope 3 emissions data notes:

* Category 3 and Category 6 included in DNV 2020/21 Assurance.

~ Includes GHG emissions associated with our water service business – Pennon Water Services – and Group shared services though considered immaterial as estimated at <1% of total Group GHG emissions.

Energy usage

Including self-supplied energy, the Continuing Group used 357GWh of energy in 2020/21, while our discontinued waste business used around 94 GWh up to the point of sale in July 2020. A breakdown of Group energy usage and associated data assessment methodologies is shown below. In 2019/20, the Group used a total of 734 GWh of energy; details of this and previous years' data are provided at www.pennon-group.co.uk/sustainability/environmental-leadership.

	Continuing Group* (MWh)	Waste business (discontinued) (MWh)	Total Group* (MWh)	Methodology (South West Water/ Bournemouth Water)	Methodology (discontinued waste business)
Imported grid electricity^	310,688	13,998	324,686	Verifiable metered data except some nHH supply~	Verifiable metered data
Imported private wire electricity (renewable)	4,786	–	4,786	Verified metered data	n/a
Self-supplied renewable electricity	8,885	30,822	39,708	Verified metered data	Estimated based on verifiable data
Self-supplied heat	5,935	–	5,935	Estimated that 60% of heat generated by sewage gas CHP is beneficially used, the rest (40%) is lost to atmosphere	n/a
Natural gas^	2,432	6,594	9,027	Verified metered data – from billing (some element of estimates)	Verified metered data
Liquid fuels (for stationary applications)^	7,023	22,908	29,931	Estimated based on verifiable data (i.e. fuel expenditure)	Estimated based on verifiable data
Energy used by fleet transport^	17,571	20,282	37,853	Estimated based on verifiable data (i.e. fuel expenditure)	Estimated based on verifiable data
Total energy usage	357,320	94,604	451,926		
Intensity measure: MWh/£100,000 revenue	Continuing Group		55.4		
	Group (including discontinued business)		54.0		

Energy usage data notes:

No heat, steam or cooling was purchased by any Group company in 2020/21.

'Self-supplied renewable electricity' includes power from South West Water's two hydroelectric power stations.

^ Energy consumption used to calculate Scope 1 and 2 GHG emissions.

* Includes small amount of electricity and transport related energy use for Pennon Water Services/Group shared services totalling an estimated 0.7 GWh or around 0.1% of Group total.

~ Estimate used for non-half hourly electricity supply (c.6% of total imported electricity) based on supplier renewal quotation estimate.

Energy efficiency action taken

The 2020/21 energy efficiency actions are presented for the Continuing Group only. South West Water retained its ISO 50001 energy management system accreditation. A summary of improvement activities undertaken in 2020/21 is provided below.

South West Water

Some of our planned energy efficiency projects during 2020/21 were disrupted by COVID-19 where during the various lockdowns attendance at operational sites was limited to essential visits only. Notable examples of projects that were able to be completed during 2020/21 include upgrades to 2 x 20 megalitres / day high-lift pumps and motors at Restormel Water Treatment Works substantially reducing kWh cost per megalitre and saving about 82 MWh per year. There have also been improvements to pumps at Dotton Water Treatment Works (25 MWh saved) and Pynes (Exeter) Water Treatment Works (54 MWh saved). Energy savings have also been made on our wastewater part of the business, the most substantial of these at our Countess Wear (Exeter) Wastewater Treatment Works where retesting the pumps and subsequent refurbishment has led to projected annual savings of 378 MWh.

We have accelerated our meter change and meter reading programme, and this is also helping to identify further areas for efficiency improvement.

Finally, we have rolled out our new energy efficiency training to over 1,000 of our employees during 2020/21 with the aim of raising the energy awareness and carbon literacy of all employees involved in our operational activities. This first phase of our energy training programme consists of a series of online learning modules that utilise short instructive videos and quiz questions to introduce staff to basic energy and carbon concepts.

As part of our newly established Net Zero strategy, we will be accelerating energy efficiency programme towards our 2030 target as well as further supporting our customers to manage water responsibly thus reducing demand and associated energy costs.

Directors' report – other statutory disclosures continued

Research and development

Research and development within the Group involving water and wastewater treatment processes amounted to £0.1 million during the year (2019/20 £0.1 million).

Overseas branches

The Company has no overseas branches.

Pennon Group donations

During 2020/21, the Group provided a total of £50,000 in charitable donations (2019/20 £65,000).

No political donations were made or political expenditure incurred and no contributions were made to a non-UK political party (2019/20 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 2020), which was valid as at 31 March 2021 and remains currently valid. No purchases were made during the year and no shares were made subject to a lien or charge. As at 1 April 2021, 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. On 3 June 2021, the Company will announce its intention to initiate a c.£0.4 billion share buy-back programme in order to purchase ordinary shares from shareholders.

The Company will seek authority from shareholders at the General Meeting on 28 June 2021 (to be renewed at the AGM on 22 July 2021) to purchase up to 14.99% of its own ordinary shares.

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 Guidance and Transparency Rules (DTR).

As at 31 March 2021:

- 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 195. All of the Company's issued ordinary 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 ordinary 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 213. 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) £57,120,060 (such amount to be reduced by any shares allotted or rights granted under (ii) below in excess of £57,120,060); and
 - (ii) £114,240,120 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 2020 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.
 - (iii) The Directors were also given the authority by shareholders at the 2019 AGM, to allot a single non-cumulative redeemable preference share of one penny nominal value (the WaterShare+ Share), the rights and restrictions in relation to which are set out in Article 5A of the Company's Articles of Association. The share was allotted on 20 October 2020;
- 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

At 31 March 2021, the Group has access to undrawn committed funds and cash and cash deposits totalling £3.2 billion (£3.0 billion after restricted cash). Having considered the Group's strong funding position, the potential use of proceeds from the sale of Viridor and prudent financial projections, which take into account a range of possible impacts from the COVID-19 pandemic as described in this report, the Directors have a reasonable expectation that the Group has adequate resource to continue in operational existence for the period of at least 12 months from the date of the approval of the financial statements and that there are no material uncertainties to disclose. 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 and the Group 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 elected to prepare the Group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) in conformity with the Companies Act 2006. 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.

Under the Financial Conduct Authority's Disclosure Guidance and Transparency Rules, group financial statements are required to be presented in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006 and international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

In preparing these financial statements the Directors are required to:

- select suitable accounting policies in accordance with IAS 8 Accounting Policies, Changes in Estimates and Errors and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements of IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions of the Group's financial position and financial performance;

- in respect of the Group financial statements, state whether IFRSs in conformity with the Companies Act 2006 and IFRSs adopted pursuant to Regulation (EC) No 1606/2002 as it applies to the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- in respect of the parent company financial statements, state whether IFRSs in conformity with the Companies Act 2006 have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is appropriate to presume that the Company and/or Group will not continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's and Group'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 Company and Group financial statements comply with the Companies Act 2006 and, with respect to 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.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with the law and those regulations. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website.

Each of the Directors, whose names and functions are listed on pages 90 and 91, confirms that, to the best of his or her knowledge:

- The consolidated financial statements, prepared in accordance with IFRSs in conformity with the Companies Act 2006 and IFRSs adopted pursuant to Regulation (EC) No 1606/2002 as it applies to the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the parent company and undertakings included in the consolidation taken as a whole.
- The annual report, including the Strategic Report (pages 2 to 81), includes a fair review of the development and performance of the business during the year and the position of the Company and undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face.
- They consider that the annual report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the Company's position, performance, business model and strategy.

Statement as to disclosure of information to the auditor

- 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
- 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 84 to 107 and 130 to 135 was approved by the Board on 2 June 2021.

By order of the Board



Simon A F Pugsley
Group General Counsel and
Company Secretary

2 June 2021

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Independent auditor's report

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Alternative performance measures

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An aerial view of Burrator Reservoir

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 2021 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006 and International Financial Reporting Standards adopted pursuant to Regulation (EC) No. 1606/2002 as it applies in the European Union;
- the parent company financial statements have been properly prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006 as applied in accordance with section 408 of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Pennon Group plc (the 'parent company') and its subsidiaries (the 'Group') for the year ended 31 March 2021 which comprise:

GROUP	PARENT COMPANY
Group balance sheet as at 31 March 2021	Balance sheet as at 31 March 2021
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
Group statement of changes in equity for the year then ended	Related notes 1 to 45 to the financial statements including a summary of significant accounting policies
Group cash flow statement for the year then ended	
Related notes 1 to 45 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 Accounting Standards in conformity with the requirements of the Companies Act 2006 and, as regards the group financial statements, International Financial Reporting Standards adopted pursuant to Regulation (EC) No. 1606/2002 as it applies in the European Union, as regards the parent company financial statements, as applied in accordance with section 408 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. We are independent of the group 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 going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the directors' assessment of the group and parent company's ability to continue to adopt the going concern basis of accounting included the following procedures:

- We have obtained management's going concern assessment, including the cash forecast, liquidity requirements and forecast covenant calculations for the going concern period which covers the period from approval of the 2021 financial statements through to 30 June 2022, and have tested this for arithmetical accuracy. Management has modelled a downside scenario in their cash forecasts and covenant calculations in order to incorporate unexpected changes to the forecasted liquidity of the Group.
- We have reviewed the forecasts used for the going concern assessment period for reasonableness and, where applicable, corroborated the data with audit information from other areas. We have evaluated the appropriateness of the key assumptions in management's forecasts including revenue growth, by comparing these to year to date performance and through consideration of historical forecasting accuracy.
- The largest component of the Group's operations relates to the regulated water business, undertaken by South West Water Limited, which has an agreed business plan with Ofwat for the five year price period from 1 April 2020 to 31 March 2025, setting out the basis of allowed tariff changes. We have compared the key assumptions in the Group forecasts to the agreed business plan for consistency.
- We have evaluated management's stress test modelling including management's downside scenario, to understand the impact on the Group's liquidity and covenant ratios.
- We have compared facilities assumed in the forecasts to supporting documentation.
- We have compared the risks identified in management's assessment to the group risk register and evaluated the quantification by management. We have considered whether there are other alternative risks based on our knowledge of the business.
- We tested the extent of changes in assumptions required to give rise to a reduction in liquidity or breach in covenants.
- We have reviewed the Group's going concern disclosures included in the annual report in order to assess whether the disclosures were appropriate and in conformity with the reporting standards.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group and parent company's ability to continue as a going concern for a period to 30 June 2022 from when the financial statements are authorised for issue.

In relation to the Group and parent company's reporting on how they have applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's ability to continue as a going concern.

Overview of our audit approach

Audit scope	<ul style="list-style-type: none"> We performed an audit of the complete financial information of three components. The components where we performed full audit procedures accounted for 100% of Profit before taxation and non-underlying items from continuing operations, 100% of Revenue and 95% of Total assets.
Key audit matters	<ul style="list-style-type: none"> Revenue recognition in respect of accrued income in the group's material trading components South West Water Limited (SWW) and Pennon Water Services (PWS) Valuation of the expected credit loss provision for customer balances in SWW and PWS Profit from discontinued operations
Materiality	<ul style="list-style-type: none"> Overall group materiality of £7.9 million which represents 5% of the Group's Profit before taxation and non-underlying items from continuing operations.

An overview of the scope of the parent company and group audits

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each company 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 company.

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 five reporting components of the Group, we selected three components covering entities Pennon Group plc, South West Water Limited and Pennon Water Services Limited, which represent the principal business units within the Group. In addition to these procedures on continuing operations, we also performed procedures on the profit from discontinued operations, further detail is set out in the key audit matter below.

We performed an audit of the complete financial information of all three components ("full scope components") which were selected based on their size or risk characteristics.

The reporting components where we performed audit procedures accounted for 100% (2020: 100%) of the Group's Profit before taxation and non-underlying items from continuing operations, 100% (2020: 100%) of the Group's Revenue and 95% (2020: 95%) of the Group's Total assets. For the current year, the full scope components contributed 100% (2020: 100%) of the Group's Profit before taxation and non-underlying items from continuing operations, 100% (2020: 83%) of the Group's Revenue and 95% (2020: 95%) of the Group's Total assets. In the prior year, we allocated specific scope to Pennon Water Services which contributed 0.4% of the Group's Profit before taxation before non-underlying items, 27% of the Group's Revenue from continuing operations and 1% of the Group's Total assets for that year.

Of the remaining two components that together represent less than 1% of the Group's Profit before taxation and non-underlying items from continuing operations, none are individually greater than 1% of the Group's Profit before taxation and non-underlying items from continuing operations. 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.

Profit from discontinued operations relates entirely to the disposal of the Group's Viridor division and further detail is set out in the key audit matter below which was scoped to cover 100% of profit from discontinued operations.

Changes from the prior year

In the prior year, the Group's Viridor division was a full scope component. Following the completion of the sale of the Viridor division in July 2020, we performed audit procedures on the profit from discontinued operations. These procedures were performed by the primary audit engagement team. Additionally, following the sale of Viridor, we increased the scope of the Pennon Water Services component, from specific scope to full scope to ensure appropriate coverage of key measures as shown above.

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. The audit teams for Pennon Group plc and South West Water are led by the Senior Statutory Auditor. A separate team audits the other full scope component, Pennon Water Services. 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 working papers and were responsible for the scope and direction of the audit process. We maintained continuous and open dialogue with all component audit teams in addition to holding formal meetings to ensure that we were fully aware of their progress and results of their procedures. The Senior Statutory Auditor discussed the planned audit approach with the component teams and any issues arising from their work, attended meetings with local management, attended closing meetings and reviewed key audit working papers on risk areas. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

As a result of the Covid-19 outbreak and resulting lockdown restrictions, we have modified our audit strategy to allow for the audit to be performed remotely at Group level and also across all component locations. This approach was facilitated by EY's electronic audit file platform, for the secure and timely delivery of requested audit evidence from management. This platform was used by all components and used to enable access and review of audit working papers by the Group audit team.

Based upon the above approach we are satisfied that we have been able to perform sufficient and appropriate oversight of our component teams.

Independent auditor's report continued to the members of Pennon Group plc

Key audit matters

Key audit matters are those matters that, in our professional judgment, 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
<p>Revenue recognition, specific to accrued income in South West Water and Pennon Water Services £624.1 million (PY comparative £636.7 million) of which £104.0 million is accrued at 31 March (PY comparative £98.4 million)</p> <p><i>Refer to the Audit Committee Report (page 100); Accounting policies (pages 152-153); and Note 5 of the Consolidated Financial Statements (page 163-165)</i></p> <p>The Group's material revenue streams relate to the provision of water and sewerage services by South West Water and Pennon Water Services. ISAs (UK & Ireland) presume there is a risk of fraud relating to revenue recognition. For the Group, given the targets associated with financial performance and potential pressures to meet market expectations, there is an incentive to overstate revenue. This risk over revenue recognition specifically arises in relation to income from measured water services, which 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. In the current year, management's estimation has also taken into account the impact of Covid-19 on consumption patterns by customers, which has seen increased consumption by household customers and decreased consumption by non household customers.</p> <p>The accrued income balance at 31 March 2021 is £776 million (2020: £71.6 million) for South West Water and £26.4 million (2020: £26.8 million) for Pennon Water Services.</p>	<p>We obtained an understanding of the process for the supply of measured services, meter reading and related billing in order to assess the completeness of the accrual for revenue at the year end;</p> <p>We tested key controls linked to system generated information and around the estimation process for measured revenue;</p> <p>We obtained internal and external data on factors that influence demand from customers, such as weather patterns and leaks in infrastructure networks and formed an expectation of the impact of these matters on revenue to compare to assumptions used in management's estimate;</p> <p>Given the changes in customer consumption patterns (increase in household consumption and decreased in non household consumption) arising from the impact of Covid-19, we used evidence from actual meter readings throughout the year to compare the assumptions used to estimate revenue recognised for metered customers without a recent reading;</p> <p>We obtained a system report of invoices raised post year end based on actual meter readings taken since the year end. We selected a sample of items from the report to compare to supporting evidence. We compared this report to the year end assumptions used to accrue income for these customer accounts, to assess the reliability of the assumptions used to determine accrued income;</p> <p>We performed analytical procedures by comparing revenue balances for the year against expectations and obtained support for significant variances; and</p> <p>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.</p>	<p>We concluded that the estimation process undertaken by management to calculate the measured income accrual reflected latest operational factors in the key assumptions and that the income accrual was appropriately determined.</p>

RISK	OUR RESPONSE TO THE RISK	KEY OBSERVATIONS COMMUNICATED TO THE AUDIT COMMITTEE
<p>Valuation of the expected credit loss provision for customer balances in South West Water & Pennon Water Services (£102.3 million, PY comparative £106.1 million)</p> <p><i>Refer to the Audit Committee Report (page 100); Accounting policies (page 156); and included within the total Group balance per Note 22 of the Consolidated Financial Statements (page 179)</i></p> <p>The South West Water credit loss provision of £88.3 million (2020: £91.6 million) and the Pennon Water Services credit loss provision of £14.0 million (2020: £14.5 million) are calculated using a combination of system generated information on historic debt recovery rates and management's judgement of the future likely recovery rates.</p> <p>Management's key assumptions include:</p> <ul style="list-style-type: none"> that the historic level of collections is indicative of the ability to collect at the same levels in the future; that the risk of non recovery from customers varies, depending on factors such as whether the household customer no longer occupies a property in the area, has previously paid/not paid, is/is not on a payment plan etc and for non household customers depends on the general economic performance of the business sector they operate within; and that the collection processes implemented in response to the Covid-19 pandemic will enable management to maintain the current level of collection performance <p>There is a risk that the assumptions used by management in calculating the 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.</p>	<p>We performed a walkthrough of the process for calculating the bad debt provision and assessed the design effectiveness of the relevant key controls;</p> <p>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 each component's billing systems;</p> <p>We tested historic data on collection rates and evaluated how this data was used in the preparation of the provision;</p> <p>We addressed 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 considered whether the historic collection performance evidenced the behaviour patterns assumed by management depending on categorisation of household customer and business sector for non household customers;</p> <p>For debt relating to household customers, we utilised collection information over previous periods, with sensitivities to consider the impact of a deterioration which might arise from a downturn in the economy, post removal of Government support packages, to determine an acceptable range of the likely ultimate collection of debts existing at the balance sheet date and compared this to the provision recorded by management;</p> <p>For debt relating to non household customers, we tested management's segmentation by business sector and the risk factors considered for each sector, re non recovery of debt. We compared this analysis with information on actual collections, by sector, in the current year and since the balance sheet date, this time period has been impacted throughout by the Covid-19 pandemic; and</p> <p>We tested the appropriateness of journal entries and adjustments impacting the doubtful debt provision, particularly those raised close to the balance sheet date.</p>	<p>We have concluded that the provision of £102.3 million is within an acceptable range and appropriately reflects the recent history of collection of outstanding debts and considerations of the impact on future collections of the economic environment arising from Covid-19.</p>

Independent auditor's report continued to the members of Pennon Group plc

Key audit matters continued

RISK	OUR RESPONSE TO THE RISK	KEY OBSERVATIONS COMMUNICATED TO THE AUDIT COMMITTEE
<p>Profit from discontinued operations (£1,654.7 million)</p> <p><i>Refer to the Audit Committee Report (page 100); Accounting policies (pages 152-158); and Note 44 of the Consolidated Financial Statements (page 204-205)</i></p> <p>The disposal of Viridor was completed in July 2020.</p> <p>The financial statements report the "profit from discontinued operations" in the income statement which comprises the trading results up to the date of disposal, together with the profit on disposal.</p> <p>In order to calculate the profit on disposal, the net assets at the date of disposal have been determined, which included the consideration of judgements and estimates in respect of key areas such as accrued income, provisions and pensions.</p> <p>The sale and purchase agreement for the disposal of Viridor also included deferred consideration amount recognised as other receivables. The fair value of the amount expected to be received at 31 March 2021 has been updated at 31 March 2021 to reflect latest information and is now estimated to be £9.2 million.</p>	<p>We obtained an understanding of the procedures adopted by management to ensure appropriate cut off in preparing the balance sheet at the disposal date for the calculation of the profit on disposal. We tested transactions around the disposal date;</p> <p>We performed testing over the three months trading activity and the closing balances as at 8 July 2020, the date when the Viridor sale was completed;</p> <p>We assessed whether there should be any significant changes in key assumptions and estimates at the date of disposal, compared to those at 31 March 2020, in recognising revenue, including accrued income and judgements in respect of provisions for liabilities and charges;</p> <p>We assessed management's calculation in relation to the deferred consideration amount recognised in the 31 March 2021 results. This relates to two items; first, the receivable related to the Interserve claim; and second, the potential recovery of landfill tax from HMRC which is a waste sector wide matter. For these matters, in assessing the fair value of each, we understood the latest position on the claims, considered management's assessment of the likelihood of any amounts and reviewed the latest correspondence with the company's advisors in connection with both matters;</p> <p>We tested management's calculation of the profit on disposal and considered whether it appropriately reflected the terms of the sale and purchase agreement in respect of consideration and claims from the purchaser, repayment of debt relating to Viridor; and</p> <p>We reviewed the appropriateness of the disclosures included in the Group financial statements.</p>	<p>We have concluded that the profit recognised from discontinued operations is appropriate and that the necessary disclosures have been made in accordance with IFRS 5.</p>

In the prior year, our auditor's report included two key audit matters related to the Viridor business: valuation of landfill related provisions and valuation of the receivable related to Interserve claim. Following the completion of sale of this entity in July 2020, these landfill provisions are no longer recognised in the Group balance sheet and therefore are not considered as a key audit matter in current year. The accounting and disclosure relating to the profit on discontinued operations, relating to the Viridor business, which includes the assessment of the Interserve receivable is included as a key audit matter above.

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 £7.9 million (2020: £14.4 million), which is 5% (2020: 5%) of the Group's Profit before taxation and non-underlying items from continuing operations. We believe that Profit before taxation and non-underlying items from continuing operations 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. The profit before taxation and non-underlying items is reduced as a result of the disposal of the Viridor business and our materiality is therefore also reduced compared to the prior year, to reflect this.

We determined materiality for the parent company to be £29.6 million (2020: £21.4 million), which is 1% (2020: 1%) of Equity.

Starting basis	Adjustments	Materiality
<ul style="list-style-type: none"> Reported profit before taxation from continuing operations £132.1 million (2020: £193.1 million) 	<ul style="list-style-type: none"> Non-underlying items (Refer to Note 6 – increase basis by £24.9 million (2020: £13.1 million decrease)) 	<ul style="list-style-type: none"> Totals £157.0 million (2020: £183.0 million) profit before taxation and non-underlying items from continuing operations (note this excludes profit from discontinued operations). Materiality of £7.9 million (5% of profit before taxation and 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% (2020: 75%) of our planning materiality, namely £5.9 million (2020: £10.8 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. The significant year over year change is due to completion of Viridor sale on 8 July 2020.

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 £2.8 million to £5.2 million (2020: £3.7 million to £9.5 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 £0.4 million (2020: £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. The significant year over year change is due to completion of Viridor sale on 8 July 2020.

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 on pages 1 to 136 other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report.

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.

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 course of 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 themselves. 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.

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 statement 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.

Independent auditor's report continued to the members of Pennon Group plc

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
- a Corporate Governance Statement has not been prepared by the company

Corporate Governance Statement

The Listing Rules require us to review the directors' statement in relation to going concern, longer-term viability and that part of the Corporate Governance Statement relating to the group and company's compliance with the provisions of the UK Corporate Governance Code specified for our review.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the Corporate Governance Statement is materially consistent with the financial statements or our knowledge obtained during the audit:

- Directors' statement with regards to the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on page 135;
- Directors' explanation as to its assessment of the company's prospects, the period this assessment covers and why the period is appropriate set out on page 80;
- Directors' statement on fair, balanced and understandable set out on page 135;
- Board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 68;
- The section of the annual report that describes the review of effectiveness of risk management and internal control systems set out on page 96; and
- The section describing the work of the audit committee set out on page 100.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 135, 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

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect irregularities, including fraud. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the company and management.

- 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 sector which is highly regulated. 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

- Following the recommendation from the audit committee, we were appointed by the company on 31 March 2014 to audit the financial statements for the year ending 31 March 2015 and subsequent financial periods.

The period of total uninterrupted engagement including previous renewals and reappointments is 7 years, covering the years ending 31 March 2015 to 31 March 2021.

- 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.

Christabel Cowling (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Leeds

2 June 2021

Consolidated income statement

For the year ended 31 March 2021

	Notes	Before non-underlying items 2021 £m	Non-underlying items (note 6) 2021 £m	Total 2021 £m	Before non-underlying items 2020 £m	Non-underlying items (note 6) 2020 £m	Total 2020 £m
Revenue	5	644.6	(20.5)	624.1	636.7	–	636.7
Operating costs	7						
Employment costs		(75.0)	(4.4)	(79.4)	(70.0)	–	(70.0)
Raw materials and consumables used		(18.1)	–	(18.1)	(14.9)	–	(14.9)
Other operating expenses		(216.8)	–	(216.8)	(186.5)	(7.9)	(194.4)
Earnings before interest, tax, depreciation and amortisation	5	334.7	(24.9)	309.8	365.3	(7.9)	357.4
Depreciation and amortisation	7	(119.4)	–	(119.4)	(119.8)	–	(119.8)
Operating profit	5	215.3	(24.9)	190.4	245.5	(7.9)	237.6
Finance income	8	4.2	–	4.2	4.1	–	4.1
Finance costs	8	(62.5)	–	(62.5)	(66.6)	18.0	(48.6)
Net finance costs	8	(58.3)	–	(58.3)	(62.5)	18.0	(44.5)
Profit before tax	5	157.0	(24.9)	132.1	183.0	10.1	193.1
Taxation charge	9	(29.6)	4.8	(24.8)	(38.4)	(32.2)	(70.6)
Profit from continuing operations		127.4	(20.1)	107.3	144.6	(22.1)	122.5
Profit from discontinued operations	44	35.5	1,619.2	1,654.7	91.0	(7.2)	83.8
Profit for the year		162.9	1,599.1	1,762.0	235.6	(29.3)	206.3
Attributable to:							
Ordinary shareholders of the parent				1,762.2			200.4
Non-controlling interests				(0.2)			(1.1)
Perpetual capital security holders				–			7.0
Earnings per ordinary share (pence per share)	11						
From continuing operations							
– Basic				25.5			27.7
– Diluted				25.4			27.6
From continuing and discontinued operations							
– Basic				418.5			47.7
– Diluted				416.9			47.5

The notes on pages 152 to 206 form part of these financial statements.

Consolidated statement of comprehensive income

For the year ended 31 March 2021

	Notes	Before non-underlying items 2021 £m	Non-underlying items (note 6) 2021 £m	Total 2021 £m	Before non-underlying items 2020 £m	Non-underlying items (note 6) 2020 £m	Total 2020 £m
Profit for the year		162.9	1,599.1	1,762.0	235.6	(29.3)	206.3
Other comprehensive income/(loss)							
Items that will not be reclassified to profit or loss							
Remeasurement of defined benefit obligations	30	(28.8)	–	(28.8)	17.7	–	17.7
Income tax on items that will not be reclassified	9	5.5	–	5.5	0.1	–	0.1
Total items that will not be reclassified to profit or loss		(23.3)	–	(23.3)	17.8	–	17.8
Items that may be reclassified subsequently to profit or loss							
Share of other comprehensive income from joint ventures	20	–	–	–	0.2	–	0.2
Cash flow hedges		13.5	–	13.5	(14.3)	–	(14.3)
Income tax on items that may be reclassified	9	(2.4)	–	(2.4)	3.1	–	3.1
Total items that may be reclassified subsequently to profit or loss		11.1	–	11.1	(11.0)	–	(11.0)
Other comprehensive (loss)/income for the year net of tax	36	(12.2)	–	(12.2)	6.8	–	6.8
Total comprehensive income for the year		150.7	1,599.1	1,749.8	242.4	(29.3)	213.1
Total comprehensive income attributable to:							
Ordinary shareholders of the parent				1,750.0			207.2
Non-controlling interests				(0.2)			(1.1)
Perpetual capital security holders				–			7.0

The notes on pages 152 to 206 form part of these financial statements.

Balance sheets

At 31 March 2021

		Group		Company	
	Notes	2021 £m	2020 £m	2021 £m	2020 £m
Assets					
Non-current assets					
Goodwill	15	42.3	42.3	–	–
Other intangible assets	16	1.2	1.2	–	–
Property, plant and equipment	17	3,221.0	3,171.8	0.1	0.2
Other non-current assets	19	–	–	26.1	1,223.5
Deferred tax assets	31	–	–	12.5	1.8
Derivative financial instruments	23	3.8	4.1	2.3	4.1
Investments in subsidiary undertakings	20	–	–	846.4	845.2
Investments in joint ventures	20	–	–	–	–
Retirement benefit obligations	30	8.8	6.6	–	–
		3,277.1	3,226.0	887.4	2,074.8
Current assets					
Inventories	21	5.4	4.9	–	–
Trade and other receivables	22	216.8	185.8	73.0	24.7
Current tax receivable	27	0.1	1.9	–	–
Derivative financial instruments	23	1.3	2.7	1.1	2.5
Cash and cash deposits	25	2,919.3	665.9	2,495.6	367.9
		3,142.9	861.2	2,569.7	395.1
Assets held for sale					
	44	–	2,675.3	–	1,135.6
		3,142.9	3,536.5	2,569.7	1,530.7
Liabilities					
Current liabilities					
Borrowings	28	(88.3)	(59.9)	(283.4)	(290.5)
Financial liabilities at fair value through profit	24	(2.8)	(1.5)	(0.5)	(0.5)
Derivative financial instruments	23	(6.3)	(7.1)	(0.2)	(0.9)
Trade and other payables	26	(126.1)	(115.3)	(10.2)	(19.8)
Current tax liabilities	27	–	–	(4.4)	(2.5)
Provisions	32	(0.3)	(0.6)	–	–
		(223.8)	(184.4)	(298.7)	(314.2)
Liabilities directly associated with assets classified as held for sale					
	44	–	(756.3)	–	–
Net current assets					
		2,919.1	2,595.8	2,271.0	1,216.5
Non-current liabilities					
Borrowings	28	(2,766.7)	(3,654.9)	(184.4)	(1,135.4)
Other non-current liabilities	29	(128.3)	(122.9)	(8.6)	(8.6)
Financial liabilities at fair value through profit	24	(39.4)	(43.1)	(1.0)	(1.1)
Derivative financial instruments	23	(17.4)	(27.2)	–	(2.8)
Retirement benefit obligations	30	–	–	(5.5)	(0.1)
Deferred tax liabilities	31	(259.6)	(261.6)	–	–
		(3,211.4)	(4,109.7)	(199.5)	(1,148.0)
Net assets					
		2,984.8	1,712.1	2,958.9	2,143.3
Shareholders' equity					
Share capital	33	171.8	171.3	171.8	171.3
Share premium account	34	232.1	227.0	232.1	227.0
Capital redemption reserve	35	144.2	144.2	144.2	144.2
Retained earnings and other reserves	36	2,436.8	872.8	2,410.8	1,304.1
Total shareholders' equity					
		2,984.9	1,415.3	2,958.9	1,846.6
Non-controlling interests		(0.1)	0.1	–	–
Perpetual capital securities	37	–	296.7	–	296.7
Total equity					
		2,984.8	1,712.1	2,958.9	2,143.3

The profit for the year attributable to ordinary shareholders' equity dealt with in the accounts of the Parent Company is £1,312.3 million (2020 £330.6 million). The notes on pages 152 to 206 form part of these financial statements.

The financial statements on pages 146 to 206 were approved by the Board of Directors and authorised for issue on 2 June 2021 and were signed on its behalf by:

Susan Davy
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 2021

	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 31 March 2019	171.1	223.6	144.2	843.0	1.2	296.7	1,679.8
Opening adjustment on adoption of IFRS 16	–	–	–	(8.0)	–	–	(8.0)
At 1 April 2019 (adjusted for IFRS 16)	171.1	223.6	144.2	835.0	1.2	296.7	1,671.8
Profit for the year	–	–	–	200.4	(1.1)	7.0	206.3
Other comprehensive income for the year	–	–	–	6.8	–	–	6.8
Total comprehensive income for the year	–	–	–	207.2	(1.1)	7.0	213.1
Transactions with equity shareholders:							
Dividends paid	–	–	–	(172.6)	–	–	(172.6)
Adjustment in respect of share-based payments (net of tax)	–	–	–	4.8	–	–	4.8
Distributions to perpetual capital security holders	–	–	–	–	–	(8.6)	(8.6)
Current tax relief on distribution to perpetual capital security holders	–	–	–	–	–	1.6	1.6
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	–	–	–	(1.6)	–	–	(1.6)
Proceeds from shares issued under the Sharesave Scheme	0.2	3.4	–	–	–	–	3.6
Total transactions with equity shareholders	0.2	3.4	–	(169.4)	–	(7.0)	(172.8)
At 31 March 2020	171.3	227.0	144.2	872.8	0.1	296.7	1,712.1
Profit for the year	–	–	–	1,762.2	(0.2)	–	1,762.0
Other comprehensive income for the year	–	–	–	(12.2)	–	–	(12.2)
Total comprehensive income for the year	–	–	–	1,750.0	(0.2)	–	1,749.8
Transactions with equity shareholders:							
Dividends paid	–	–	–	(184.3)	–	–	(184.3)
Adjustment in respect of share-based payments (net of tax)	–	–	–	2.2	–	–	2.2
Redemption of perpetual capital securities	–	–	–	(3.3)	–	(296.7)	(300.0)
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	–	–	–	(1.2)	–	–	(1.2)
Deferred tax recognised directly in equity	–	–	–	0.6	–	–	0.6
Proceeds from shares issued under the Sharesave Scheme	0.5	5.1	–	–	–	–	5.6
Total transactions with equity shareholders	0.5	5.1	–	(186.0)	–	(296.7)	(477.1)
At 31 March 2021	171.8	232.1	144.2	2,436.8	(0.1)	–	2,984.8

The notes on pages 152 to 206 form part of these financial statements.

Statements of changes in equity continued

For the year ended 31 March 2021

	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 2019	171.1	223.6	144.2	1,144.7	296.7	1,980.3
Profit for the year (note 10)	–	–	–	330.6	7.0	337.6
Other comprehensive income for the year	–	–	–	0.5	–	0.5
Total comprehensive income for the year	–	–	–	331.1	7.0	338.1
Transactions with equity shareholders:						
Dividends paid	–	–	–	(172.6)	–	(172.6)
Distributions to perpetual capital security holders	–	–	–	–	(8.6)	(8.6)
Current tax relief on distribution to perpetual capital security holders	–	–	–	–	1.6	1.6
Adjustment in respect of share-based payments (net of tax)	–	–	–	2.0	–	2.0
Charge in respect of share options vesting	–	–	–	(1.1)	–	(1.1)
Proceeds from shares issued under the Sharesave Scheme	0.2	3.4	–	–	–	3.6
Total transactions with equity shareholders	0.2	3.4	–	(171.7)	(7.0)	(175.1)
At 31 March 2020	171.3	227.0	144.2	1,304.1	296.7	2,143.3
Profit for the year (note 10)	–	–	–	1,312.3	–	1,312.3
Other comprehensive income for the year	–	–	–	(17.8)	–	(17.8)
Total comprehensive income for the year	–	–	–	1,294.5	–	1,294.5
Transactions with equity shareholders:						
Dividends paid	–	–	–	(184.3)	–	(184.3)
Redemption of perpetual capital securities	–	–	–	(3.3)	(296.7)	(300.0)
Adjustment in respect of share-based payments (net of tax)	–	–	–	1.4	–	1.4
Charge in respect of share options vesting	–	–	–	(2.2)	–	(2.2)
Deferred tax recognised directly in equity	–	–	–	0.6	–	0.6
Proceeds from shares issued under the Sharesave Scheme	0.5	5.1	–	–	–	5.6
Total transactions with equity shareholders	0.5	5.1	–	(187.8)	(296.7)	(478.9)
At 31 March 2021	171.8	232.1	144.2	2,410.8	–	2,958.9

The notes on pages 152 to 206 form part of these financial statements.

Cash flow statements

For the year ended 31 March 2021

		Group		Company	
	Notes	2021 £m	2020 £m	2021 £m	2020 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	38	298.1	516.3	(69.4)	(180.3)
Interest paid	38	(80.2)	(97.7)	(23.1)	(37.4)
Tax paid		(7.4)	(52.6)	(1.7)	(3.7)
Net cash generated/(outflow) from operating activities		210.5	366.0	(94.2)	(221.4)
Cash flows from investing activities					
Interest received		4.3	3.4	8.1	45.1
Dividends received	43	–	6.0	43.5	335.6
Loan repayments received from joint ventures		4.0	13.4	–	–
Deposit of restricted deposits		(23.6)	(23.3)	–	–
Purchase of property, plant and equipment		(190.1)	(332.8)	–	–
Proceeds on disposal of subsidiaries, net of cash disposed at Group level and transaction costs		3,628.5	–	3,690.2	–
Purchase of intangible assets		(0.2)	(0.6)	–	–
Proceeds from sale of property, plant and equipment		0.4	10.6	–	–
Investment in subsidiary undertakings		–	–	(1.2)	–
Net cash received from/(used in) investing activities		3,423.3	(323.3)	3,740.6	380.7
Cash flows from financing activities					
Proceeds from issuance of ordinary shares		5.6	3.6	5.6	3.5
Proceeds from derivatives early settlement		–	87.2	–	–
Purchase of ordinary shares by the Pennon Employee Share Trust		(1.2)	(1.6)	–	–
Proceeds from new borrowing		330.0	268.2	200.0	151.7
Repayment of borrowings		(1,265.4)	(84.8)	(1,231.4)	(51.8)
Cash inflows from lease financing arrangements		15.0	115.0	–	–
Lease principal repayments		(28.4)	(142.8)	–	–
Dividends paid		(184.3)	(172.6)	(184.3)	(172.6)
Perpetual capital securities periodic return	37	(8.6)	(8.6)	(8.6)	(7.0)
Redemption of perpetual capital securities		(300.0)	–	(300.0)	–
Net cash (used in)/received from financing activities		(1,437.3)	63.6	(1,518.7)	(76.2)
Net increase in cash and cash equivalents					
Cash and cash equivalents at beginning of the year	25	472.0	365.7	367.9	284.8
Cash and cash equivalents at end of the year	25	2,668.5	472.0	2,495.6	367.9

The cash flow statement above includes the entire Group, including cash flows relating to the discontinued Viridor business. Disaggregated information relating to the Viridor business is provided in note 44.

The notes on pages 152 to 206 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 214. Pennon Group's continuing business is operated through two principal subsidiaries. South West Water Limited includes the integrated water companies 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. 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. On 8 July 2020 Pennon completed the sale of Viridor Limited (the "Disposal Group"), a recycling, energy recovery and waste management business. In accordance with IFRS 5 'Non-current assets held for sale and discontinued operations', the net results for Viridor are presented within discontinued operations in the Group income statement. The balance sheet as at 31 March 2021 shows the financial position of the Continuing Group only. At 31 March 2020 the assets and liabilities of Viridor were presented as assets and liabilities held for sale in the consolidated balance sheet. The effect of the disposal on the financial position of the Group is detailed in note 44.

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), (v) and (n) respectively) and in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006 and international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union. 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. At 31 March 2021 the Group has access to undrawn committed funds and cash and cash deposits totalling £3.2 billion (£3.0 billion excluding restricted cash). Having considered the Group's strong funding position, the planned use of the residual proceeds from the Viridor disposal after the retirement of debt and prudent financial projections, which take into account a range of possible impacts, as described in this report, from the COVID-19 pandemic, the Directors have a reasonable expectation that the Group has adequate resource to continue in operational existence for the period of at least 12 months from the date of the approval of the financial statements and that there are no material uncertainties to disclose. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

New standards or interpretations which were mandatory for the first time in the year beginning 1 April 2020 did not have a material impact on the net assets or results of the Group. Although the IASB's interest rate benchmark reform amendments IFRS 7 'Financial Instrument (FI) disclosures' and IFRS 9 'FI recognition and measurement' came into effect from 1 January 2020, these had already been early adopted by the Group in its 2020 financial statements as explained in the accounting policy for financial instruments.

New standards or interpretations due to be adopted from 1 April 2021 are not expected to have a material impact on the Group's net assets or results. Existing borrowing covenants are not impacted by changes in accounting standards.

(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.

Assets held for sale and discontinued operations

In accordance with IFRS 5 'Non-current assets held for sale and discontinued operations', non-current assets and disposal groups are classified as held for sale only if available for immediate sale in their present condition and a sale is highly probable and expected to be completed within one year from the date of classification. Such assets are measured at the lower of carrying amount and fair value, less the costs of disposal, and are not depreciated or amortised. Accordingly, the net results of Viridor are presented within discontinued operations in the Group income statement and the asset and liabilities of these operations are presented separately in the Group balance sheet at 31 March 2020. Further information is provided in note 44.

(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.

2. Principal accounting policies continued

(c) Revenue recognition continued

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 wastewater 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 wastewater 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 wastewater 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.

Energy sales (discontinued operations)

The Group received revenue from the sale of electricity from generating assets. These assets included solar, anaerobic digestion, gas from landfill and energy recovery facilities (ERFs). Revenue from the sale of electricity from the Group's generating assets was measured based upon metered output delivered at rates specified under contract terms or prevailing market rates. Revenue was recognised at a 'point in time', being the point of distribution. Typically, invoices were raised monthly with standard payment terms.

Waste management services (discontinued operations)

For Viridor, in respect of single services with fixed fees, such as the receipt of gate and collection fees, revenue was recognised at the time the service was provided.

Viridor also delivered other waste management services for which revenue was recognised 'over time' in accordance with contracts with customers. The nature of contracts and/or performance obligations included management fees to operate local authority recycling centres and ERFs, multi service contracts including collections and gate fees.

Revenue from other services could be fixed (i.e. management fees) or variable (i.e. gate fees).

Gate fee revenue, derived from Viridor's operational assets, was recognised as customer waste was deposited and was based on tonnage received.

In respect of waste collection services, revenue was recognised at the point of collection from customer premises.

In respect of its landfill business, revenue was set to cover total costs, including landfill tax (LFT), and to achieve a desired profit margin. Viridor, as the operator, had a direct obligation to pay LFT, which represented a significant waste disposal cost of production for the business.

A majority of waste management customers were invoiced monthly for services provided within the monthly billing period. Payments were typically due on an end of month following invoice basis. Alternative billing and/or payment terms were agreed in exceptional circumstances.

Viridor transferred control of such waste management services prior to invoicing. Receipt of payment following invoice was based solely on the passage of time. A trade receivable was recognised until payment was made and/or refund issued.

Where Viridor entered into service concession arrangements it accounted for these contracts in accordance with IFRIC 12. Consideration was treated as contract assets or other intangible assets, depending upon the right to receive cash from the asset. Consideration was split between construction of assets, operation of the service and provision of finance recognised as interest receivable.

Revenue in respect of construction services was recognised over time and was 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 reflected the manner in which control passed to the customer. While construction was in progress the consideration was disclosed as a contract asset within non-current financial assets. On entry into operational service, in accordance with IFRIC 12, the contract asset was reclassified as either costs recoverable from construction activities disclosed within other intangible assets when the concession grantor had 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 guaranteed 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 were received during construction.

In respect of operating services, revenue was recognised over time in line with delivery of operational services in accordance with the contract with the local authority.

Once the operational phase commenced the Group had a right to receive consideration for the construction and operational services delivered. Invoicing typically occurred monthly and payments were due by the end of the month following date of invoice.

Notes to the financial statements continued

2. Principal accounting policies continued

(c) Revenue recognition continued

Recyclate (discontinued operations)

Viridor transformed waste into recyclate ready for resale. Revenue was measured at the agreed transaction price per tonne of recyclate under the contract with the customer. Revenue recognition occurred when control over the recyclate assets had been transferred to the customer.

In respect of UK sales, Viridor's performance obligation was satisfied at the point of collection by the customer. This was the point in time when an invoice was issued and revenue was recognised. Payment terms were typically end of month following invoice date. Overseas sales were predominantly agreed under a letter of credit. Goods were despatched at the point the letter of credit was accepted by the customer's bank. Payment was released when the customer confirmed satisfactory receipt of the recyclate. This was the point legal title (i.e. control) passed to the customer and revenue was 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 (v) 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) 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. Following the sale of Viridor, which represented the waste management business segment, the waste management business was removed from the continuing operations segmental reporting. Further information relating to income, expenses and cash flows of Viridor's waste management business is provided in note 44.

The remaining business segments of the Continuing Group include the water business, comprising the regulated water and wastewater services undertaken by South West Water, and the non-household retail business, comprising the services provided by Pennon Water Services in the non-household water and wastewater retail market which, while regulated, is open to competition. Other segments, including Pennon Group plc, are not reportable segments as they are not reported to Chief Decision makers. Segmental revenue and results include transactions between businesses. Inter-segmental transactions are eliminated on consolidation.

(e) 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 (CGUs) or group of CGUs, 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 (i).

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

(f) Other intangible assets

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

In discontinued operations, other intangible assets were recognised in relation to long-term service concessions contracts to the extent that future amounts to be received were not contracted.

(g) 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 to 120 years
Sewers	40 to 120 years

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

ii) Landfill sites (discontinued operations)

For the Viridor business, landfill sites were included within land and buildings at cost less accumulated depreciation. Cost included acquisition and development expenses. The cost of a landfill site was depreciated to its residual value over its estimated operational life taking account of the usage of void space.

iii) Landfill restoration (discontinued operations)

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

2. Principal accounting policies continued

(g) Property, plant and equipment continued

iv) Other assets (including ERFs, 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 to 60 years
Land and buildings – leasehold buildings	Over the estimated economic lives or the finance lease period, whichever is the shorter
Operational properties	40 to 80 years
ERFs (including major refurbishments)	25 to 40 years
Fixed plant	20 to 40 years
Vehicles, mobile plant and computers	3 to 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 (v).

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.

(h) Leased assets

All are accounted for by recognising a right-of-use asset and a lease liability except for:

- Low value assets; and
- Leases with a duration of 12 months or less.

Contracts are initially measured at the present value of contractual payments due to the lessor over the lease term, with the discount rate determined by reference to the rate inherent in the lease unless this is not readily determinable, in which case the Group's incremental borrowing rate on commencement of the lease is used. After initial measurement, lease payments are allocated between the liability and finance cost. The finance cost is charged to profit and loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The interest element of cash payments in respect of these leases is included within interest payments in determining net cash generated from operating activities. The capital element of the cash payment is included within cash flows from financing activities. Right-of-use assets are amortised on a straight-line basis over the remaining term of the lease or the remaining economic life of the asset if shorter. When the Group revisits its estimate of lease term (because, for example, it reassesses an extension option), it adjusts the carrying amount of the lease liability to reflect the payments to make over the revised term, which is discounted at the same discount rate that applied on lease commencement. In these circumstances an equivalent adjustment is made to the carrying value of the right-of-use asset, with the revised carrying amount being amortised over the remaining (revised) lease term.

Assets are included as property, plant and equipment as right-of-use assets 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.

The Group regularly uses sale and leaseback transactions to finance its capital programme. A sale and leaseback transaction is where the Group sells an asset and immediately reacquires the use of the asset by entering into a lease with the buyer. Each transaction is assessed as to whether it meets the criteria within IFRS 15 'Revenue from contracts with customers' for a sale to have occurred. As a result, a lease liability is recognised, the associated property, plant and equipment asset is derecognised, and a right-of-use asset is recognised at the proportion of the carrying value relating to the right retained. Any gain or loss arising relates to the rights transferred to the buyer.

(i) 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 (CGUs). Value-in-use represents the present value of projected future cash flows expected to be derived from a CGU, discounted using a pre-tax discount rate which reflects an assessment of the market cost of capital of the CGU. 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 CGU'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.

(j) 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.

Notes to the financial statements continued

2. Principal accounting policies continued

(k) 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.

(l) 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. The costs of items of inventory are determined using weighted average costs.

(m) Cash and cash deposits

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

(n) Financial instruments

Financial instruments are recognised and measured in accordance with IFRS 9. 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 IFRS 9, 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 (discontinued operations)

For Viridor, where the provision of waste management services was performed through a contract with a public sector entity, which controlled a significant residual interest in asset infrastructure at the end of the contract, then consideration was treated as contract receivables, split between profit on the construction of assets, operation of the service and the provision of finance which was recognised in notional interest within finance income.

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.

In January 2020, the IASB's interest rate benchmark reform amendments to IFRS 7 'Financial Instrument (FI) disclosures' and to IFRS 9 'FI recognition and measurement' (the 'Phase 1 amendments') were endorsed by the EU. The amendments modify hedge accounting requirements to allow hedge accounting to continue for affected hedges during the period of uncertainty before the hedged items or hedging instruments are affected when current interest rate benchmarks are amended due to the ongoing interest rate benchmark reforms. The Group chose to early adopt the Phase 1 amendments, which are mandatory for annual reporting periods commencing after 1 January 2020, for its reporting period ended 31 March 2020.

The Phase 1 amendments are relevant to the Group given that it applies hedge accounting to its benchmark interest rate exposures.

2. Principal accounting policies continued

(n) Financial instruments continued

v) Derivative financial instruments and hedging activities continued

The application of the Phase 1 amendments impacts the Group's accounting policies in the following ways:

The Group has floating rate debt, linked to the UK's benchmark rate GBP London Inter-Bank Offered Rate (GBP LIBOR), which it fixes through cash flow hedges using interest rate swaps. The Phase 1 amendments permit continuation of hedge accounting even though there is uncertainty about the timing and amount of the hedged cash flows due to the interest rate benchmark reforms.

The Group uses cross-currency interest rate swaps to hedge the foreign currency risk, where applicable, within its financial instruments. The Phase 1 amendments permit continuation of hedge accounting even though there is uncertainty about the replacement of the floating interest rates included in its cross-currency interest rate swaps.

The Group will retain the cumulative gain or loss in the hedging reserve for designated cash flow hedges that are subject to interest rate benchmark reforms even though there is uncertainty arising from the reform with respect to the timing and amount of the cash flows of the hedged items. If the hedged future cash flows are no longer expected to occur due to reasons other than interest rate benchmark reform, the cumulative gain or loss will be immediately reclassified to profit or loss.

The IASB published its Phase 2 amendments on interest rate benchmark reform in August 2020. These amendments deal with issues that might arise during the reform of an interest rate benchmark. The Phase 2 amendments are applicable to periods commencing after 1 January 2021, with early adoption permitted. The Group will adopt the Phase 2 amendments at the appropriate time.

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.

vii) Receivables due from subsidiary undertakings

Amounts owed by subsidiaries are classified and recorded at amortised cost and reduced by allowances for ECLs. Estimated future credit losses are first recorded on initial recognition of a receivable and are based on estimated probability of default. Individual balances are written off when management deems them not to be collectible.

(o) 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.

(p) Provisions

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

The Group's policies on specific provisions are:

i) Landfill restoration costs (discontinued operations)

For Viridor, provisions for the cost of restoring landfill sites were made when the obligation arose. Where the obligation recognised as a provision was an integral part of a landfill site's future economic benefit, an asset in property, plant and equipment was recognised. Provisions were otherwise charged against profits based on the usage of void space.

ii) Environmental control and aftercare costs (discontinued operations)

For Viridor, environmental control and aftercare costs were incurred during the operational life of each landfill site and for a considerable period thereafter. Provision for all such costs was 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 were 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 (i).

(q) Share capital and treasury shares

Ordinary shares are classified as equity.

Where the Company purchases the Company's equity share capital (treasury shares) the consideration paid, including any directly attributable costs, is deducted from equity until the shares are cancelled or 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 2019 to supersede the Pennon Employee Share Trust which was registered in Guernsey.

Notes to the financial statements continued

2. Principal accounting policies continued

(r) Dividend distributions

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

(s) Employee benefits

i) Retirement benefit obligations

The Group operates defined benefit and defined contribution pension schemes.

Defined benefit pension schemes

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 a 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.

(t) 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.

(u) 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.

(v) 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 a contract liability 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.

(w) 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.

(x) 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.

(y) 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.

(z) Grants and contributions

Grants and contributions receivable in respect of property, plant and equipment are deducted from the cost of those assets. Grants and contributions receivable in respect of expenses charged against profits in the year have been included in the income statement.

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 Group Finance Director 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 unregulated EBITDA plus interest receivable on service concession arrangements) and interest cover. Existing covenants are not impacted by subsequent changes to accounting standards.

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	Due over 5 years £m	Total £m
Group					
31 March 2021					
Non-derivative financial liabilities					
Borrowings excluding lease liabilities	40.1	70.0	194.0	1,111.7	1,415.8
Interest payments on borrowings	32.5	33.6	103.4	600.9	770.4
Lease liabilities including interest	55.3	37.8	267.3	1,543.0	1,903.4
Trade and other payables	126.1	–	–	–	126.1
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	9.3	6.7	3.9	(2.3)	17.6
31 March 2020					
Non-derivative financial liabilities					
Borrowings excluding lease liabilities	40.7	244.4	511.9	1,479.3	2,276.3
Interest payments on borrowings	59.1	56.3	135.8	618.2	869.4
Lease liabilities including interest	39.5	94.4	150.9	1,750.6	2,035.4
Trade and other payables	115.3	–	–	–	115.3
Guarantees	197.1	–	–	–	197.1
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	7.0	7.3	20.3	0.7	35.3
Company					
31 March 2021					
Non-derivative financial liabilities					
Borrowings (including intercompany borrowings)	283.4	30.0	58.2	96.2	467.8
Interest payments on borrowings	5.8	5.3	14.0	5.2	30.3
Trade and other payables	10.2	–	–	–	10.2
Derivative financial liabilities					
Derivative contracts – net payments	–	–	–	–	–
31 March 2020					
Non-derivative financial liabilities					
Borrowings (including intercompany borrowings)	290.5	204.4	393.1	537.9	1,425.9
Interest payments on borrowings	33.1	30.9	61.3	64.8	190.1
Trade and other payables	19.8	–	–	–	19.8
Guarantees	658.0	–	–	–	658.0
Derivative financial liabilities					
Derivative contracts – net payments	0.6	0.7	1.5	0.3	3.1

No liability is expected to arise in respect of the guarantees noted above. Guarantees are analysed in note 41.

Notes to the financial statements continued

3. Financial risk management continued

(a) Financial risk factors continued

ii) Market risk

During the year the Group has operated in a net cash position. The treasury policy states at least 60% of the Group's debt should be fixed, this is managed through fixed rate debt and the use of derivatives to ensure these levels are met. Following the completion of the strategic review the Group expects to manage its debt portfolio in line with the strategy used before the strategic review commenced. During the current financial year South West Water has continued to manage its debt portfolio in line with the Treasury policy to manage the risk of fluctuating interest rates impacting the financial performance of the subsidiary. Of the Group's net borrowings a proportion is RPI index-linked. The interest rate for index-linked debt is based mainly upon an RPI measure; due to the change in the Ofwat methodology the Group has considered other index linked borrowings which are also used in determining the amount of revenue from customers in South West Water. The Group uses a combination of fixed rate, index-linked borrowings and fixed rate interest swaps as cash flow hedges of future variable interest payments to achieve this policy. 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.

The Group is primarily exposed to the UK's benchmark interest rate, GBP LIBOR, within its hedge accounting relationships, which are subject to interest rate benchmark reform. The Group also has a small amount of Euro denominated debt on which the foreign currency risk has been managed through cross currency swaps.

The Group has closely monitored the market and the output from the various industry working groups managing the transition to new benchmark interest rates.

The Financial Conduct Authority (FCA) has made clear that, at the end of 2021, it will no longer seek to persuade or compel the banks to submit to LIBOR.

During 2019/20 the Group converted a LIBOR revolving credit facility (RCF) to a Sterling Overnight Index Average (SONIA) linked RCF; this was to address the documentary changes and allow the Group to test the changes in the Treasury management system. Further work continues to ensure the Group is well placed to amend the debt portfolio before the December 2021 transition. The Group has updated some of its documentation to include SONIA switch language and is looking now looking to address the derivative book.

Below are the details of the hedging instruments and hedged items in scope of the amendments to IFRS 7 and 9 due to interest rate benchmark reform, by hedge type. The terms of the hedged items listed match those of the corresponding hedging instruments.

Hedge type	Instrument type	Maturing	Nominal £m	Hedged item
Fair value hedges	Pay six-month UK benchmark rate (GBP LIBOR), receive sterling fixed cross currency swap	2026	16	Fixed-rate Euro denominated financial instrument of the same maturity and nominal as the swap
Cash flow hedges	Receive three-month UK benchmark rate (GBP LIBOR), pay GBP fixed interest rate swap	2024–2030	701	UK benchmark rate (GBP LIBOR) issued financial instruments of the same nominals as the swaps
	Receive six-month UK benchmark rate (GBP LIBOR), pay GBP fixed interest rate swap	2025	100	UK benchmark rate (GBP LIBOR) issued financial instruments of the same nominals as the swaps

The Group will continue to apply the amendments to IFRS 9 until the uncertainty arising from the interest rate benchmark reforms with respect to the timing and the amount of the underlying cash flows that the Group is exposed ends. The Group has assumed that this uncertainty will not end until alternate language has been agreed with the counterparties and is dependent on the outcome of the introduction of fallback provisions and the clauses negotiated with lenders.

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 2021 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 £5.5 million (2020 £2.4 million), for the equity sensitivity fair value, with derivative impacts excluded.

For 2021 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 (2020 £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.

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 note 22.

Counterparty risk arises from the investment of surplus funds and from the use of derivative financial instruments. The Board has agreed a policy for managing such risk which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures.

The Group has no other significant concentration of credit risk. The Group's surplus funds are managed by the Group's treasury function and are usually placed in short-term fixed interest deposits or the overnight money markets. Deposit counterparties must meet Board approved minimum criteria based on their short-term credit ratings and therefore be of good credit quality.

3. Financial risk management continued

(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 2021 the Group had cash and facilities, including restricted funds, of £3.2 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 Group currently manages a net cash position of £64.3 million following the sale of its Viridor subsidiary.

The gearing ratios at the balance sheet date were:

	2021 £m	2020 £m
Net borrowings (note 39)	–	3,048.9
Total equity	2,984.8	1,712.1
Total capital	2,984.8	4,761.0
Gearing ratio	0.0%	64.0%

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 K7 (2020-25) regulatory period is set at 60%.

	Water business	
	2021 £m	2020 £m
Regulatory capital value	3,393.4	3,572.5
Net borrowings	2,273.6	2,307.2
Net borrowings/regulatory capital value	67.0%	64.6%

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.

Notes to the financial statements continued

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 impacting continuing operations

Provision for doubtful debts

The Group has a material level of exposure to collection of trade receivables. Provisions in respect of these balances are calculated with reference to historical credit loss experience, adjusted for forward-looking factors which by their nature are subject to uncertainty. Analysis of actual recovery compared with provisioning levels have not, to date, resulted in material variances.

Under its regular review procedures at the balance sheet date, the Group applies a simplified approach in calculating 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 informed by its historical credit loss experience, adjusted for forward-looking factors specific to the receivables and the economic environment.

In the prior year, at the onset of the COVID-19 pandemic, an additional assessment of ECLs was focused on the potential impact from the pandemic. Considerations in this assessment have included the type of customers, whether they conduct essential business operations, are linked to central or regional government and past experience of behaviours in challenging economic times. This additional level of assessment continues. The precise quantum of the impact of the pandemic on both the Group's business and household customers remains uncertain as the Group's assessment anticipates that the ongoing financial support from government will potentially delay the full impact on expected credit losses.

The actual level of debt collected may differ from the estimated levels of recovery. As at 31 March 2021 the Continuing Group's current trade receivables were £253.2 million (2020 £241.9 million), against which £102.3 million (2020 £106.1 million) had been provided for ECLs (note 22). The provision for ECLs includes a non-underlying charge of £nil (2020 £7.9 million) in relation to the impact of COVID-19. The additional amounts provided in the previous year continue to be required based on the Group's ongoing assessment of the impact of the pandemic.

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 most recent triennial valuation of the main scheme was as at 31 March 2019, the outcome of which is summarised in note 30.

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 2019 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.

Judgements impacting continuing operations

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.

Estimates impacting discontinued operations

Deferred consideration

Under the Viridor Sale Agreement deferred consideration may be receivable in future. At the time of the disposal, the Group considered that the amount of deferred consideration could be up to £0.2 billion, dependent upon future actions and the outcome of underlying events. As required under IFRS and the Group's accounting policies, the latest available information at each balance sheet date is used to determine a range of possible outcomes and a probability weighting for each of those outcomes to determine the fair value of the deferred consideration. This approach is in accordance with the Level 3 valuation technique for determining the fair value of financial instruments. The initial fair value assessment of deferred consideration of £54.0 million was based on detailed assessment of the value and probability of a number of possible outcomes supported by expert opinion. Specific events have arisen to reduce the range and the likelihood of a number of the more favourable outcomes. The fair value of the amount now expected has been adjusted to £9.2 million and this amount is expected to be received within the first half of the financial year ending 31 March 2022. The receipt of further additional deferred consideration remains possible, albeit the likelihood is judged as not probable and has therefore not been recognised in the financial statements. The Company's current estimated deferred consideration of £9.2 million has been recognised in other receivables.

Other judgements and estimates impacting discontinued operations

Judgements and estimates in respect of discontinued operations as disclosed in the consolidated financial statements for the year ended 31 March 2020 were consistently applied up to the date of disposal.

Other estimates

In the previous financial year, management reassessed the critical estimates and resolved that the level of estimation for revenue recognition of accrued revenue relating to water and waste was no longer considered critical as the estimates are largely calculated on a systematic basis and have not, to date, resulted in a material adjustment within the following 12-month period. However, management consider the total level of estimation of accrued revenue relating to water and waste to be material and highlight this as a material other estimate.

In addition, following the sale of Viridor, management have re-assessed the level of estimation in respect of taxation and have concluded that taxation is no longer an area of critical estimation in preparation of the financial statements.

5. Segmental information

Operating segments are reported in a manner consistent with internal reporting provided to the Chief Operating Decision-Maker (CODM), which has been identified as the Pennon Group plc Board. The earnings measures below are used by the Board in making decisions.

Following the disposal of Viridor, the Continuing Group is organised into two operating segments. The water business comprises the regulated water and wastewater services undertaken by South West Water. 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.

The segmental disclosures for revenue, operating profit and profit before tax are presented below for Continuing Operations only. Segmental disclosures on assets, liabilities and other information include discontinued operations for the comparative period, in order to reconcile to the Group balance sheet at 31 March 2020.

	2021 £m	2020 £m
Revenue from continuing operations		
Water	563.0	570.3
Non-household retail	162.8	173.5
Other	5.6	10.1
Less intra-segment trading ⁽¹⁾	(86.8)	(117.2)
Total underlying revenue	644.6	636.7
Water non-underlying revenue (note 6)	(20.5)	–
	624.1	636.7
Operating profit before depreciation, amortisation and non-underlying items (EBITDA) from continuing operations		
Water	340.6	364.2
Non-household retail	1.4	1.9
Other	(7.3)	(0.8)
	334.7	365.3
Operating profit before non-underlying items from continuing operations		
Water	222.3	245.4
Non-household retail	0.7	1.2
Other	(7.7)	(1.1)
	215.3	245.5
Profit before tax and non-underlying items from continuing operations		
Water	164.6	174.0
Non-household retail	(1.0)	(0.4)
Other	(6.6)	9.4
	157.0	183.0
Profit before tax from continuing operations		
Water	140.6	189.0
Non-household retail	(1.0)	(5.4)
Other	(7.5)	9.5
	132.1	193.1

(1) Intra-segment transactions between and to different segments are under normal market-based commercial terms and conditions. Intra-segment revenue of the other segment is at cost.

Notes to the financial statements continued

5. Segmental information continued

	Water £m	Non- household retail £m	Other £m	Total Continuing Group (pre- eliminations) £m	Disposal Group (pre- eliminations) £m	Eliminations £m	Group £m
Balance sheet							
31 March 2021							
Assets (excluding investments in joint ventures)	3,861.7	53.1	2,893.2	6,808.0	–	(388.0)	6,420.0
Investments in joint ventures	–	–	–	–	–	–	–
Total assets	3,861.7	53.1	2,893.2	6,808.0	–	(388.0)	6,420.0
Liabilities	(3,019.3)	(51.7)	(752.2)	(3,823.2)	–	388.0	(3,435.2)
Net assets	842.4	1.4	2,141.0	2,984.8	–	–	2,984.8
31 March 2020							
Assets (excluding investments in joint ventures)	3,654.6	54.6	1,928.0	5,637.2	2,618.4	(1,553.2)	6,702.4
Investments in joint ventures	–	–	–	–	60.1	–	60.1
Total assets	3,654.6	54.6	1,928.0	5,637.2	2,678.5	(1,553.2)	6,762.5
Liabilities	(2,854.6)	(54.2)	(1,727.6)	(4,636.4)	(1,967.2)	1,553.2	(5,050.4)
Net assets	800.0	0.4	200.4	1,000.8	711.3	–	1,712.1

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. Note 44 provides details of this Disposal Group as at 31 March 2020 which excluded intercompany receivables of £3.2 million and intercompany payables of £1,210.9 million which were due to be settled on completion as part of the sale being completed on a debt free basis.

	Notes	Water £m	Non- household retail £m	Other and eliminations £m	Total from continuing operations £m	Discontinued operations £m	Group £m
Other information							
31 March 2021							
Amortisation of other intangible assets	7	–	0.2	–	0.2	–	0.2
Capital expenditure	17	168.3	–	–	168.3	–	168.3
Depreciation	7	118.7	–	0.5	119.2	–	119.2
Finance income	8	0.8	–	3.4	4.2	–	4.2
Finance costs (before non-underlying items)	8	58.5	1.7	2.3	62.5	–	62.5
31 March 2020							
Amortisation of other intangible assets	7	0.4	0.2	–	0.6	4.1	4.7
Capital expenditure	17	161.1	–	0.1	161.2	165.7	326.9
Depreciation	7	118.3	0.5	0.4	119.2	78.0	197.2
Finance income	8	2.3	–	1.8	4.1	22.5	26.6
Finance costs (before non-underlying items)	8	73.4	0.3	(7.1)	66.6	48.7	115.3

Finance income and costs above reflect the segment in which the amounts arise and exclude intercompany transactions.

5. Segmental information continued

The grouping of revenue streams by how they are affected by economic factors, as required by IFRS 15, is as follows:

	Water	Non-household retail	Other	Total from continuing operations
	UK total £m	UK total £m	UK total £m	£m
Year ended 31 March 2021				
Segment revenue – underlying	563.0	162.8	5.6	731.4
Segment revenue – non-underlying (note 6)	(20.5)	–	–	(20.5)
Inter-segment revenue	(81.6)	(0.4)	(4.8)	(86.8)
Revenue from external customers	460.9	162.4	0.8	624.1
Significant service lines				
Water	460.9	–	–	460.9
Non-household retail	–	162.4	–	162.4
Other	–	–	0.8	0.8
	460.9	162.4	0.8	624.1
	Water	Non-household retail	Other	Total from continuing operations
	UK total £m	UK total £m	UK total £m	£m
Year ended 31 March 2020				
Segment revenue	570.3	173.5	10.1	753.9
Inter-segment revenue	(106.4)	(0.9)	(9.9)	(117.2)
Revenue from external customers	463.9	172.6	0.2	636.7
Significant service lines				
Water	463.9	–	–	463.9
Non-household retail	–	172.6	–	172.6
Other	–	–	0.2	0.2
	463.9	172.6	0.2	636.7

The Group's country of domicile is the United Kingdom and this 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.

Notes to the financial statements continued

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	Continuing operations 2021 £m	Continuing operations 2020 £m
Revenue			
WaterShare+ ⁽¹⁾		(20.5)	–
Operating costs			
Pension curtailment charge ⁽²⁾		(4.4)	–
COVID-19 provision for expected credit losses ⁽³⁾		–	(7.9)
Earnings before interest, tax, depreciation and amortisation		(24.9)	(7.9)
Remeasurement of fair value movement in derivatives ⁽⁴⁾	8	–	18.0
Net tax credit / (charge) arising on non-underlying items above	9	4.8	(1.9)
Deferred tax change in rate ⁽⁵⁾	9	–	(30.3)
Net non-underlying charge		(20.1)	(22.1)

(1) In September 2020, the Group offered its WaterShare+ scheme to its customers whereby customers could choose to accept a credit on their bill or take shares in Pennon Group plc. The value of the rebate equates to £20 per customer and the total value of £20.5 million (2020 £nil) has been recognised in full as a non-underlying reduction to revenue. £19.3 million of the WaterShare+ credits were taken as credits on customers' bills, with the balance of £1.2 million being taken as shares in Pennon Group Plc. This item is non-underlying in nature given its individual size and its non-recurring nature.

(2) The Group completed its employee consultation to modernise its ongoing pension arrangements. The outcome of the consultation resulted in a decision to close Pennon's principal defined benefit pension scheme to future accrual with effect from 30 June 2021. This resulted in a curtailment charge of £4.4 million (2020 £nil).

(3) In response to the COVID-19 pandemic a detailed expected credit loss review was undertaken in 2020. Economic and credit conditions were worsening, however the UK Government continued to implement economic measures to support the wider economy. As a result of the review a Group provision of £7.9 million was recognised in 2020. The charge is considered non-underlying due to its size and nature.

(4) In 2020 a gain of £18.0 million was recognised relating to fair value movements associated with derivatives that were not designated as being party to an accounting hedge relationship. These instruments were early settled, as the instruments no longer met the Group's accounting hedging requirements, and this has locked in the mark to market gain.

(5) Following the Chancellor's Budget on 11 March 2020, the UK headline corporation tax rate remained at 19%. It was previously set to reduce to 17% from 1 April 2020 and that change was cancelled. All deferred tax assets and liabilities at 31 March 2020 were therefore recalculated to crystallise at 19%, resulting in a non-underlying deferred tax charge in 2020 of £30.3 million. The change was substantively enacted on 17 March 2020.

7. Operating costs

	Notes	2021 £m	2020 £m
Employment costs before non-underlying items	13	75.0	70.0
Raw materials and consumables		18.1	14.9
Other operating expenses before non-underlying items include:			
Profit on disposal of property, plant and equipment		(0.1)	(0.4)
Short-term/low value asset lease expense		1.4	1.2
Research and development expenditure		–	0.1
Trade receivables impairment	22	3.8	11.4
Depreciation of property, plant and equipment:			
– Owned assets		87.4	73.2
– Under leases		31.8	46.0
Amortisation of other intangible assets	16	0.2	0.6

Operating costs include a charge of £4.4 million (2020 £7.9 million) relating to non-underlying items, as detailed in note 6.

The costs above are exclusive of amounts relating to discontinued operations.

7. Operating costs continued

Fees payable to the Company's auditor in the year were:

	2021 £000	2020 £000
Fees payable to the Company's auditor and its associates for the audit of parent company and consolidated financial statements	217	143
Fees payable to the Company's auditor and its associates for other services:		
The audit of Company's subsidiaries	579	784
Audit-related assurance services	89	50
Other non-audit services	144	85
Services related to corporate finance transactions	443	–
Total fees	1,472	1,062
Fees payable to the Company's auditor in respect of Pennon Group pension schemes:		
Audit	36	52

Expenses reimbursed to the auditor in relation to the audit of the Group were £nil (2020 £39,000).

A description of the work of the Audit Committee is set out in its report on pages 98 to 101 which includes an explanation of how the auditor's objectivity and independence are safeguarded when non-audit services are provided by the auditor's firm.

8. Net finance costs

	Notes	2021			2020		
		Finance cost £m	Finance income £m	Total £m	Finance cost £m	Finance income £m	Total £m
Cost of servicing debt							
Bank borrowing and overdrafts		(32.6)	–	(32.6)	(28.1)	–	(28.1)
Interest element of lease payments		(25.7)	–	(25.7)	(35.6)	–	(35.6)
Other finance costs		(3.5)	–	(3.5)	(2.7)	–	(2.7)
Interest receivable		–	4.2	4.2	–	4.1	4.1
		(61.8)	4.2	(57.6)	(66.4)	4.1	(62.3)
Notional interest							
Retirement benefit obligations	30	(0.7)	–	(0.7)	(0.2)	–	(0.2)
Net finance cost before non-underlying items		(62.5)	4.2	(58.3)	(66.6)	4.1	(62.5)
Non-underlying items							
Fair value remeasurement of non-designated derivative financial instruments providing commercial hedges	6	–	–	–	18.0	–	18.0
Net finance cost after non-underlying items		(62.5)	4.2	(58.3)	(48.6)	4.1	(44.5)

In addition to the above, finance costs of £0.9 million (2020 £2.0 million) have been capitalised on qualifying assets included in property, plant and equipment.

Excluded from the amounts above are net finance costs relating to discontinued operations of £89.7 million (2020 £26.2 million), consisting of finance income of £6.0 million (2020 £22.5 million) and finance costs of £95.7 million (2020 £48.7 million) (see note 44).

Notes to the financial statements continued

9. Taxation

	Before non-underlying items 2021 £m	Non-underlying items (note 6) 2021 £m	Total 2021 £m	Before non-underlying items 2020 £m	Non-underlying items (note 6) 2020 £m	Total 2020 £m
Analysis of charge in year						
Current tax charge/(credit)	23.0	(3.9)	19.1	28.3	15.5	43.8
Deferred tax – other	6.6	(0.9)	5.7	10.1	(13.6)	(3.5)
Deferred tax arising on change of rate of corporation tax	–	–	–	–	30.3	30.3
Total deferred tax charge	6.6	(0.9)	5.7	10.1	16.7	26.8
Tax charge/(credit) for year – Continuing Operations	29.6	(4.8)	24.8	38.4	32.2	70.6

UK corporation tax is calculated at 19% (2020 19%) of the estimated assessable profit for the year.

UK corporation tax for the Group is stated after a credit relating to prior year current tax of £0.7 million (2020 credit of £0.3 million) and a prior year deferred tax charge of £0.4 million (2020 £3.5 million charge).

The tax for the year differs from the theoretical amount which would arise using the standard rate of corporation tax in the UK of 19% (2019 19%) as follows:

	Continuing operations 2021 £m	Continuing operations 2020 £m
Reconciliation of total tax charge		
Profit before tax for continuing operations	132.1	193.1
Profit multiplied by the standard rate of UK corporation tax of 19% (2020 19%)	25.1	36.7
Effects of:		
(Income)/expenses not deductible for tax purposes	(0.2)	0.4
Adjustments to tax charge in respect of prior years	(0.3)	3.2
Change in UK tax rates	–	30.3
Depreciation charged on non-qualifying assets	0.4	0.3
Other	(0.2)	(0.3)
Tax charge for year	24.8	70.6

Excluded from the above is a tax credit of £4.3 million (2020 charge of £24.6 million) reported in the income statement under discontinued operations (see note 44).

9. Taxation continued

	Continuing operations 2021 £m	Continuing operations 2020 £m
Reconciliation of current tax charge		
Profit before tax	132.1	193.1
Profit multiplied by the standard rate of UK corporation tax of 19% (2020 19%)	25.1	36.7
Effects of:		
Relief for capital allowances in place of depreciation	(21.5)	(21.8)
Disallowance of depreciation charged in the accounts	20.2	19.5
Other timing differences	(4.0)	9.3
(Income)/expenses not deductible for tax purposes	(0.2)	0.4
Adjustments to tax charge in respect of prior years	(0.7)	(0.3)
Depreciation charged on non-qualifying assets	0.4	0.3
Relief for capitalised interest and foreign exchange gains/losses	(0.2)	(0.3)
Current tax charge for year	19.1	43.8

The Continuing Group's current tax charge is lower than the UK headline 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. As an infrastructure business, these allowances help the Group to plan major investment and consequently to maintain lower customer bills, as corporation tax relief is given against the investments made.

Other differences relate to the timing of relief for items including pension contributions, general provisions and financial derivatives. The reduction in the year relates mainly to additional pension contributions made to fund deficits in the schemes.

In addition to the amounts recognised in the income statement, the following tax charges and credits were recognised:

	2021 £m	2020 £m
Amounts recognised directly in other comprehensive income		
Deferred tax credit on defined benefit pension schemes	(5.5)	(0.1)
Deferred tax charge/(credit) on cash flow hedges	2.4	(3.1)
Amounts recognised directly in equity		
Deferred tax charge/(credit) on share-based payments	0.9	(1.4)
Deferred tax on costs relating to perpetual capital securities	(0.6)	–
Current tax credit on perpetual capital securities periodic return	–	(1.6)

Included in the deferred tax credit on defined benefit schemes above is a credit of £3.1 million (2020 £1.4 million) which has been accounted for in discontinued operations. Included in the deferred tax charge/(credit) on share-based payments is a charge of £0.5 million (2020 £0.6 million) which has also been accounted for in discontinued operations.

Factors affecting future tax charges

During the Chancellor's Budget on 4 March 2021, it was announced that the UK main rate of corporation tax will increase to 25% from 1 April 2023. The change in tax rate was not substantively enacted at the balance sheet date and thus this change is not reflected in these accounts. When the rate is substantively enacted, deferred tax assets and liabilities will be recalculated and recorded at the tax rate at which they are expected to unwind. It is anticipated the change in the tax rate will increase the Group's tax charge by c.£85 million. In the same Budget, the Chancellor also announced the introduction of a "super-deduction" on qualifying plant and machinery equivalent to 130% of spend on expenditure relating to contracts entered into after 3 March 2021 for the period from April 2021 to March 2023. The first year allowance on certain other types of assets, including long-life was boosted to 50% for the same period, again for contracts entered into after 3 March 2021. These enhanced allowances will therefore increase capital allowance claims for the next two years and hence reduce the current tax charge for those years. There will also be a consequently higher deferred tax liability and charge due to the additional capital allowance deductions and the increase in the rate of corporation tax to 25% from April 2023. These changes were substantively enacted on 24 May 2021.

10. Profit of the parent company

	2021 £m	2020 £m
Profit attributable to ordinary shareholders' equity dealt within the accounts of the parent company	1,312.3	330.6

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

Notes to the financial statements continued

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:

	2021	2020
Number of shares (millions)		
For basic earnings per share	421.1	420.2
Effect of dilutive potential ordinary shares from share options	1.6	1.9
For diluted earnings per share	422.7	422.1

Basic and diluted earnings per ordinary share

Earnings per ordinary share before non-underlying items, deferred tax and adjusted to annualise depreciation and amortisation in the Disposal Group are presented as the Directors believe that this measure provides a more useful year on year comparison of business trends and performance. Deferred tax is excluded as the Directors believe it reflects a distortive effect of changes in corporation tax rates and the level of long-term capital investment. Following the announcement on 18 March 2020 of the proposed sale of Viridor, the assets and liabilities of the Disposal Group were transferred to assets held for sale and in accordance with IFRS 5, the property, plant and equipment and intangible assets were not depreciated or amortised from that date. In 2020 the Directors believed that to aid comparison of earnings with 2019, it was appropriate to reflect a proforma depreciation and amortisation charge consistent with all other revenues and costs recognised for the full year in the Disposal Group. No such adjustment was appropriate in 2021. Earnings per share have been calculated as follows:

	2021			2020		
	Profit after tax £m	Earnings per share		Profit after tax £m	Earnings per share	
Continuing and discontinued operations		Basic p	Diluted p		Basic p	Diluted p
Statutory earnings attributable to ordinary shareholders of the parent	1,762.2	418.5	416.9	200.4	47.7	47.5
Deferred tax charge before non-underlying items	14.2	3.4	3.4	33.2	7.9	7.8
Non-underlying items (net of tax)	(1,599.1)	(379.8)	(378.4)	29.3	6.9	6.9
Non-controlling interests' share of non-underlying items	-	-	-	(1.0)	(0.2)	(0.2)
Proforma depreciation and amortisation charge in the Disposal Group	-	-	-	(2.6)	(0.6)	(0.6)
Adjusted earnings	177.3	42.1	41.9	259.3	61.7	61.4

	2021			2020		
	Profit after tax £m	Earnings per share		Profit after tax £m	Earnings per share	
Continuing operations		Basic p	Diluted p		Basic p	Diluted p
Statutory earnings attributable to ordinary shareholders of the parent	107.5	25.5	25.4	116.6	27.7	27.6
Deferred tax charge before non-underlying items	6.6	1.6	1.6	10.1	2.4	2.4
Non-underlying items (net of tax)	20.1	4.8	4.7	22.1	5.3	5.2
Non-controlling interests' share of non-underlying items	-	-	-	(1.0)	(0.2)	(0.2)
Adjusted earnings	134.2	31.9	31.7	147.8	35.2	35.0

	2021			2020		
	Profit after tax £m	Earnings per share		Profit after tax £m	Earnings per share	
Discontinued operations		Basic p	Diluted p		Basic p	Diluted p
Statutory earnings attributable to ordinary shareholders of the parent	1,654.7	393.0	391.5	83.8	20.0	19.9
Deferred tax charge before non-underlying items	7.6	1.8	1.8	23.1	5.4	5.4
Non-underlying items (net of tax)	(1,619.2)	(384.6)	(383.1)	7.2	1.7	1.7
Non-controlling interests' share of non-underlying items	-	-	-	-	-	-
Proforma depreciation and amortisation charge in the Disposal Group	-	-	-	(2.6)	(0.6)	(0.6)
Adjusted earnings	43.1	10.2	10.2	111.5	26.5	26.4

12. Dividends

	2021 £m	2020 £m
Amounts recognised as distributions to ordinary equity holders in the year		
Interim dividend paid for the year ended 31 March 2020 13.66p (2019 12.84p) per share	57.5	54.0
Final dividend paid for the year ended 31 March 2020 30.11p (2019 28.22p) per share	126.8	118.6
	184.3	172.6
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2021: 6.77p (2020 13.66p) per share	28.6	57.5
Proposed final dividend for the year ended 31 March 2021: 14.97p (2020 30.11p) per share	63.2	126.8
	91.8	184.3

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

The proposed interim dividend for 2021 was paid on 1 April 2021 and the proposed final dividend is subject to approval by shareholders at the AGM.

13. Employment costs

	Notes	Continuing operations 2021 £m	Continuing operations 2020 £m
Wages and salaries		72.5	67.2
Social security costs		7.6	7.1
Pension costs	30	15.1	8.5
Share-based payments	33	2.1	2.9
Total employment costs		97.3	85.7
Charged:			
Employment costs (excluding non-underlying items) – consolidated income statement		75.0	70.0
Employment costs (non-underlying items) – consolidated income statement		4.4	–
Capital schemes – property, plant and equipment		17.9	15.7
Total employment costs		97.3	85.7

Details of Directors' emoluments are set out in note 14. There are no personnel, other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Group. Members of other executive committees assist the Directors in their duties but do not hold authority to control the activities of the Group.

	2021	2020
Employees (average full-time equivalent number)		
The average monthly number of employees (including Executive Directors) was:		
Water	1,745	1,623
Non-household retail	160	143
Other	82	101
Total continuing operations	1,987	1,867
Waste management	–	2,986
Total – continuing and discontinued operations	1,987	4,853

The total number of employees (full-time equivalent) of the continuing operations at 31 March 2021 was 1,988 (2020 1,937). The total number of employees of the continuing operations and discontinued operations at 31 March 2021 was 1,988 (2020 4,801).

Notes to the financial statements continued

14. Directors' emoluments

	2021 £000	2020 £000
Executive Directors:		
Salary	857	951
Performance-related bonus paid or payable	467	372
Share-based payments	1,010	872
Other emoluments, including payments in lieu of pension provision	164	316
Payment in lieu of notice on retirement	749	–
Non-Executive Directors	541	528
	3,788	3,039

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 £155,000 (2020 £nil).

Total emoluments include £nil (2020 £nil) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2021 one Director (2020 one) is accruing retirement benefits under defined benefit pension schemes in respect of which the Group contributed £29,000 (2020 £29,000).

At 31 March 2021 one Director (2020 none) is a member of the Group's defined contribution pension scheme in respect of which the Group contributed £10,000 (2020 £nil).

At 31 March 2021 two Directors received payments in lieu of pension provision (2020 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 112 to 127.

15. Goodwill

	£m
Cost:	
At 1 April 2019	385.0
Disposals	(1.9)
Assets transferred to Disposal Group	(340.8)
At 31 March 2020	42.3
At 31 March 2021	42.3
Carrying amount:	
At 1 April 2019	385.0
At 31 March 2020	42.3
At 31 March 2021	42.3

Goodwill acquired in a business combination is allocated at acquisition to the CGU expected to benefit from that business combination. Goodwill with a total carrying value of £340.8 million was transferred to the Disposal Group in 2020. The remaining £42.3 million is allocated to the water business, representing the lowest level 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 results of tests performed during the year demonstrate significant headroom in the water CGU, 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.

16. Other intangible assets

	Service concession arrangements £m	Customer contracts £m	Patents £m	Other £m	Total £m
Cost:					
At 1 April 2019	94.3	34.3	0.2	3.6	132.4
Additions	0.1	–	–	0.6	0.7
Disposals	–	(34.3)	–	(0.2)	(34.5)
Transferred to assets held for sale	(94.4)	–	–	–	(94.4)
At 31 March 2020	–	–	0.2	4.0	4.2
Additions	–	–	–	0.2	0.2
Disposals	–	–	–	(0.2)	(0.2)
At 31 March 2021	–	–	0.2	4.0	4.2
Accumulated amortisation:					
At 1 April 2019	3.7	33.9	0.2	2.5	40.3
Charge for year	3.8	0.4	–	0.5	4.7
Disposals	–	(34.3)	–	(0.2)	(34.5)
Transferred to assets held for sale	(7.5)	–	–	–	(7.5)
At 31 March 2020	–	–	0.2	2.8	3.0
Charge for year	–	–	–	0.2	0.2
Disposals	–	–	–	(0.2)	(0.2)
Transferred to assets held for sale	–	–	–	–	–
At 31 March 2021	–	–	0.2	2.8	3.0
Carrying amount:					
At 1 April 2019	90.6	0.4	–	1.1	92.1
At 31 March 2020	–	–	–	1.2	1.2
At 31 March 2021	–	–	–	1.2	1.2

Assets that belong to Pennon Group plc's waste management business, Viridor, were transferred to assets held for sale at 18 March 2020, at which point amortisation of its assets ceased.

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 five years. The average remaining life is two years (2020 three 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.

Notes to the financial statements continued

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 31 March 2019	560.5	1,953.6	741.5	3,298.1	105.6	379.5	7,038.8
IFRS 16 transition adjustment	116.6	–	–	15.6	–	–	132.2
At 1 April 2019 (adjusted for IFRS 16)	677.1	1,953.6	741.5	3,313.7	105.6	379.5	7,171.0
Additions	11.6	27.8	1.8	59.6	5.3	220.8	326.9
Assets adopted at fair value	–	8.1	–	–	–	–	8.1
Grants and contributions	–	(1.8)	–	–	–	(0.9)	(2.7)
Disposals	(4.0)	(0.6)	–	(111.4)	–	–	(116.0)
Transfers/reclassifications	1.7	17.4	19.1	137.5	–	(175.7)	–
Transferred to assets held for sale	(560.6)	–	–	(1,439.4)	(110.9)	(304.6)	(2,415.5)
At 31 March 2020	125.8	2,004.5	762.4	1,960.0	–	119.1	4,971.8
Additions	0.1	17.0	2.6	49.4	–	99.2	168.3
Assets adopted at fair value	–	7.4	–	–	–	–	7.4
Grants and contributions	–	–	–	–	–	(3.7)	(3.7)
Disposals	–	–	–	(0.7)	–	–	(0.7)
Transfers/reclassifications	0.5	13.5	12.6	70.2	–	(96.8)	–
At 31 March 2021	126.4	2,042.4	777.6	2,078.9	–	117.8	5,143.1
Accumulated depreciation:							
At 31 March 2019	412.6	289.5	266.8	1,485.7	74.8	–	2,529.4
Charge for year	17.4	23.6	13.3	138.7	8.8	–	201.8
Disposals	(0.6)	(0.6)	–	(99.4)	–	–	(100.6)
Transferred to assets held for sale	(413.4)	–	–	(333.6)	(83.6)	–	(830.6)
At 31 March 2020	16.0	312.5	280.1	1,191.4	–	–	1,800.0
Charge for year	2.9	23.1	13.9	82.8	–	–	122.7
Disposals	–	–	–	(0.6)	–	–	(0.6)
At 31 March 2021	18.9	335.6	294.0	1,273.6	–	–	1,922.1
Net book value:							
At 31 March 2019	147.9	1,664.1	474.7	1,812.4	30.8	379.5	4,509.4
At 31 March 2020	109.8	1,692.0	482.3	768.6	–	119.1	3,171.8
At 31 March 2021	107.5	1,706.8	483.6	805.3	–	117.8	3,221.0

Assets that belong to Pennon Group plc's waste management business, Viridor, were transferred to assets held for sale at 18 March 2020 at which point depreciation of its assets ceased.

Of the total depreciation charge of £122.7 million (2020 £201.8 million), £1.5 million (2020 £2.6 million) has been charged to capital projects, £2.0 million (2020 £2.0 million) has been offset by deferred income and £119.2 million (2020 £197.2 million) has been charged against profits. Asset lives and residual values are reviewed annually. During the year borrowing costs of £0.9 million (2020 £10.6 million) have been capitalised on qualifying assets, at an average borrowing rate of 2.7% (2020 3.8%).

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 2020/21.

17. Property, plant and equipment continued

The Group leases many assets as a lessee, across several categories of asset. Right-of-use assets held under leases included in property, plant and equipment 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 2019	3.3	428.4	471.1	672.9	5.2	1,580.9
IFRS 16 transition adjustment	116.6	–	–	15.6	–	132.2
At 1 April 2019 (adjusted for IFRS 16)	119.9	428.4	471.1	688.5	5.2	1,713.1
Additions	1.1	5.7	22.9	91.5	–	121.2
Disposals	(1.7)	(29.2)	(17.7)	(67.2)	–	(115.8)
Transfers/reclassifications	–	–	5.2	–	(5.2)	–
Transferred to assets held for sale	(84.2)	–	–	(193.8)	–	(278.0)
At 31 March 2020	35.1	404.9	481.5	519.0	–	1,440.5
Additions	0.2	8.8	0.7	5.7	–	15.4
At 31 March 2021	35.3	413.7	482.2	524.7	–	1,455.9
Accumulated depreciation:						
At 31 March 2019	0.1	68.2	126.7	315.2	–	510.2
Charge for year	6.7	10.1	8.3	39.7	–	64.8
Disposals	(0.1)	–	–	(8.3)	–	(8.4)
Transferred to assets held for sale	(5.2)	–	–	(65.3)	–	(70.5)
At 31 March 2020	1.5	78.3	135.0	281.3	–	496.1
Charge / (credit) for year	1.3	(0.3)	7.8	23.0	–	31.8
At 31 March 2021	2.8	78.0	142.8	304.3	–	527.9
Net book amount:						
At 31 March 2019	3.2	360.2	344.4	357.7	5.2	1,070.7
At 31 March 2020	33.6	326.6	346.5	237.7	–	944.4
At 31 March 2021	32.5	335.7	339.4	220.4	–	928.0

During 2021 the depreciation on leased infrastructure assets included a credit of £5.1 million in respect of depreciation on owned assets which had been treated as relating to leased assets in the 2020 financial statements. There was a corresponding charge to depreciation on owned infrastructure assets in 2021.

Notes to the financial statements continued

17. Property, plant and equipment continued

Fixed and
mobile plant,
vehicles and
computers
£m

Company

Cost:

At 31 March 2019	0.5
Additions	0.1
Disposals	(0.2)
At 31 March 2020	0.4
Additions	–
Disposals	(0.1)
At 31 March 2021	0.3

Accumulated depreciation:

At 31 March 2019	0.2
Charge for year	0.1
Disposals	(0.1)
At 31 March 2020	0.2
Charge for year	0.1
Disposals	(0.1)
At 31 March 2021	0.2

Net book value:

At 31 March 2019	0.3
At 31 March 2020	0.2

At 31 March 2021	0.1
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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 2021							
Financial assets							
Trade receivables	22	-	-	-	-	150.9	150.9
Derivative financial instruments	23	2.8	2.3	-	-	-	5.1
Cash and cash deposits	25	-	-	-	2,919.3	-	2,919.3
Total		2.8	2.3	-	2,919.3	150.9	3,075.3
Financial liabilities							
Borrowings	28	-	-	-	(2,855.0)	-	(2,855.0)
Derivative financial instruments	23	-	(23.7)	-	-	-	(23.7)
Trade payables	26	-	-	-	-	(74.4)	(74.4)
Total		-	(23.7)	-	(2,855.0)	(74.4)	(2,953.1)
31 March 2020							
Financial assets							
Trade receivables	22	-	-	-	-	135.8	135.8
Derivative financial instruments	23	3.4	3.4	-	-	-	6.8
Cash and cash deposits	25	-	-	-	665.9	-	665.9
Total		3.4	3.4	-	665.9	135.8	808.5
Financial liabilities							
Borrowings	28	-	-	-	(3,714.8)	-	(3,714.8)
Derivative financial instruments	23	-	(34.1)	(0.2)	-	-	(34.3)
Trade payables	26	-	-	-	-	(64.2)	(64.2)
Total		-	(34.1)	(0.2)	(3,714.8)	(64.2)	(3,813.3)
Company							
31 March 2021							
Financial assets							
Amounts owed by subsidiaries	19,22	-	-	-	86.0	-	86.0
Other receivables	22	-	-	-	11.7	-	11.7
Derivative financial instruments	23	2.8	0.6	-	-	-	3.4
Cash and cash deposits	25	-	-	-	2,495.6	-	2,495.6
Total		2.8	0.6	-	2,593.3	-	2,596.7
Financial liabilities							
Borrowings	28	-	-	-	(467.8)	-	(467.8)
Derivative financial instruments	23	-	(0.2)	-	-	-	(0.2)
Trade payables	26	-	-	-	-	(1.2)	(1.2)
Total		-	(0.2)	-	(467.8)	(1.2)	(469.2)
31 March 2020							
Financial assets							
Amounts owed by subsidiaries	19,22	-	-	-	1,241.8	-	1,241.8
Other receivables	22	-	-	-	0.2	-	0.2
Derivative financial instruments	23	3.4	3.2	-	-	-	6.6
Cash and cash deposits	25	-	-	-	367.9	-	367.9
Total		3.4	3.2	-	1,609.9	-	1,616.5
Financial liabilities							
Amounts due to subsidiaries	26	-	-	-	(0.4)	-	(0.4)
Borrowings	28	-	-	-	(1,425.9)	-	(1,425.9)
Derivative financial instruments	23	-	(3.7)	-	-	-	(3.7)
Trade payables	26	-	-	-	-	(2.8)	(2.8)
Total		-	(3.7)	-	(1,426.3)	(2.8)	(1,432.8)

Notes to the financial statements continued

19. Other non-current assets

Non-current receivables

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Amounts owed by subsidiary undertakings	–	–	26.1	1,223.5
	–	–	26.1	1,223.5

Non-current receivables were due:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Between 1 and 2 years	–	–	5.2	66.1
Over 2 years and less than 5 years	–	–	15.6	211.4
Over 5 years	–	–	5.3	946.0
	–	–	26.1	1,223.5

The fair values of non-current receivables were:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Amounts owed by subsidiary undertakings	–	–	27.0	1,205.2
	–	–	27.0	1,205.2

Excluded from the balances at 31 March 2020 above is £261.5 million relating to assets held for sale (see note 44 for further details).

20. Investments

Subsidiary undertakings

	£m
Company	
At 1 April 2019	1,980.8
Transferred to assets held for sale	(1,135.6)
At 31 March 2020	845.2
Investment in subsidiary undertaking	1.2
At 31 March 2021	846.4

The recoverable amount of investments is determined based on value-in-use calculations, which are set out in note 15.

Joint ventures

	Shares £m
Group	
At 1 April 2019	51.1
Share of post-tax profit	14.8
Share of other comprehensive income	0.2
Dividends received	(6.0)
Transferred to assets held for sale	(60.1)
At 31 March 2020	–
At 31 March 2021	–

21. Inventories

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Raw materials and consumables	5.4	4.9	–	–

Excluded from the balance at 31 March 2020 above is £29.9 million relating to assets held for sale (see note 44 for further details).

22. Trade and other receivables – current

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Trade receivables	253.2	241.9	–	–
Less: allowance for expected credit losses in respect of trade receivables	(102.3)	(106.1)	–	–
Net trade receivables	150.9	135.8	–	–
Amounts owed by subsidiary undertakings	–	–	59.9	18.3
Other receivables	29.3	10.0	11.7	0.2
Accrued income	28.2	29.3	0.1	0.2
Prepayments	8.4	10.7	1.3	6.0
	216.8	185.8	73.0	24.7

Excluded from the balances at 31 March 2020 above is £277.9 million relating to assets held for sale (see note 44 for further details).

Trade receivables include accrued income relating to customers with water budget payment plans. Due to the impact on demand patterns caused by the COVID-19 pandemic, overall demand has increased in the South West Water business, causing increased levels of receivables despite the resilient cash collection performance.

The increase in other receivables in 2021 is attributable to deferred consideration receivable for the sale of Viridor of £9.2 million (2020 £nil), together with an increase in other taxation receivables.

Accrued income includes £21.7 million (2020 £26.9 million) in respect of metered accrual revenue in the retail water business. Metered accrual revenue relates to performance obligations that have been fully extinguished in providing services to customers prior to the reporting date. Payment in respect of these services is a matter of time following issuance of invoices.

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:

	2021 £m	2020 £m
Group		
Not due	40.3	33.7
Past due 1 – 30 days	18.2	15.8
Past due 31 – 120 days	18.9	17.2
More than 120 days	175.8	175.2
	253.2	241.9

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 (n) ii). 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:

	2021 £m	2020 £m
At 1 April	106.1	99.0
Provision for expected credit losses	3.8	11.6
Receivables written off during the year as uncollectable	(7.6)	(1.6)
Transfer to assets held for sale	–	(2.9)
At 31 March	102.3	106.1

Notes to the financial statements continued

23. Derivative financial instruments

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Derivatives used for cash flow hedging				
Non-current assets	1.8	1.2	0.3	1.2
Current assets	0.5	2.2	0.3	2.0
Current liabilities	(6.3)	(6.9)	(0.2)	(0.9)
Non-current liabilities	(17.4)	(27.2)	–	(2.8)
Derivatives used for fair value hedging				
Non-current assets	2.0	2.9	2.0	2.9
Current assets	0.8	0.5	0.8	0.5
Current liabilities	–	–	–	–
Non-current liabilities	–	–	–	–
Derivatives not in a hedge accounting relationship				
Non-current assets	–	–	–	–
Current assets	–	–	–	–
Current liabilities	–	(0.2)	–	–
Non-current liabilities	–	–	–	–

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 (2020 £nil).

During the year a £4.7 million charge (2020 £8.6 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 £13.5 million credit (2020 £14.3 million charge) was recognised in 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. Due to the current net cash position within the Group, the Group expects following the completion of the strategic review to manage its debt portfolio to the strategy used before the strategic review commenced.

At 31 March 2021 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £801 million and a weighted average maturity of 4.4 years (2020 £1,178 million, with 4.0 years). The weighted average interest rate of the swaps for their nominal amount was 1.29% (2020 1.42%).

The periods for which the 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 2021					
Assets	0.5	0.3	0.8	0.7	2.3
Liabilities	(6.3)	(6.1)	(11.3)	–	(23.7)
31 March 2020					
Assets	2.2	0.8	0.4	–	3.4
Liabilities	(7.3)	(7.0)	(19.4)	(0.8)	(34.5)
Company					
31 March 2021					
Assets	0.3	0.1	0.2	–	0.6
Liabilities	(0.2)	–	–	–	(0.2)
31 March 2020					
Assets	2.0	0.8	0.4	–	3.2
Liabilities	(0.9)	(0.8)	(1.6)	(0.4)	(3.7)

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	
	2021 £m	2020 £m	2021 £m	2020 £m
Assets				
Derivatives used for cash flow hedging	2.3	3.4	0.6	3.2
Derivatives used for fair value hedging	2.8	3.4	2.8	3.4
Derivatives not in a hedge accounting relationship	–	–	–	–
Total assets	5.1	6.8	3.4	6.6
Liabilities				
Derivatives used for cash flow hedging	(23.7)	(34.1)	(0.2)	(3.7)
Derivatives not in a hedge accounting relationship	–	(0.2)	–	–
Total liabilities	(23.7)	(34.3)	(0.2)	(3.7)

24. Financial instruments at fair value through profit

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Current liabilities	2.8	1.5	0.5	0.5
Non-current liabilities	39.4	43.1	1.0	1.1

Financial instruments at fair value through profit reflect the fair value movement of the hedged risk on the hedged item which had been designated in a fair value hedging relationship.

The hedged item was the £150 million bond issued by South West Water Finance Plc in 2010 which matures in July 2040 (see note 28). The hedging relationship was de-designated in previous periods at which point the fair value amount recognised at that point ceased to be revalued. The fixed financial liability at the point of de-designation is released to the income statement over the remaining life of the debt.

Notes to the financial statements continued

25. Cash and cash deposits

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Cash at bank and in hand	56.1	64.9	30.1	17.8
Short-term bank deposits	437.0	175.0	315.0	150.0
Other deposits	2,426.2	426.0	2,150.5	200.1
Total cash and cash deposits	2,919.3	665.9	2,495.6	367.9

Excluded from the balances at 31 March 2020 above is £33.3 million relating to assets held for sale (see note 44 for further details).

Group short-term deposits have an average maturity of one working day (2020 one working day).

Group other deposits have an average maturity of 33 days (2020 50 days).

Group other deposits include restricted funds of £250.8 million (2020 £227.2 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	
	2021 £m	2020 £m	2021 £m	2020 £m
Cash and cash deposits as above	2,919.3	665.9	2,495.6	367.9
Cash and cash deposits held in the Disposal Group	–	33.3	–	–
Less: deposits with a maturity of three months or more (restricted funds)	(250.8)	(227.2)	–	–
	2,668.5	472.0	2,495.6	367.9

26. Trade and other payables – current

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Trade payables	74.4	64.2	1.2	2.8
Contract liabilities	2.0	2.0	–	–
Amounts owed to subsidiary undertakings	–	–	–	0.4
Other tax and social security	2.7	2.8	0.9	0.8
Accruals	28.1	15.5	–	–
Other payables	18.9	30.8	8.1	15.8
	126.1	115.3	10.2	19.8

Excluded from the balances at 31 March 2020 above is £141.7 million relating to liabilities directly associated with assets classified as held for sale (see note 44 for further details).

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

The movement in the contract liabilities was:

Contract liabilities	2021 £m	2020 £m
At 1 April	124.9	126.4
Revenue recognised in the year	(2.1)	(9.6)
Consideration received in advance of completion of performance obligations	7.5	24.7
Transfer to liabilities associated with assets held for sale	–	(16.6)
At 31 March	130.3	124.9

The analysis of contract liabilities between current and non-current is:

	2021 £m	2020 £m
Current	2.0	2.0
Non-current (note 29)	128.3	122.9
	130.3	124.9

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 2022.

27. Current tax assets/(liabilities)

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Current year (creditor)/debtor	(2.0)	0.7	(1.2)	(0.6)
Prior year tax items	2.1	1.2	(3.2)	(1.9)
	0.1	1.9	(4.4)	(2.5)

Excluded from the balances above at 31 March 2020 is £1.0 million of current tax liabilities relating to liabilities directly associated with assets classified as held for sale (see note 44 for further details).

28. Borrowings

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Current				
Short-term loans	7.7	7.6	–	–
European Investment Bank	32.4	33.1	–	6.1
Amounts owed to subsidiary undertakings (note 43)	–	–	283.4	284.4
	40.1	40.7	283.4	290.5
Leases	48.2	19.2	–	–
Total current borrowings	88.3	59.9	283.4	290.5
Non-current				
Bank and other loans	294.3	702.1	49.7	520.4
Private placements	301.0	618.2	134.7	511.6
Bond 2040	134.9	134.5	–	–
RPI index-linked bonds	440.5	440.0	–	–
European Investment Bank	205.0	340.8	–	103.4
	1,375.7	2,235.6	184.4	1,135.4
Leases	1,391.0	1,419.3	–	–
Total non-current borrowings	2,766.7	3,654.9	184.4	1,135.4
Total borrowings	2,855.0	3,714.8	467.8	1,425.9

Excluded from the balances at 31 March 2020 above is £19.0 million of current and £229.4 million of non-current borrowings relating to liabilities directly associated with assets classified as held for sale (see note 44 for further details).

The Company issued a £100 million private placement in July 2007 maturing in 2022. Interest is payable at a fixed rate of 3.3%. During the year, as part of the Group debt restructuring plans, a liability management process was completed resulting in £70 million of the outstanding notional being repaid. In addition, significant bank and other loans and other private placement borrowings have been repaid during 2021 as part of the Group debt restructuring exercise.

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.

Notes to the financial statements continued

28. Borrowings continued

The fair values of non-current borrowings, valued using level 2 measures (as set out in note 23) were:

	2021		2020	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Group				
Bank and other loans	294.3	311.6	702.1	709.7
Private placements	301.0	306.4	618.2	689.8
Bond 2040	134.9	202.6	134.5	206.1
RPI index-linked bond	440.5	550.1	440.0	536.0
European Investment Bank	205.0	188.8	340.8	324.3
	1,375.7	1,559.5	2,235.6	2,465.9
Leases	1,391.0	–	1,419.3	–
	2,766.7	1,559.5	3,654.9	2,465.9
Company				
Bank and other loans	49.7	55.2	520.4	528.0
European Investment Bank	–	–	103.4	103.4
Private placements	134.7	136.5	511.6	583.1
	184.4	191.7	1,135.4	1,214.5

Under IFRS 16 the disclosure of the fair value of leases is not required.

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, excluding leases, was:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Between 1 and 2 years	70.0	244.3	30.0	204.4
Over 2 years and less than 5 years	194.0	511.9	58.2	393.0
Over 5 years	1,111.7	1,479.4	96.2	538.0
	1,375.7	2,235.6	184.4	1,135.4

The weighted average maturity of non-current borrowings, excluding leases, was 17.7 years (2020 17 years).

Undrawn committed borrowing facilities at the balance sheet date were:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Floating rate:				
Expiring after 1 year	285.0	940.0	105.0	705.0
	285.0	940.0	105.0	705.0

In addition at 31 March 2021 the Group had undrawn uncommitted short-term bank facilities of £nil (2020 £30.0 million) available to the Company.

28. Borrowings continued

Information on leases

The Group has leases for various assets as shown in note 17.

The maturity of lease liabilities was:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Within 1 year	48.2	19.2	–	–
Over 1 year and less than 5 years	243.2	149.0	–	–
Over 5 years	1,147.8	1,270.3	–	–
	1,439.2	1,438.5	–	–

Analysed as:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Current	48.2	19.2	–	–
Non-current	1,391.0	1,419.3	–	–
	1,439.2	1,438.5	–	–

For the purposes of calculating debt or borrowings under the Group's financing agreements, all of which were negotiated under IFRS prior to the implementation of IFRS 16, borrowings that were previously categorised as operating leases under IAS 17 are excluded from the definition of debt. As at 31 March 2021 the carrying value of leases previously categorised as IAS 17 operating leases was £35.4 million (2020 £36.1 million).

The Group does not face a significant liquidity risk with regard to its lease liabilities. Lease liabilities are monitored within the Group's treasury function.

The discount rate used to calculate the lease liabilities above involves estimation. Where the Group cannot readily determine the rate implicit in the lease the Group uses an estimated incremental borrowing rate (IBR). At 31 March 2021 the range of IBRs used was between 2.93% and 4.50% (2020 between 2.93% and 4.50%) and the weighted average IBR across all leases was 3.8% (2020 3.8%). If the weighted average rate used increased or decreased by 10bps, this would result in a c.12% increase or reduction in the present value of lease liabilities recognised at 31 March 2021 (2020 c.3.8%).

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, £250.8 million at 31 March 2021 (2020 £225.9 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.

Cash outflows in respect of leasing relate to principal repayments of £28.4 million (2020 £142.8 million) and interest repayments of £19.1 million (2020 £37.7 million), in addition to inflows from lease financing arrangements of £15.0 million (2020 £115.0 million).

Other information required to be disclosed under IFRS 16 is included in note 17.

29. Other non-current liabilities

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Amounts owed to subsidiary undertakings	–	–	8.6	8.6
Contract liabilities	128.3	122.9	–	–
	128.3	122.9	8.6	8.6

Excluded from the balances above at 31 March 2020 is £14.3 million relating to liabilities directly associated with assets classified as held for sale (see note 44 for further details).

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 12 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. The majority of the contract liabilities included above are expected to unwind after five years.

Notes to the financial statements continued

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 Chair, are nominated by members of the schemes, including pensioners.

Defined contribution schemes

Pension costs for defined contribution schemes were £6.4 million (2020 £9.0 million), of which £4.4 million (2020 £2.5 million) relates to the Continuing Group.

Defined benefit schemes

Assumptions

The principal actuarial assumptions at 31 March were:

	2021 %	2020 %	2019 %
Rate of increase in pensionable pay	3.2	2.7	3.3
Rate of increase for current and future pensions	2.9	2.5	3.2
Rate used to discount schemes' liabilities and expected return on schemes' assets	2.05	2.30	2.40
Inflation	3.2	2.7	3.3

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 2019 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:

	2021	2020	2019
Male	24.7	24.7	23.9
Female	27.0	26.9	26.3

The average life expectancy in years of a future pensioner retiring at age 62, 20 years after the balance sheet date, is projected as:

	2021	2020	2019
Male	25.5	25.4	25.0
Female	27.9	27.9	28.1

The sensitivities regarding the principal assumptions used to measure the schemes' liabilities are:

	Change in assumption	Impact on schemes' liabilities
Rate of increase in current and future pensions	+/- 0.5%	+/- 6.6%
Rate used to discount schemes' liabilities	+/- 0.5%	-/+ 9.3%
Inflation	+/- 0.5%	+/- 6.3%
Life expectancy	+/- 1 year	+/- 4.1%

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 scheme's membership. This is the same approach as has been adopted in previous years. The sensitivity in respect of changes in pensionable pay has been removed from the analysis this year as it is no longer relevant as the scheme is closing to future accrual on 30 June 2021.

The amounts recognised in the balance sheet, excluding amounts transferred to liabilities directly associated with assets classified as held for sale, were:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Present value of financial obligations	(901.7)	(685.3)	(205.7)	47.9
Fair value of plan assets	910.5	691.9	200.2	(48.0)
Surplus/(deficit) of funded plans	8.8	6.6	(5.5)	(0.1)
Impact of minimum funding asset ceiling	-	-	-	-
Net asset/(liability) recognised in the balance sheet	8.8	6.6	(5.5)	(0.1)

30. Retirement benefit obligations continued

The movement in the net defined benefit obligation over the accounting period is as follows:

	2021			2020		
	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	(685.3)	691.9	6.6	(994.8)	934.0	(60.8)
Current service cost	(6.3)	–	(6.3)	(8.1)	–	(8.1)
Past service cost, curtailments and gains/losses on settlements	54.9	(53.7)	1.2	2.0	–	2.0
Interest (expense)/income	(15.7)	15.0	(0.7)	(23.1)	22.3	(0.8)
	32.9	(38.7)	(5.8)	(29.2)	22.3	(6.9)
Remeasurements:						
Return/(loss) on plan assets excluding amounts included in interest expense	–	59.7	59.7	–	(16.1)	(16.1)
Loss from change in demographic assumptions	–	–	–	(3.9)	–	(3.9)
(Loss)/gain from change in financial assumptions	(75.9)	–	(75.9)	51.9	(9.0)	42.9
Experience gains/(losses)	3.9	–	3.9	(5.2)	–	(5.2)
	(72.0)	59.7	(12.3)	42.8	(25.1)	17.7
Contributions:						
Employers	–	50.6	50.6	–	41.5	41.5
Plan participants	–	–	–	(0.3)	0.3	–
Payments from plans:						
Benefit payments	39.2	(39.2)	–	38.7	(38.7)	–
	39.2	11.4	50.6	38.4	3.1	41.5
Transfer (from)/to liabilities directly associated with assets held for sale	(216.5)	186.2	(30.3)	257.5	(242.4)	15.1
At 31 March	(901.7)	910.5	8.8	(685.3)	691.9	6.6

Prior to the completion of the Viridor sale, the responsibilities for certain pension schemes that Viridor participated in transferred to Pennon Group plc. The net liabilities of the transferred obligations were £30.3 million.

Certain schemes that transferred from Viridor to Pennon were in respect of Viridor's Greater Manchester contract which ceased in May 2019. In respect of these obligations an agreement was reached, in September 2020, to transfer the liabilities of the active employees of the Greater Manchester contract to the new operator's pension fund. This resulted in a gain on settlement of £5.6 million which has been recognised in non-underlying items within discontinued operations (see note 44). A settlement payment of £7.2 million was made to ensure that the plan was fully funded on transfer to the new operator.

The Group completed its employee consultation to modernise its ongoing pension arrangements. The outcome of the consultation resulted in a decision to close the Pennon principal defined benefit pension scheme to future accrual with effect from 30 June 2021. This resulted in a curtailment charge of £4.4 million, which has been included within non-underlying items for the Continuing Group (see note 6).

The overall net gain of £1.2 million arising in respect of the settlement in connection with Greater Manchester and the curtailment charge is shown in the effects of past service cost, curtailments and gains/losses on settlements.

The total amount charged to Other Comprehensive Income for remeasurement of defined benefit obligations of £28.8 million (2020 charge of £17.7 million) includes a charge of £16.5 million (2020 £nil) that has been accounted for in discontinued operations.

Notes to the financial statements continued

30. Retirement benefit obligations continued

The movement in the Company's net defined benefit obligation over the accounting period is as follows:

	2021			2020		
	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	(48.0)	47.9	(0.1)	(58.5)	55.1	(3.4)
Current service cost	(0.5)	–	(0.5)	(0.2)	–	(0.2)
Past service cost and gains and losses on settlements	58.4	(53.7)	4.7	–	–	–
Interest (expense)/income	(3.2)	2.9	(0.3)	(0.4)	0.3	(0.1)
	54.7	(50.8)	3.9	(0.6)	0.3	(0.3)
Remeasurements:						
Loss on plan assets excluding amounts included in interest expense	–	(22.4)	(22.4)	–	(6.0)	(6.0)
Loss from change in demographic assumptions	–	–	–	(0.2)	–	(0.2)
(Loss)/gain from change in financial assumptions	(3.3)	–	(3.3)	3.0	–	3.0
Experience (losses)/gains	(0.8)	–	(0.8)	6.1	–	6.1
	(4.1)	(22.4)	(26.5)	8.9	(6.0)	2.9
Contributions:						
Employers	–	47.5	47.5	–	0.7	0.7
Payments from plans:						
Benefit payments	8.2	(8.2)	–	2.2	(2.2)	–
	8.2	39.3	47.5	2.2	(1.5)	0.7
Transfer (from)/to Group companies prior to sale	(216.5)	186.2	(30.3)	–	–	–
At 31 March	(205.7)	200.2	(5.5)	(48.0)	47.9	(0.1)

In the prior year, the Group had one smaller pension scheme which was in surplus and was deemed to have irrecoverable assets in accordance with IFRIC 14 'The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'. This related to the Disposal Group and was transferred to liabilities associated with assets held for sale in the 31 March 2020 balance sheet (see note 44).

Changes in the effect of the asset ceiling during the year were:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Irrecoverable asset at start of the year	–	20.6	–	–
Interest on irrecoverable surplus	–	0.5	–	–
Actuarial (losses)/gains	–	(7.0)	–	–
Transfer to liabilities associated with assets held for sale	–	(14.1)	–	–

The schemes' assets relating to the Continuing Group were:

	2021			2020		
	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	170.0	–	19	109.9	–	16
Government bonds	116.1	–	13	78.1	–	11
Other bonds	246.3	101.0	38	174.2	104.0	40
Diversified growth	145.9	–	16	110.0	–	16
Property/Infrastructure	56.7	8.0	7	48.5	6.8	8
Insurance linked security	55.2	–	6	49.2	–	7
Other (including cash funds)	11.3	–	1	11.2	–	2
	801.5	109.0	100	581.1	110.8	100

Other assets represent principally cash contributions received from the Group towards the year end which were invested during the subsequent financial year.

30. Retirement benefit obligations continued

The Company's share of the schemes' assets at the balance sheet date was:

	2021			2020		
	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	37.4	–	19	7.6	–	16
Government bonds	25.5	–	13	5.4	–	11
Other bonds	54.1	22.2	38	19.3	–	40
Diversified growth	32.1	–	16	7.6	–	16
Property/Infrastructure	12.5	1.7	7	3.8	–	8
Insurance linked security	12.2	–	6	3.4	–	7
Other	2.5	–	1	0.8	–	2
	176.3	23.9	100	47.9	–	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 assets 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).

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 2019 triennial actuarial valuation of the principal defined benefit scheme was agreed in the previous financial year with an actuarial valuation deficit of £53.0 million. The Group has made deficit recovery contributions of £2.8 million during the current financial year (2020 £31.9 million of which £18.8 million was in advance of the previously agreed recovery plan). In accordance with the agreed 2019 actuarial valuation, the Group is required to make further deficit recovery contributions, in addition to those amounts paid in the years to 31 March 2020 and 31 March 2021, of £0.4 million in March 2022, with this amount being adjusted for inflation. An additional contribution of £36 million was paid in to the scheme using some of the proceeds from the Viridor disposal. The Group monitors funding levels on an annual basis and the Continuing Group expects to pay total contributions of around £2.7 million, including expenses, during the year ended 31 March 2022. The schedule of contributions in the 2019 valuation is in line with the 2016 triennial actuarial valuation. These will cease when the scheme closes to future accrual on 30 June 2021.

Notes to the financial statements continued

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	
	2021 £m	2020 £m	2021 £m	2020 £m
Liabilities/(assets) at 1 April	261.6	305.1	(1.8)	(1.2)
Opening adjustment on adoption of IFRS 16 Leases	–	(1.8)	–	–
Charged/(credited) to the income statement	4.2	33.2	1.8	(0.1)
(Credited)/charged to equity, including impact of change in tax rate	(0.2)	(4.6)	(4.8)	–
Change of tax rate charged to the income statement – non-underlying	–	40.6	–	(0.5)
Other non-underlying charges in the income statement	(6.0)	(12.7)	(7.7)	–
Transferred to liabilities associated with assets classified as held for sale	–	(98.2)	–	–
Liabilities/(assets) at 31 March	259.6	261.6	(12.5)	(1.8)

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:

	Accelerated tax depreciation £m	Fair value adjustments £m	Revenue on service concession arrangements £m	Derivatives £m	Total £m
At 1 April 2019	272.0	16.5	48.1	0.9	337.5
Opening adjustment on adoption of IFRS 16 Leases	(1.8)	–	–	–	(1.8)
Charged/(credited) to the income statement	24.8	(1.3)	2.1	–	25.6
Non-underlying charge/(credit) to the income statement	33.0	1.9	5.5	(12.5)	27.9
Charged to equity/SOCI	–	–	–	(3.1)	(3.1)
Transfer to deferred tax assets	–	–	–	14.7	14.7
Transferred to liabilities directly associated with assets classified as held for sale	(53.6)	–	(55.7)	–	(109.3)
At 31 March 2020	274.4	17.1	–	–	291.5
Charged/(credited) to the income statement	1.9	(0.1)	–	–	1.8
At 31 March 2021	276.3	17.0	–	–	293.3

31. Deferred tax continued**Group continued****Deferred tax assets**

	Short-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 2019	(5.3)	(11.6)	–	(1.2)	(1.2)	(8.6)	(4.5)	(32.4)
Charged/(credited) to the income statement	3.5	3.4	–	(0.3)	(0.1)	0.7	0.4	7.6
Non-underlying (credit)/charge to the income statement	(1.1)	2.8	–	(0.1)	(0.2)	(1.0)	(0.4)	–
Charged to equity/SOCI	–	(0.1)	–	(1.4)	–	–	–	(1.5)
Transfer from deferred tax liabilities	–	–	(14.7)	–	–	–	–	(14.7)
Transferred to liabilities directly associated with assets classified as held for sale	1.1	3.0	–	1.0	1.5	–	4.5	11.1
At 31 March 2020	(1.8)	(2.5)	(14.7)	(2.0)	–	(8.9)	–	(29.9)
Charged/(credited) to the income statement	0.6	0.9	0.4	(0.1)	–	0.6	–	2.4
Non-underlying (credit)/charge to the income statement	0.3	(2.1)	–	–	(4.2)	–	–	(6.0)
Charged to equity/SOCI	–	(2.3)	2.3	0.4	(0.6)	–	–	(0.2)
At 31 March 2021	(0.9)	(6.0)	(12.0)	(1.7)	(4.8)	(8.3)	–	(33.7)

Net liability

At 31 March 2020	261.6
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At 31 March 2021	259.6
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An element of the deferred tax credited to the income statement in 2021 has been reported as part of discontinued operations (see note 44).

Company**Deferred tax assets**

	Retirement benefit obligations £m	Derivatives £m	Share-based payments £m	Tax losses £m	Other £m	Total £m
At 1 April 2019	(0.6)	(0.3)	(0.2)	–	(0.1)	(1.2)
(Credited) / charged to the income statement	–	–	(0.2)	–	0.1	(0.1)
Non-underlying credit to the income statement	(0.5)	–	–	–	–	(0.5)
Charged / (credited) to equity, including impact on change in tax rate	1.0	(0.6)	(0.4)	–	–	–
At 31 March 2020	(0.1)	(0.9)	(0.8)	–	–	(1.8)
Charged/(credited) to the income statement	1.9	–	(0.1)	–	–	1.8
Non-underlying charge to equity	–	–	–	(0.6)	–	(0.6)
Non-underlying credit to the income statement	(3.5)	–	–	(4.2)	–	(7.7)
(Credited)/charged to equity, including impact on change in tax rate	(5.1)	0.9	–	–	–	(4.2)
At 31 March 2021	(6.8)	–	(0.9)	(4.8)	–	(12.5)

Notes to the financial statements continued

31. Deferred tax continued

Company continued

Deferred tax assets continued

Deferred tax (charged)/credited to equity or other comprehensive income during the year was:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Remeasurement of defined benefit obligations	(2.4)	(1.5)	(5.1)	1.0
Costs related to perpetual capital securities	(0.6)	–	–	–
Cash flow hedges	2.4	(3.1)	0.9	(0.6)
Share-based payments	0.4	(0.8)	–	(0.4)
	(0.2)	(5.4)	(4.2)	–

The above excludes deferred tax accounted for in equity relating to the discontinued operations.

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 2% up to 100% in certain instances, with most items qualifying at either 6% or 18% per annum. Given the Group's continuing capital expenditure programme, it is likely that the deferred tax liability will continue into the longer term.

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. As explained in note 9, the Government has introduced capital expenditure super-deduction allowance incentives for the two-year period to April 2023 which increases the rate of capital allowances to up to 130% for expenditure on qualifying plant and machinery. This is expected to provide an increase in current tax relief for the Group with a consequently higher deferred tax liability and charge due to the additional capital allowance deductions and the increase in the rate of corporation tax to 25% from April 2023.

Short-term temporary differences arise on items such as retirement benefit obligations, derivatives, fair value adjustments and share-based payments 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 is reflected in the deferred tax charge in these financial statements. Specifically, retirement benefit obligations will crystallise over the life of the pension scheme and/or the period when spreading applies (this can be up to three years for spreading purposes), the fair value items will be released over their useful remaining life which is up to 115 years whilst share-based payments will crystallise over the remaining lives of the share schemes, which are up to five years. Short-term liabilities including provisions will typically crystallise in the following year.

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.

Derivatives reflect the fair value movements on treasury derivatives, these can fluctuate considerably each year. The balance will crystallise when derivative items are either terminated or mature, the life of these items can be up to ten years.

Tax losses relate to non-trade deficits carried forwards in relation to the UK's corporate interest restriction rules, these are anticipated to be utilised within the next two years.

32. Provisions

	Restructuring £m	Total £m
Group		
At 1 April 2020	0.6	0.6
Utilised	(0.3)	(0.3)
At 31 March 2021	0.3	0.3

The amount charged to the income statement includes £nil (2020 £7.9 million) charged to finance costs as the unwinding of discounts in provisions.

The analysis of provisions between current and non-current is:

	2021 £m	2020 £m
Current	0.3	0.6
Non-current	–	–
	0.3	0.6

The restructuring provision relates principally to severance costs and will be utilised within one year.

33. Share capital

Allotted, called-up and fully paid

	Number of shares		£m
	Treasury shares	Ordinary shares	
Group and Company			
At 1 April 2019 ordinary shares of 40.7p each	8,443	420,520,598	171.1
For consideration of £3.6 million, shares issued under the Company's Sharesave Scheme	–	515,959	0.2
At 31 March 2020 ordinary shares of 40.7p each	8,443	421,036,557	171.3
For consideration of £5.6 million, shares issued under the Company's Sharesave Scheme	–	1,083,624	0.5
At 31 March 2021 ordinary shares of 40.7p each	8,443	422,120,181	171.8

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.

Outstanding options to subscribe for ordinary shares of 40.7 pence 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	
			2021	2020
14 July 2014	611p	2017 – 2019	–	2
24 June 2015	683p	2018 – 2020	2	142
29 June 2016	709p	2020 – 2021	37	76
28 June 2017	767p	2020 – 2022	31	327
3 July 2018	635p	2021 – 2023	674	1,115
9 July 2019	620p	2022 – 2024	484	874
19 July 2020	928p	2023 – 2025	266	–
			1,494	2,536

The number and weighted average exercise price of Sharesave options are:

	2021		2020	
	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	2,536	652	2,643	674
Granted	286	928	925	620
Forfeited	(441)	689	(295)	678
Exercised	(789)	638	(514)	680
Expired	(98)	686	(223)	681
At 31 March	1,494	687	2,536	652

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 1,021 pence (2020 820 pence). The options outstanding at 31 March 2021 had a weighted average exercise price of 687 pence (2020 652 pence) and a weighted average remaining contractual life of 1.5 years (2020 1.9 years). The number of exercisable Sharesave options at 31 March 2021 was 3,000 (2020 4,000) and the weighted average exercise price of exercisable Sharesave options was 698 pence (2020 649 pence).

Notes to the financial statements continued

33. Share capital continued

Employee share schemes continued

i) Sharesave Scheme continued

The aggregate fair value of Sharesave options granted during the year was £0.4 million (2020 £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:

	2021	2020
Weighted average share price (pence)	1,089	765
Weighted average exercise price (pence)	928	620
Expected volatility	21.0%	20.0%
Expected life	3.5 years	3.3 years
Risk-free rate	0.10%	0.75%
Expected dividend yield	4.0%	5.7%

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:

	2021		2020	
	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	–	–	256	920
Vested	–	–	(86)	920
Lapsed	–	–	(170)	920
At 31 March	–	–	–	–

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:

	2021		2020	
	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	1,346	781	962	796
Granted	229	1,074	509	753
Vested	(280)	787	–	–
Lapsed	(296)	791	(125)	787
At 31 March	999	843	1,346	781

The awards outstanding at 31 March 2021 had a weighted exercise price of 843 pence (2020 781 pence) and a weighted average remaining contractual life of 3.3 years (2020 2.8 years).

The aggregate fair value of awards granted during the year was £1.0 million (2020 £1.5 million), determined from market value. No option pricing methodology is applied since the vesting of the shares depends on non-market performance vesting conditions.

33. Share capital continued

Employee share schemes continued

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:

	2021		2020	
	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	524	772	450	825
Granted	99	1,079	215	755
Vested	(277)	788	(113)	950
Lapsed	(1)	755	(28)	786
At 31 March	345	847	524	772

The awards outstanding at 31 March 2021 had a weighted average exercise price of 847 pence (2020 772 pence) and a weighted average remaining contractual life of 1.3 years (2020 1.5 years). The Company's share price at the date of the awards ranged from 762 pence to 1,079 pence (2020 761 pence to 950 pence).

The aggregate fair value of awards granted during the year was £1.1 million (2020 £1.6 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 2019	223.6
Shares issued under the Sharesave Scheme	3.4
At 31 March 2020	227.0
Shares issued under the Sharesave Scheme	5.1
At 31 March 2021	232.1

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 2019	144.2
At 31 March 2020	144.2
At 31 March 2021	144.2

Notes to the financial statements continued

36. Retained earnings and other reserves

	Own shares £m	Hedging reserve £m	Retained earnings £m	Total £m
Group				
At 31 March 2019	(4.0)	(16.9)	863.9	843.0
IFRS 16 Leases opening adjustment	–	–	(8.0)	(8.0)
At 1 April 2019 (adjusted for IFRS 16)	(4.0)	(16.9)	855.9	835.0
Profit for the year	–	–	200.4	200.4
Other comprehensive income for the year	–	(11.2)	18.0	6.8
Dividends paid relating to 2019	–	–	(172.6)	(172.6)
Credit to equity in respect of share-based payments (net of tax)	–	–	4.8	4.8
Charge in respect of share options vesting	1.1	–	(1.1)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(1.6)	–	–	(1.6)
At 31 March 2020	(4.5)	(28.1)	905.4	872.8
Profit for the year	–	–	1,762.2	1,762.2
Other comprehensive income for the year	–	11.1	(23.3)	(12.2)
Dividends paid relating to 2020	–	–	(184.3)	(184.3)
Credit to equity in respect of share-based payments (net of tax)	–	–	2.2	2.2
Charge in respect of share options vesting	2.2	–	(2.2)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(1.2)	–	–	(1.2)
Redemption of perpetual capital securities	–	–	(3.3)	(3.3)
Deferred tax recognised directly in equity	–	–	0.6	0.6
At 31 March 2021	(3.5)	(17.0)	2,457.3	2,436.8

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 423,000 ordinary shares (2020 589,000 ordinary shares) held by the Trust at 31 March 2021 was £4.1 million (2020 £6.4 million).

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 2019	(1.8)	1,146.5	1,144.7
Profit for the year	–	330.6	330.6
Other comprehensive (loss)/income for the year	(2.1)	2.6	0.5
Dividends paid relating to 2019	–	(172.6)	(172.6)
Credit to equity in respect of share-based payments (net of tax)	–	2.0	2.0
Charge in respect of share options vesting	–	(1.1)	(1.1)
At 31 March 2020	(3.9)	1,308.0	1,304.1
Profit for the year	–	1,312.3	1,312.3
Other comprehensive (loss)/income for the year	3.8	(21.6)	(17.8)
Dividends paid relating to 2020	–	(184.3)	(184.3)
Credit to equity in respect of share-based payments (net of tax)	–	1.4	1.4
Charge in respect of share options vesting	–	(2.2)	(2.2)
Redemption of perpetual capital securities	–	(3.3)	(3.3)
Deferred tax recognised directly in equity	–	0.6	0.6
At 31 March 2021	(0.1)	2,410.9	2,410.8

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.

37. Perpetual capital securities

	£m
Group and Company	
At 1 April 2019	296.7
Distributions due to perpetual capital security holders	(8.6)
Current tax relief on distributions to perpetual capital security holders	1.6
Profit for the year attributable to perpetual capital security holders	7.0
At 31 March 2020	296.7
Redemption of perpetual capital securities	(296.7)
At 31 March 2021	-

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 had no fixed redemption date but the Company could 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 had the option to defer periodic returns on any relevant payment date, as long as a dividend on the ordinary shares had not been paid or declared in the previous 12 months. Deferred periodic returns were to 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 2020, a periodic return of £8.6 million was recognised as a financial liability in 2020.

The securities were fully redeemed during 2021 by a cash payment of £300 million.

Notes to the financial statements continued

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	
	2021 £m	2020 £m	2021 £m	2020 £m
Profit for the year	1,762.0	206.3	1,312.3	337.7
Adjustments for:				
Share-based payments	3.1	3.4	1.3	1.7
Profit on disposal of property, plant and equipment	(0.1)	(2.5)	-	-
Profit on disposal of discontinued operations	(1,682.7)	-	-	-
Profit on disposal of investment in subsidiary undertaking	-	-	(1,287.1)	-
Depreciation charge	119.2	197.2	-	-
Amortisation of intangible assets	0.2	4.7	-	-
Continuing Group:				
- non-underlying pension items	4.4	-	(4.7)	-
- non-underlying remeasurement of fair value movement in derivatives	-	(18.0)	-	-
- non-underlying increase in customer debt provisions	-	7.9	-	-
Discontinued operations:				
- non-underlying pension items	(5.6)	-	-	-
- non-underlying restructuring costs and share scheme charge	6.8	-	6.2	-
- non-underlying debt retirement cost	74.4	-	74.4	-
- non-underlying increase in customer debt provisions	-	1.1	-	-
- non-underlying past service credit	-	(4.9)	-	-
Share of post-tax profit from joint ventures	(4.3)	(14.8)	-	-
Finance income (before non-underlying items)	(10.1)	(26.6)	(11.0)	(45.4)
Finance costs (before non-underlying items)	83.7	115.3	27.6	38.2
Dividends receivable	-	-	(101.6)	(335.6)
Taxation charge	20.5	95.2	(23.7)	4.2
Changes in working capital:				
Increase in inventories	(4.0)	(6.0)	-	-
(Increase)/decrease in trade and other receivables	(42.4)	32.6	(3.4)	(182.9)
Increase in service concession arrangements receivable	(3.8)	(17.4)	-	-
(Decrease)/increase in trade and other payables	27.4	(19.2)	(15.4)	2.5
Decrease in retirement benefit obligations from contributions	(47.3)	(30.8)	(44.3)	(0.7)
Decrease in provisions	(3.3)	(7.2)	-	-
Cash generated/(outflow) from operations	298.1	516.3	(69.4)	(180.3)
Group cash generated/(outflow) from operations comprises:				
- Cash generated from discontinued operations	28.7	177.6	-	-
- Cash generated/(outflow) from Continuing Group	269.4	338.7	(69.4)	(180.3)
Cash generated/(outflow) from operations	298.1	516.3	(69.4)	(180.3)

Reconciliation of total interest paid:

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Interest paid in operating activities	80.2	97.7	23.1	37.4
Interest paid in investing activities	-	10.6	-	-
Total interest paid	80.2	108.3	23.1	37.4

The above includes the entire Group, including cash flows relating to the discontinued operations business. Disaggregated information relating to the discontinued business is provided in note 44.

During the year, the Group completed a number of sale and leaseback transactions in respect of its infrastructure assets as part of its ongoing financing arrangements. Cash proceeds of £15.0 million (2020 £115 million) were received and a gain of £nil (2020 £nil) was recognised. These assets are primarily being leased back over an initial 10-year lease term at market rentals.

39. Net borrowings

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Cash and cash deposits	2,919.3	665.9	2,495.6	367.9
Borrowings – current				
Bank and other loans	(7.7)	(7.6)	–	–
Other current borrowings	(32.4)	(33.1)	–	(6.1)
Lease obligations	(48.2)	(19.2)	–	–
Amounts owed to subsidiary undertakings	–	–	(283.4)	(284.4)
Total current borrowings	(88.3)	(59.9)	(283.4)	(290.5)
Borrowings – non-current				
Bank and other loans	(1,170.7)	(1,894.8)	(49.7)	(1,032.0)
Other non-current borrowings	(205.0)	(340.8)	(134.7)	(103.4)
Lease obligations	(1,391.0)	(1,419.3)	–	–
Total non-current borrowings	(2,766.7)	(3,654.9)	–	(1,135.4)
Total net borrowings in Continuing Group	64.3	(3,048.9)	(184.4)	(1,058.0)
Net borrowings in Disposal Group	–	(215.1)	–	–
Net borrowings in total Group	64.3	(3,264.0)	2,027.8	(1,058.0)

The movements in net borrowings during the periods presented were as follows:

Group	Net borrowings at 1 April 2019 £m	IFRS 16 transition adjustment £m	Cash flows £m	Transfer between non-current and current £m	Other non-cash movements £m	Transfer to Disposal Group £m	Net borrowings at 31 March 2020 £m
Cash and cash deposits	569.6	–	129.6	–	–	(33.3)	665.9
Bank and other loans due within one year	(59.8)	–	57.6	(8.0)	2.6	–	(7.6)
Other current borrowings	(27.0)	–	27.0	(33.1)	–	–	(33.1)
Current lease obligations	(63.6)	(8.6)	76.6	(34.0)	(8.6)	19.0	(19.2)
Bank and other loans due after one year	(1,628.0)	–	(268.0)	8.0	(6.8)	–	(1,894.8)
Other non-current borrowings	(373.9)	–	–	33.1	–	–	(340.8)
Non-current lease obligations	(1,496.8)	(137.1)	(48.8)	34.0	–	229.4	(1,419.3)
	(3,079.5)	(145.7)	(26.0)	–	(12.8)	215.1	(3,048.9)
Net borrowings in Disposal Group							(215.1)
Net borrowings in total Group							(3264.0)

	Net borrowings at 1 April 2020 £m	Viridor disposal £m	Cash flows £m	Transfer between non-current and current £m	Other non-cash movements £m	Transfer to Disposal Group £m	Net borrowings at 31 March 2021 £m
Cash and cash deposits	665.9	–	2,253.4	–	–	–	2,919.3
Bank and other loans due within one year	(7.6)	–	130.2	(130.1)	(0.2)	–	(7.7)
Other current borrowings	(33.1)	–	33.1	(32.4)	–	–	(32.4)
Current lease obligations	(19.2)	–	18.8	(43.2)	(4.6)	–	(48.2)
Bank and other loans due after one year	(1,894.8)	–	668.7	130.1	(74.7)	–	(1,170.7)
Other non-current borrowings	(340.8)	–	103.4	32.4	–	–	(205.0)
Non-current lease obligations	(1,419.3)	–	(15.0)	43.2	0.1	–	(1,391.0)
	(3,048.9)	–	3,192.6	–	(79.4)	–	64.3
Net borrowings in Disposal Group	(215.1)	179.0	38.0	–	(1.9)	–	–
Net borrowings in total Group	(3,264.0)	179.0	3,230.6	–	(81.3)	–	64.3

Other non-cash movements for the Group includes £69.3 million of make whole costs associated with the retirement of debt from the discontinued operations, which crystallised on settlement as well as the increase in borrowings from interest which is rolled into the amount repayable.

Notes to the financial statements continued

39. Net borrowings continued

Company	Net borrowings at 1 April 2019 £m	Cash flows £m	Other non-cash movements £m	Net borrowings at 31 March 2020 £m
Cash and cash deposits	284.8	83.1	–	367.9
Bank and other loans due within one year	(51.8)	49.6	2.2	–
Other current borrowings	–	–	(6.1)	(6.1)
Amounts due to subsidiary undertakings	(283.9)	(0.5)	–	(284.4)
Bank and other loans due after one year	(880.2)	(150.0)	(1.8)	(1,032.0)
Other non-current borrowings	(109.5)	–	6.1	(103.4)
	(1,040.6)	(17.8)	0.4	(1058.0)

	Net borrowings at 1 April 2020 £m	Cash flows £m	Other non-cash movements £m	Net borrowings at 31 March 2021 £m
Cash and cash deposits	367.9	2,127.7	–	2,495.6
Other current borrowings	(6.1)	6.1	–	–
Amounts due to subsidiary undertakings	(284.4)	1.0	–	(283.4)
Bank and other loans due after one year	(1,032.0)	1,055.6	(73.3)	(49.7)
Other non-current borrowings	(103.4)	(31.3)	–	(134.7)
	(1,058.0)	3,159.1	(73.3)	2,027.8

The significant cash flows in the current year and reduction in net borrowings reflect the receipt of proceeds on the disposal of Viridor and subsequent repayment of borrowings in connection with that investment.

Other non-cash movements for the Group includes £69.3 million of make whole costs associated with the retirement of debt from the discontinued operations, which crystallised on settlement as well as the increase in borrowings from interest which is rolled into the amount repayable.

40. Subsidiary and joint venture undertakings at 31 March 2021

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
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

* Indicates the shares are held directly by Pennon Group plc, the Company.

(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
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 Trustee 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

40. Subsidiary and joint venture undertakings at 31 March 2021 continued

Other dormant companies	Registered office address	Country of incorporation
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
Avon Valley Water 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
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
Greenhill Environmental Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Haul Waste 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 Share Plans (Guernsey) Limited*	Albert House, South Esplanade, St Peter Port, GY1 1AW	Guernsey
Pennon Share Scheme Trustees 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
Rydon Properties Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Seal Security Systems 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
The Metropolitan Water Company Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Contracting Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Enterprises Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor South West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste 2 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.

Notes to the financial statements continued

41. Contingencies

Contingent liabilities

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	-	-	-	460.9
Performance bonds	-	197.1	-	197.1
	-	197.1	-	658.0

Guarantees of the borrowing facilities of subsidiary undertakings were released during 2021 by agreement with the lenders. Guarantees in respect of performance bonds in 2020 related to the Disposal Group and have been transferred on completion of the sale.

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. In previous accounting periods, there were matters where it was uncertain that these conditions had been met in respect of discontinued operations. Following the disposal these uncertainties do not impact the Continuing Group.

42. Capital commitments

	Group		Company	
	2021 £m	2020 £m	2021 £m	2020 £m
Contracted but not provided relating to the Continuing Group	76.7	72.0	-	-

Excluded from the balances at 31 March 2020 above is £98.6 million relating to discontinued operations (see note 44 for further details).

43. Related party transactions

Group companies entered into the following transactions with joint ventures which were not members of the Group. All transactions listed below related to the Disposal Group and were reported as part of discontinued operations. The year end balances as at 31 March 2020 with joint ventures were included within assets held for sale (see note 44 for further details).

	2021 £m	2020 £m
Sales of goods and services		
INEOS Runcorn (TPS) Limited	3.5	18.2
Purchase of goods and services		
Lakeside Energy from Waste Limited	3.8	12.8
INEOS Runcorn (TPS) Limited	2.2	8.3
Dividends received		
Lakeside Energy from Waste Holdings Limited	-	6.0

Year-end balances

	2021 £m	2020 £m
Receivables due from related parties		
Lakeside Energy from Waste Limited (loan balance)	-	7.1
INEOS Runcorn (TPS) Limited (loan balance)	-	59.5
	-	66.6
Lakeside Energy from Waste Limited (trading balance)	-	1.0
INEOS Runcorn (TPS) Limited (trading balance)	-	1.2
	-	2.2
Payables due to related parties		
Lakeside Energy from Waste Limited (trading balance)	-	1.1
INEOS Runcorn (TPS) Limited (trading balance)	-	1.7
	-	2.8

43. Related party transactions continued**Company**

The following transactions with subsidiary undertakings occurred in the year:

	2021 £m	2020 £m
Sales of goods and services (management fees)	10.5	17.9
Purchase of goods and services (support services)	3.3	0.6
Interest receivable	4.7	43.4
Interest payable	–	0.1
Dividends received	101.6	335.6

Sales of goods and services to subsidiary undertakings are at cost. Purchases of goods and services from subsidiary undertakings are under normal commercial terms and conditions which would also be available to unrelated third parties.

Year-end balances

	2021 £m	2020 £m
Receivables due from subsidiary undertakings		
Loans	26.1	1,225.6
Trading balances	59.9	16.0

Interest on £13.1 million (2020 £13.0 million) of the loans has been charged at a fixed rate of 5%. Interest on £13.0 million (2020 £13.0 million) of the loans has been 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 (2020 £nil).

	2021 £m	2020 £m
Payables due to subsidiary undertakings		
Loans	283.4	284.4
Trading balances	8.6	9.1

The loans from subsidiary undertakings are unsecured and interest-free without any terms for repayment.

Notes to the financial statements continued

44. Discontinued operations and non-current assets held for sale

On 18 March 2020, the Group entered into a formal sale agreement to dispose of Viridor Limited to Planets UK Bidco Limited (Bidco), a newly formed company established by funds advised by Kohlberg Kravis Roberts & Co. L.P. (KKR). The Viridor business which represented the entirety of the waste operating segment was classified as a discontinued operation at that date. Consequently, Viridor has not been presented as an operating segment in the segment note. The sale completed on 8 July 2020 and the results of the discontinued operation and the effect of the disposal on the financial position of the Group were as follows:

	Before non-underlying items 2021 £m	Non-underlying items (see below) 2021 £m	Total 2021 £m	Before non-underlying items 2020 £m	Non-underlying items (see below) 2020 £m	Total 2020 £m
Discontinued operations						
Revenue	192.2	–	192.2	753.2	–	753.2
Operating costs						
Employment costs	(34.4)	0.5	(33.9)	(130.4)	4.9	(125.5)
Raw materials and consumables used	(22.4)	–	(22.4)	(87.2)	–	(87.2)
Other operating expenses	(81.1)	(1.7)	(82.8)	(337.5)	(1.1)	(338.6)
Earnings before interest, tax, depreciation and amortisation	54.3	(1.2)	53.1	198.1	3.8	201.9
Depreciation and amortisation	–	–	–	(82.1)	–	(82.1)
Operating profit	54.3	(1.2)	53.1	116.0	3.8	119.8
Finance income	6.0	–	6.0	22.5	–	22.5
Finance costs	(21.3)	(74.4)	(95.7)	(48.7)	–	(48.7)
Net finance costs	(15.3)	(74.4)	(89.7)	(26.2)	–	(26.2)
Share of post-tax profit from joint ventures	4.3	–	4.3	14.8	–	14.8
Profit before tax	43.3	(75.6)	(32.3)	104.6	3.8	108.4
Taxation (charge)/credit	(7.8)	12.1	4.3	(13.6)	(11.0)	(24.6)
Profit from operating activities, net of tax	35.5	(63.5)	(28.0)	91.0	(7.2)	83.8
Gain on sale of discontinued operation	–	1,682.7	1,682.7	–	–	–
Profit from discontinued operations, net of tax	35.5	1,619.2	1,654.7	91.0	(7.2)	83.8
Attributable to:						
Ordinary shareholders of the parent			1,654.7			83.8
Cash flows used in discontinued operations					2021 £m	2020 £m
Cash generated from operations					28.7	177.6
Interest paid					(17.6)	(39.4)
Tax paid					(4.4)	10.9
Cash flows from / (used in) operating activities					6.7	149.1
Cash flows from investing activities					(24.0)	(133.0)
Cash flows from financing activities					(79.2)	(23.1)
Net decrease in cash and cash equivalents from discontinued operations, net of inter-company					(96.5)	(7.0)

Non-underlying items

Non-underlying items in 2021 represent employment costs (restructuring, accelerated share scheme charges and a settlement gain on transfer of pension liabilities), other operating restructuring costs and finance costs relating to debt retirements of £74.4 million, of which £176 million was incurred on debt retirements completed in the second half of the financial year, together with the related taxation credit.

Non-underlying items in 2020 represent a past service pension credit of £4.9 million from employees transferring from active to deferred status upon cessation of the Viridor Greater Manchester contract and an expense from COVID-19 provision for expected credit losses of £1.1 million. The non-underlying taxation credit represents the taxation impact of the above items, together with the impact of change in the tax rate used to calculate deferred tax balances. Further background to the COVID-19 expected credit losses and the change in the deferred tax rate are disclosed in note 6.

44. Discontinued operations and non-current assets held for sale continued**Non-underlying items** continued

The net assets relating to the Disposal Group at the date of disposal and the gain on disposal are shown below:

	£m
Assets of the Disposal Group	
Goodwill	340.8
Other intangible assets	86.9
Property, plant and equipment	1,619.2
Other non-current assets	266.7
Investment in joint ventures	64.4
Inventories	33.4
Trade and other receivables	298.7
Current tax asset	0.6
Cash and cash deposits	61.7
Total assets	2,772.4
Liabilities of the Disposal Group	
Borrowings	(240.7)
Trade and other payables	(157.7)
Provisions	(236.8)
Other non-current liabilities	(12.7)
Retirement benefit obligations	1.5
Deferred tax liabilities	(109.4)
Total liabilities	(755.8)
Net assets disposed of	2,016.6
Consideration received in cash, net of transaction costs	3,690.2
Deferred consideration	9.2
Gain on sale before income tax and reclassification of reserves	1,682.8
Items previously recognised in equity recycled to the income statement	(0.1)
Gain on sale of discontinued operation	1,682.7
Net cash inflow arising on disposal	
Consideration received in cash, net of transaction costs	3,690.2
Less: cash and cash deposits disposed of	(61.7)
	3,628.5

The Company classified its investment in ordinary shares in Viridor Limited as an asset held for sale at 31 March 2020.

Deferred consideration

Under the sale agreement deferred consideration may be receivable in future. The fair value of the amount expected to be received at 31 March 2021 has been estimated at £9.2 million and this amount is expected to be received in the first half of the financial year ended 31 March 2022. The receipt of further deferred consideration remains possible, albeit the likelihood is judged as not probable and has therefore not been recognised in the financial statements. Further details on this key accounting judgement are disclosed in note 4.

Taxation on the discontinued operations

The gain on sale of discontinued operations qualified for Substantial Shareholding Exemption and consequently was not subject to corporation tax. The taxation charge from discontinued operations of £7.8 million (2020 £13.6 million charge) includes a deferred tax charge of £7.6 million (2020 £23.1 million charge).

45. Events after the reporting period

Notes to the financial statements continued

On 2 June 2021, the Company approved the acquisition of 100% of the issued share capital of Bristol Water Holdings UK Limited, including its subsidiaries (together, the Bristol Water Group), from its indirect shareholders: (a) infrastructure funds advised by iCON Infrastructure LLP and (b) ITOCHU Corporation, for an equity value of £425 million and an enterprise value of £814 million including £389 million of assumed debt. Bristol Water Holdings UK Limited is the holding company for Bristol Water plc and possesses a 30% share in water2business Limited, a joint venture with Wessex Water Limited. Bristol Water Group has Gross assets of £709 million and Net assets of £162 million as at 31 March 2021, based on the unaudited consolidated balance sheet. For the year ended 31 March 2021, the unaudited consolidated results for Bristol Water Group recorded combined revenues of £118 million, operating profits of £21 million and underlying profit before tax of £9 million. Bristol Water plc is a regulated water only company serving a population of approximately 1.2 million customers in the Bristol region, with a regulatory capital value (RCV) of £555.9 million as at 31 March 2021. No information has been presented on the fair value of assets and liabilities acquired and the separable intangibles arising on acquisition as required by IFRS 3 as management has not had sufficient time to reasonably conclude on this, given the timing of the acquisition.

On the same date the Company approved the acquisition of Bristol Water Group, it also determined that the remaining c.£1.9 billion net proceeds from the sale of Viridor should be returned to shareholders. The proposed return of capital to shareholders will be by way of a proposed special dividend of £1.5 billion, representing £3.55 per existing ordinary share and a share buy-back programme of up to £0.4 billion which will start after payment of the proposed special dividend. To maintain comparability, so far as possible, of the Company's share price before and after the proposed special dividend, Pennon intends to consolidate its Ordinary Share capital on the basis of two New Ordinary Shares in the capital of the Company for every three Existing Ordinary Shares in the capital of the Company (the Share Consolidation). In connection with the proposed return of capital, the Company has committed to contribute an additional £17 million to its remaining defined benefit pension scheme, Pennon Group Pension Scheme.

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. The following APMs have been amended from those presented previously to reflect the changing nature of the Group following the sale of Viridor:

- The APM for Adjusted EBITDA (adjusted earnings before interest, tax, depreciation and amortisation) has been removed as this measure was used to adjust for the impact of Viridor's share of EBITDA from its joint ventures and finance income on service concession arrangements. Following the disposal of Viridor these adjustments to properly assess performance are no longer required
- Return on capital employed for South West Water has been presented for 2021 to provide a more meaningful comparison of Group performance due to the Group holding a net cash position at 31 March 2021
- The Total Group Effective interest rate has been replaced as this measure does not provide comparability as the Group is in a net cash position at 31 March 2021. The more relevant measure of the Group's management of interest rates is in respect of South West Water Limited, which is in a net borrowing position. The calculations have therefore been presented for this entity
- Other measures have been updated to reflect continuing operations, rather than Total Group measures to ensure a meaningful comparison.

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 notes to 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 2021

£m	Non-underlying items			Statutory results	Earnings per share (p)
	Underlying	WaterShare+	Pension curtailment charge		
EBITDA (see below)	334.7	(20.5)	(4.4)	309.8	
Operating profit	215.3	(20.5)	(4.4)	190.4	
Profit before tax	157.0	(20.5)	(4.4)	132.1	
Taxation	(29.6)	3.9	0.9	(24.8)	
Profit after tax from continuing operations				107.3	
Profit after tax from discontinued operations				1,654.7	
Profit after tax (PAT)				1,762.0	
Non-controlling interests				0.2	
PAT attributable to shareholders				1,762.2	418.5
Deferred tax before non-underlying items				14.2	3.4
Non-underlying items post tax				(1,599.1)	(379.8)
Underlying earnings				177.3	42.1

Underlying earnings reconciliation 2020

£m	Non-underlying items				Statutory results	Earnings per share (p)
	Underlying	COVID-19 provision for expected credit losses	Remeasurement of fair value movement in derivatives	Deferred tax change in rate		
EBITDA	356.3	(7.9)	–	–	348.4	
Operating profit	245.5	(7.9)	–	–	237.6	
Profit before tax	183.0	(7.9)	18.0	–	193.1	
Taxation	(38.4)	1.5	(3.4)	(30.3)	(70.6)	
Profit after tax from continuing operations					122.5	
Profit after tax from discontinued operations					83.8	
Profit after tax (PAT)					206.3	
PAT attributable to perpetual capital holders					(7.0)	
Non-controlling interests					1.1	
PAT attributable to shareholders					200.4	47.7
Deferred tax before non-underlying items					33.2	7.9
Non-underlying items post tax					29.3	6.9
Non-controlling interests' share of non-underlying items					(1.0)	(0.2)
Adjustment for full year depreciation charge in Disposal Group					(2.6)	(0.6)
Underlying earnings					259.3	61.7

Alternative performance measures continued

EBITDA

EBITDA (earnings before interest, tax, depreciation and amortisation) is used to assess and monitor operational underlying performance.

South West Water Limited effective interest rate

A measure of the mean average interest rate payable on South West Water Limited's net debt, which excludes interest costs not directly associated with South West Water Limited net debt. This measure is presented to assess and monitor the relative cost of financing for South West Water Limited.

	2021 £m	2020 £m
Net finance costs after non-underlying items	56.5	53.1
Non-underlying net finance costs	–	18.0
Adjustment for prior period interest credit ⁽¹⁾	–	1.2
Net interest on retirement benefit obligations	(0.4)	(0.2)
Capitalised interest	0.9	2.0
Net finance costs for effective interest rate calculation	57.0	74.1
Opening net debt	2,307.2	2,062.5
Closing net debt	2,273.5	2,307.2
Average net debt (opening net debt + closing net debt divided by 2)	2,290.4	2,184.9
Effective interest rate	2.5%	3.4%

(1) Adjustment for the annualised impact of the 2040 derivative settlement on net interest charge in FY 2019/20.

Continuing operations interest cover

Underlying net finance costs (excluding pensions net interest cost) divided by operating profit before non-underlying items.

	2021 £m	2020 (restated) £m
Net finance costs after non-underlying items	58.3	44.5
Add back: non-underlying net finance credit	–	18.0
Net interest on retirement benefit obligations	(0.7)	(0.2)
Net finance costs for interest cover calculation	57.6	62.3
Operating profit before non-underlying items	215.3	245.5
Interest cover (times)	3.7	3.9

Total Group dividend cover

Proposed dividends divided by profit for the year before non-underlying items and deferred tax.

	2021 £m	2020 £m
Proposed dividends	91.8	184.3
Profit for the year attributable to ordinary shareholders	1,762.2	200.4
Deferred tax charge before non-underlying items	14.2	33.2
Non-underlying items after tax in profit for the year	(1,599.1)	29.3
Non-controlling interests' share of non-underlying items	–	(1.0)
Adjustment for full year depreciation charge in the Disposal Group	–	(2.6)
Adjusted profit for dividend cover calculation	177.3	259.3
Dividend cover (times)	1.9	1.4

Continuing operations capital investment

Property, plant and equipment additions. The measure is presented to assess and monitor the total capital investment by the Group.

	2021 £m	2020 (restated) £m
Property, plant and equipment additions to property, plant and equipment	168.3	161.0
Intangible additions to property, plant and equipment	0.2	0.6
Capital investment	168.5	161.6

Continuing operations capital payments

Payments for property, plant and equipment (PPE) additions net of proceeds from sale of PPE. The measure is presented to assess and monitor the net cash spend on PPE.

	2021 £m	2020 £m
Cash flow statements: purchase of property, plant and equipment	190.1	332.8
Cash flow statements: purchase of intangible assets	0.2	0.6
Cash flow statements: proceeds from sale of property, plant and equipment	(0.4)	(10.6)
IFRIC 12 additions to non-current assets – service concession arrangements	–	17.1
Capital payments relating to the Total Group	189.9	339.9
Capital payments relating to discontinued operations	(32.3)	(176.1)
Capital payments relating to continuing operations	157.6	163.8

Total Group 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. Return on capital employed for South West Water has been presented for 2021 to provide a more meaningful comparison of Group performance due to the Group holding a net cash position at 31 March 2021.

	2021 ⁽¹⁾ £m	2020 £m
Underlying operating profit	222.3	361.5
Underlying joint venture profit after tax	–	14.8
Joint venture interest receivable	–	5.3
Adjusted profit for return on capital employed calculation	222.3	381.6
Values at year end:		
Net debt	2,198.6	3,264.0
Share capital	250.9	171.3
Share premium account	–	227.0
Capital redemption reserve	–	144.2
Perpetual capital securities	–	296.7
Capital employed for return on capital employed calculation	2,449.5	4,103.2
Values at year end:	9.1%	9.3%

(1) Return on capital employed for South West Water has been presented for 2021 to provide a more meaningful comparison of Group performance due to the Group holding a net cash position at 31 March 2021.

Alternative performance measures continued

Continuing operations operational cash inflows and other movements

Cash generated from operations before pension contributions and other movements.

	2021 £m	2020 £m
Cash generated from operations per cash flow statements	298.1	516.3
Remove: cash generated from discontinued operations	(28.7)	(177.6)
Cash generated from operations from the Continuing Group	269.4	338.7
Other movements ⁽¹⁾	(3.6)	0.2
Other taxes ⁽²⁾	80.8	70.7
Pension contributions	50.2	39.8
Operational cash inflows and other movements	396.8	449.4

(1) Other movements reflect operational movements not related to operating cash flows, such as proceeds from share issues and share trust purchases for the employee share schemes.

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

RoRE

This is a key regulatory metric which represents the returns to shareholders expressed as a percentage of regulated equity.

Returns are made up of a base return (set by Ofwat, the water business regulator, at c.3.9% for 2020-25) plus totex outperformance, financing outperformance and ODI outperformance. Returns are calculated post tax and post sharing (only a proportion of returns are attributed to shareholders and shown within RoRE). The three different types of return calculated and added to the base return are:

- Totex outperformance – totex is defined below and outperformance is the difference between actual reported results for the regulated business compared to the Final Determination (Ofwat published document at the start of a regulatory period), in a constant price base
- Financing outperformance – is based on the difference between a company's actual effective interest rate compared with Ofwat's allowed cost of debt
- ODI outperformance – the net reward or penalty a company earns based on a number of different key performance indicators, again set in the Final Determination.

Regulated equity is a notional proportion of regulated capital value (RCV which is set by Ofwat at the start of every five-year regulatory period, adjusted for actual inflation). For 2020-25, the notional equity proportion is 40.0%.

Further information on this metric can be found in South West Water's annual performance report and regulatory reporting, published in July each year. The most recent can be found at: www.southwestwater.co.uk/about-us/how-are-we-performing.

Totex

Operating costs and capital expenditure of the regulated water and wastewater business (based on the Regulated Accounting Guidelines).

ODI

ODIs are designed to incentivise companies to deliver improvements to service and outcomes based on customers' priorities and preferences. If a company exceeds these targets a reward can be earned through future higher revenues. If a company fails to meet them, they can incur a penalty through lower future allowed revenues.

Glossary

CIC	community interest company, a type of company introduced by the UK Government in 2005 under the Companies (Audit, Investigations and Community Enterprise) Act 2004, designed for social enterprises that want to use their profits and assets for the public good
CMex	customer measure of experience, a mechanism to incentivise water companies to provide an excellent customer experience for residential customers, across both the retail and wholesale parts of the value chain
CPI	consumer price index, a measure of inflation in a representative sample of retail goods and services using a geometric mean and excluding e.g. housing costs
CPIH	consumer price index, a measure of inflation in a representative sample of retail goods and services using a geometric mean, including owner occupiers' housing costs
DNV	an independent management consultancy specialising in technical assurance in the utility sector
EBITDA	earnings before interest, tax, depreciation and amortisation
EIB	European Investment Bank
ERF	energy recovery facility
ESG	environmental, social and governance
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. In December 2018, Pennon became the first water services and waste management utility to receive it (see page 61)
GHG	greenhouse gases (see page 130)
GMP	guaranteed minimum pension
GRREC	Glasgow Recycling and Renewable Energy Centre
GVA	gross value added, the measure of the value of goods and services produced in an area, industry or sector of an economy
HomeSafe	our health & safety improvement programme (see page 47)
K7	the current regulatory price review period during which South West Water's 2020-25 New Deal business plan will be implemented (see page 50)
KPI	key performance indicator, our measures of business performance against the key targets monitored by Board and Pennon Executive (see page 16)
LTIFR	lost time injury frequency rate
MRF	materials recycling facility
ODI	outcome delivery incentives, 15 of which are common across all water companies while others are bespoke to South West Water (see page 16)
Ofwat	The Water Services Regulation Authority, or Ofwat, is the body responsible for economic regulation of the privatised water and sewerage industry in England and Wales
PRF	plastics recycling facility
ROCE	return on capital employed
RoRE	return on regulated equity
RPI	retail price index, a measure of inflation in a representative sample of retail goods and services using an arithmetic mean
SIM	service incentive mechanism, a measure of customer service
STEM	science, technology, engineering and mathematics
Sustainable Financing Framework	the way we link financial impacts with sustainability impacts; the Framework aligns with the Green Bond Principles, the Social Bond Principles and the Green Loan Principles (see page 26)
Totex	total expenditure
WaterShare	the programme through which we shared the benefits of outperformance against our 2015-20 business plan targets with water customers
WaterShare+	the enhanced benefit sharing mechanism introduced for water customers under our 2020-25 New Deal business plan (see page 32)

Five-year financial summary

	Continuing operations		Total Group			
	2021 £m	2020 £m	2020 £m	2019 £m	2018 £m	2017 £m
Income statement						
Revenue before non-underlying items	644.6	636.7	1,389.9	1,478.2	1,393.0	1,353.1
Operating profit before non-underlying items	215.3	245.5	361.5	351.0	323.9	304.6
Net finance costs before non-underlying items	(58.3)	(62.5)	(88.7)	(83.2)	(74.5)	(58.8)
Share of profit in joint ventures	–	–	14.8	12.4	9.4	4.2
Profit before tax and non-underlying items	157.0	183.0	287.6	280.2	258.8	250.0
Net non-underlying items before tax	(24.9)	10.1	13.9	(19.9)	4.1	(39.5)
Taxation charge	(24.8)	(70.6)	(95.2)	(37.7)	(41.0)	(30.0)
Profit for the year	107.3	122.5	206.3	222.6	221.9	180.5
Attributable to:						
Ordinary shareholders of the parent	107.5	116.6	200.4	214.3	200.6	164.3
Perpetual capital security holders	–	7.0	7.0	8.6	21.5	16.2
Non-controlling interests	(0.2)	(1.1)	(1.1)	(0.3)	(0.2)	–
Dividends proposed/declared	91.8	184.3	184.3	172.7	162.0	149.5
Earnings per ordinary share (basic):						
From continuing and discontinuing operations						
Earnings per share	25.5p	27.7p	47.7p	51.1p	48.0p	39.8p
Deferred tax before non-underlying items	1.6p	2.4p	7.9p	3.1p	4.4p	4.5p
Non-underlying items (net of tax)	4.8p	5.3p	6.9p	3.6p	(1.8p)	2.7p
Non-controlling interests' share of non-underlying items	–	(0.2p)	(0.2p)	–	–	–
Adjustment for full year depreciation charge in the Disposal Group	–	–	(0.6p)	–	–	–
Proportional adjustment on perpetual capital returns	–	–	–	–	0.3p	–
Earnings per share before non-underlying and deferred tax	31.9p	35.2p	61.7p	57.8p	50.9p	47.0p
Declared dividends per share	21.74p	43.77p	43.77p	41.06p	38.59p	35.96p
	2021 £m	2020 £m	2019 £m	2018 £m	2017 £m	
Capital expenditure						
Acquisitions (including investment in joint ventures)	–	–	54.8	8.4	–	–
Property, plant and equipment	168.3	326.8	387.2	389.0	377.5	
Balance sheet						
Non-current assets	3,277.1	3,226.0	5,364.5	5,125.0	4,937.0	
Net current assets ⁽¹⁾	2,919.1	2,595.8	583.9	412.6	454.4	
Non-current liabilities	(3,211.4)	(4,109.7)	(4,268.6)	(3,898.5)	(3,882.2)	
Net assets	2,984.8	1,712.1	1,679.8	1,639.1	1,509.2	
Number of employees (average full time equivalent for year)						
Water	1,745	1,623	1,616	1,575	1,589	
Waste management	–	2,986	3,426	3,285	3,153	
Non-household retail	160	143	104	81	–	
Other businesses	82	101	93	73	57	
	1,987	4,853	5,239	5,014	4,799	

(1) Net current assets for 2020 includes assets held for sale of £2675.3 million and liabilities directly associated with assets classified as held for sale of £756.3 million.

Shareholder information

Financial calendar

Financial year end	31 March
Ex-dividend date for 2021 final dividend	22 July 2021
2021 Annual General Meeting	22 July 2021
Record date for 2021 final dividend	23 July 2021
2021 final dividend payable	2 September 2021
2021/22 half-yearly results announcement	30 November 2021
2022 interim dividend payable	Early April 2022
2021/22 final results announcement	31 May 2022
2022 Annual General Meeting	July 2022
2022 final dividend payable	Early September 2022

Dividend Reinvestment Plan (DRIP) alternative

Ordinary shares quoted ex-dividend	22 July 2021
Record date for final dividend	23 July 2021
Final date for receipt of DRIP applications	10 August 2021
Posting of dividend cheques	1 September 2021
Final dividend payment date	2 September 2021

Shareholder analysis at 31 March 2021

Holding of shares	Number of shareholders	% of total shareholders	% of ordinary shares
1-100	2,400	13.52	0.19
101-1,000	7,415	41.76	0.92
1,001-5,000	6,491	36.55	3.35
5,001-50,000	1,076	6.06	2.87
50,001-100,000	84	0.47	1.40
100,001+	291	1.64	91.44
	17,757		
	Number of accounts	% of total accounts	% of total shares
Individuals	15,607	87.89	5.75
Companies	175	0.98	1.62
Trust companies (pension funds etc.)	6	0.03	0.01
Banks and nominees	1,969	0.26	6.95
	17,757		

Major shareholdings

The net position on 31 March 2021 of investors who have notified interests in the issued share capital of the Company pursuant to the Financial Conduct Authority's Disclosure Guidance and Transparency Rules is as follows:

	Number of voting rights (direct and indirect)	% of voting rights
Lazard Asset Management LLC	41,575,771	9.983%
Norges Bank	12,857,235	3.05%
BlackRock Inc	21,659,543	5.13%

No further changes to interests in the Company's issued share capital have been disclosed to the Company between 31 March 2021 and 2 June 2021 (being a date not more than one month prior to the date of the Company's Notice of Annual General Meeting).

Shareholder information continued

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
10th Floor
Central Square
29 Wellington Street
Leeds
LS1 4DL

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: www.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).

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 2021 Annual General Meeting for the payment of a final dividend for the year ended 31 March 2021, 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.

Corporate information

Registered office

Peninsula House
Rydon Lane
Exeter
Devon EX2 7HR

Company registration number: 2366640

Company Secretary

Simon A F Pugsley

Corporate brokers

Barclays 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 <http://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

Pennon encourages the use of electronic proxy voting and no longer provides paper proxy forms alongside the AGM Notice. We believe that is both more efficient and consistent with our important environmental sustainability responsibilities and objectives.

You may register your proxy votes via www.signalshares.com. Registering your vote electronically is entirely secure and ensures the privacy of your personal information. Alternatively, if you wish to vote by post you may request a hard copy proxy form by contacting our registrar, Link Asset Services. Contact details are provided above.

Pennon's website

<http://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.

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 <http://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 <http://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.uk/reporting-fraud-and-cyber-crime or by calling **0300 123 2040**.



Pennon Group plc

Peninsula House
Rydon Lane
Exeter
Devon

England EX2 7HR

www.pennon-group.co.uk

Registered in England & Wales
Registered Number: 2366640