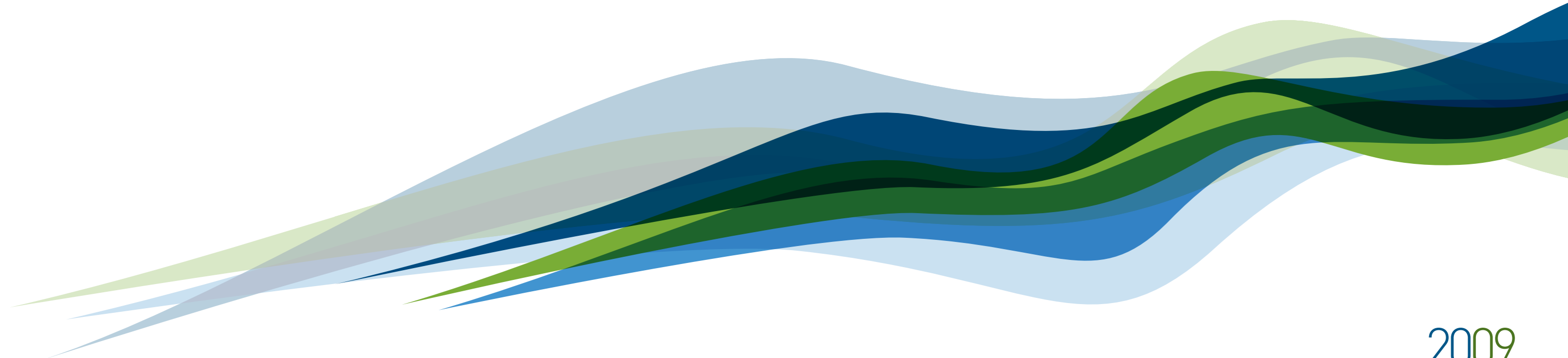




PENNON GROUP PLC ANNUAL REPORT & ACCOUNTS 2009



2009
Annual Report & Accounts

100% recycled
This report is printed
on 100% recycled paper



Pennon Group Plc Registered Office: Peninsula House, Rydon Lane, Exeter, Devon, England EX2 7HR pennon-group.co.uk
Registered in England No. 2366640

CONTENTS

Financial highlights and Group strategy..... 1

Directors' report

Business review*:

Chairman's statement..... 2

Pennon Group:

Financial performance..... 4

Funding position..... 5

Chief Executives' overviews:

South West Water..... 6

Viridor..... 10

About our businesses:

South West Water:

Regulatory and competitive environment..... 14

Customers, community and employees..... 17

Key relationships..... 20

Risks and uncertainties..... 21

Viridor:

Regulatory and competitive environment..... 22

Customers, community and employees..... 24

Key relationships..... 25

Risks and uncertainties..... 26

Pennon Group:

Other financial information..... 28

Key relationships..... 30

Risks and uncertainties..... 32

Our corporate responsibility..... 34

Interpretation..... 38

Other statutory information..... 40

Board of Directors..... 42

Directors' remuneration report..... 43

Corporate governance and internal control..... 50

Independent Auditors' report..... 53

Financial statements..... 54

Five-year financial summary..... 109

Shareholder information..... 110

* Throughout the business review 'key performance indicators' of the Group are denoted by



REVENUE UP 8.9% TO £953 MILLION

UNDERLYING OPERATING PROFIT UP 7.0% TO £259 MILLION

UNDERLYING PROFIT BEFORE TAX UP 6.7% TO £165 MILLION

UNDERLYING EARNINGS PER SHARE UP 3.5% TO 38.2p

DIVIDEND PER SHARE UP 6.0% TO 21.0p

Statutory results are:

- operating profit £253 million (2007/08 £237 million)
- profit before tax £159 million (2007/08 £150 million)
- earnings per share 26.3p (2007/08 38.2p).

A reconciliation to underlying measures of performance is given on page 4.

PENNON GROUP OPERATES AND INVESTS IN WATER AND SEWERAGE SERVICES, WASTE MANAGEMENT AND RENEWABLE ENERGY. IT HAS ASSETS OF AROUND £3.5 BILLION AND A WORKFORCE OF OVER 4,000 PEOPLE.

Pennon Group's business is operated through two main subsidiaries:

- South West Water Limited holds the water and sewerage appointments for Devon, Cornwall and parts of Dorset and Somerset
- Viridor Limited is one of the leading waste management and renewable energy businesses in the United Kingdom.

PENNON GROUP BOARD'S STRATEGY is to promote the success of the Group for the benefit of its shareholders through its focus on water and sewerage services, waste management and renewable energy.

In pursuit of its strategy the Group aims to be a pre-eminent provider of customer services to high standards of quality, efficiency and reliability whilst having regard to a wide range of matters including:

- the impact of its operations and activities on the community and the environment
- the maintenance of high standards of business conduct
- the need to foster business relationships with suppliers, customers and other key persons important to the success of the Group
- the likely long-term consequences of any decisions
- the interests of employees.



Ken Harvey
Chairman
Pennon Group Plc

Chairman's statement

Another year of profitable
growth with Group
businesses well positioned
in the current economic
slow-down

BUSINESS OVERVIEW

I am pleased to say that it has been another successful year for Pennon Group despite the extremely difficult business environment. The prudent approach to financing in the Group and the actions taken by the Directors, management and staff have ensured that the effects of the difficult economic conditions on our businesses have been minimised to date. I am confident that we are as prepared as we can be for what will undoubtedly be further challenges in 2009/10.

FINANCIAL OVERVIEW

We have seen our Group revenue increase by 8.9% to £952.9 million, our underlying* profit before tax increase by 6.7% to £165.3 million and our underlying* earnings per share rise by 3.5% to 38.2p. At the year-end we had Group cash balances of £353 million and debt facilities of £205 million were established/renewed during the year.

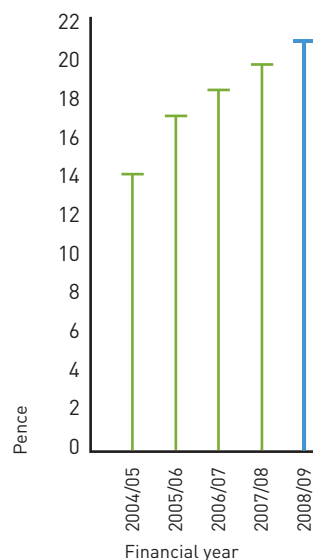
South West Water's Regulatory Capital Value (RCV) continues to grow with an expectation that it will reach £2.5 billion by March 2010 and Viridor's compound annual growth rate in profit before tax since 2001 has been 17%.

* Underlying measures are defined on page 4.

DIVIDEND

We are recommending to shareholders a final dividend per share of 14.25p, a 5.1% increase on last year's final dividend. This represents a full year dividend of 21.0p which is an increase of 6.0% compared with 2007/08. We are continuing our dividend policy of 3% per annum real increases to the end of 2009/10. The Board will then review the dividend policy following the setting of price limits for South West Water by Ofwat. Dividends have increased over the last five years as follows:

DIVIDENDS PER ORDINARY SHARE





Underlying*
profit before
tax up 6.7%
to £165.3m



Full year
dividend up 6%
to 21.0p

BUSINESS PERFORMANCE

South West Water increased its revenue in the year by 2.5% and operating profit was up by 3.6%. There were improvements in operational performance together with the outperformance of the operating cost efficiency target set by Ofwat for 2005-10. The company has submitted its Final Business Plan to Ofwat for the setting of price limits for the period 2010 – 2015. The focus of the plan has been to keep customers' bills as stable as possible whilst ensuring that the improvements in the company's infrastructure made over the last 20 years are protected and maintained and that further improvements can be made to ensure compliance with EU Directives. This is the third price review whilst I have been Chairman. What I have noticed is that each review has become increasingly detailed and time-consuming resulting in escalating costs for the company – a process which I do not believe is in the best interests of either shareholders or customers. I think that once the present review has been completed, it would be sensible for Ofwat and the industry to review the process with the objective of achieving simplification whilst maintaining the integrity of a utility review.

Viridor has once again delivered a strong financial performance in very challenging market conditions. It is apparent that the waste industry is changing rapidly with landfill becoming an increasingly scarce resource and with ambitious EU/UK waste management targets for recycling, landfill diversion and renewable energy. Viridor's strategy has developed to reflect these changes and the company is successfully pursuing a range of new opportunities. These include private finance initiative (PFI) and public private partnership (PPP) contracts and also energy from waste (EFW) projects. Recently Viridor has successfully completed the UK's largest ever combined waste and renewable energy project with the Greater Manchester Waste Disposal Authority and a 14-year recycling, anaerobic digestion and disposal contract with the South London Waste Partnership. Other major schemes are the Lakeside EFW plant joint venture at Colnbrook near Heathrow and other EFW projects for which planning permission has been obtained or is currently being sought.

HEALTH & SAFETY

Ensuring the health and safety of all our employees is central to our ethos as a responsible Group. We continually strive to improve our occupational health and safety performance and where, regrettably, incidents do occur they are fully investigated and every effort is made to ensure that they cannot be repeated.

GOVERNANCE

In Pennon Group we strive to achieve best practice in all our business areas whilst ensuring that we are environmentally sustainable and socially responsible in all the communities in which we operate. We take into account the views of our shareholders and major institutional groups on what they regard to be the key governance issues. Where necessary we revise our practices, policies and procedures to enable us to demonstrate that we have a strong and appropriately experienced Board with governance structures in place which ensure that we can successfully respond to the challenges that we face in the best interests of our shareholders and other stakeholders.

OUR PEOPLE

The support and commitment of all our staff is key to our success. My personal thanks go to them all for their dedication and commitment to the Group as we continually strive to improve performance and successfully develop our businesses which inevitably leads to more change.

During the year Kate Mortimer, one of our Non-executive Directors, sadly died. Kate brought to the Board extensive business experience and sound judgement which are missed. Martin Angle was appointed as a new Non-executive Director in December 2008. Martin has had a successful investment banking career and also has wide ranging business experience, not least of the waste industry. He is a most welcome and valued addition to the Board.

Once again, my personal thanks also go to both the Executive and Non-executive Directors for their support and significant contributions to what has been yet another successful and demanding year.

OUTLOOK

There will undoubtedly be major challenges for all our businesses in 2009/10 and beyond.

I am confident that we have the right strategy for the Group and that this strategy together with the management skills in the Group will steer us through to a successful future.

Ken Harvey, Chairman
Pennon Group Plc
25 June 2009



David Dupont
Group Director of Finance
Pennon Group Plc

Pennon Group

The Group's 2008/09 financial results showed continued growth in revenue and profit from both main businesses

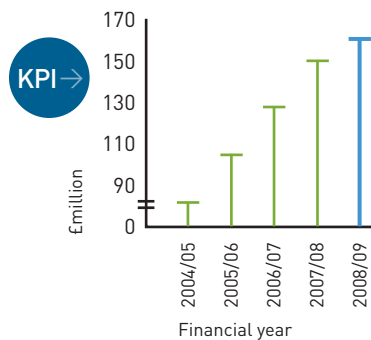
FINANCIAL PERFORMANCE

The Board's strategy is to promote the success of the Group for the benefit of its shareholders through its focus on water and sewerage services, waste management and renewable energy.

The key measures used by the Directors to assess the financial performance of the Group are:

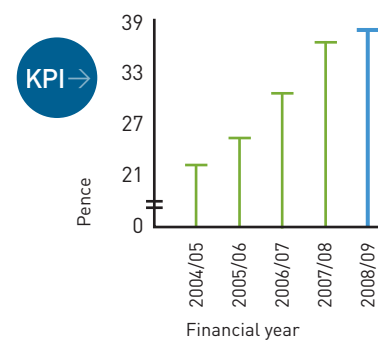
PROFIT BEFORE TAX (PBT)

PBT has grown by 16.3% Compound Annual Growth Rate (CAGR) over the five-year period.



EARNINGS PER SHARE (EPS)

EPS have grown by 15.0% CAGR over the five-year period.



The Group's 2008/09 financial results showed continued growth in revenue and profit from both main businesses. The Directors believe that underlying measures provide a more useful comparison on businesses trends and performance. Underlying results exclude restructuring costs, intangibles amortisation and deferred tax. The term underlying is not a defined term under International Financial Reporting Standards (IFRS) and may not be comparable with similarly titled measures used by other companies.

RECONCILIATION OF UNDERLYING AND STATUTORY RESULTS

	2008/09 £m	2007/08 £m	Growth
OPERATING PROFIT			
Statutory operating profit	252.8	236.8	6.8%
Non-underlying costs :			
- Restructuring – South West Water	5.0	4.0	
- Intangibles amortisation – Viridor	1.2	1.3	
Underlying operating profit	259.0	242.1	7.0%
PROFIT BEFORE TAX			
Statutory profit before tax	159.1	149.6	6.4%
Non-underlying costs :			
- Restructuring – South West Water	5.0	4.0	
- Intangibles amortisation – Viridor	1.2	1.3	
Underlying profit before tax	165.3	154.9	6.7%
EARNINGS PER SHARE - pence			
Statutory earnings per share	26.3p	38.2p	-31.2%
Non-underlying costs :			
- Restructuring (after tax) – South West Water	0.9	0.9	
- Intangibles amortisation – Viridor	0.4	0.4	
Deferred tax	10.6	(2.6)	
Underlying earnings per share	38.2p	36.9p	3.5%

All profit and earnings per share figures in this business review on pages 2 to 38 relate to underlying business performance (as defined above) unless otherwise stated.



The Group has a strong liquidity and funding position



£205 million debt facilities established/renewed during 2008/09

Revenue

Group revenue increased by 8.9% to £952.9 million. South West Water's revenue rose 2.5% to £431.7 million as a result of tariff increases and new connections, offset by the effect of customers switching to measured tariffs and lower demand. Viridor's revenue rose by 14.9% to £522.7 million from the full-year effect of previous acquisitions and the existing business.

Operating profit

Group operating profit increased by 7.0% to £259.0 million with South West Water up 3.6% to £191.6 million and Viridor up 12.7% to £65.5 million. During the year the Company sold its interest in Achilles Group Limited, a utility-based procurement specialist company, with sale proceeds and profit of £1.9 million.

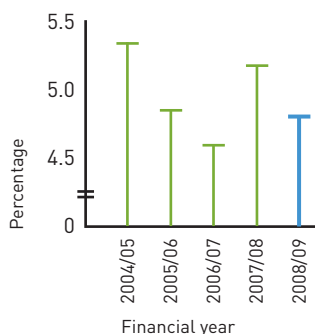
Details of the financial performance of South West Water and Viridor are set out in this business review on pages 9 to 10 respectively.

Finance costs

Excluding pensions net interest and discount unwind on provisions, net finance costs were £88.4 million (2007/08 £85.6 million) and were 2.9 times covered by Group operating profits (2007/08 2.8 times). On this measure, net interest payable equated to a rate of 4.8% on average net debt (2007/08 5.2%) and demonstrates the Group's effective management of interest rates.

Over the last five years the interest rates on Group average net debt have been:

INTEREST RATE ON AVERAGE NET DEBT



South West Water's interest rate on average net debt for the year was 4.6% (2007/08 4.7%). Interest rate management is analysed further on page 33.

Profit before tax

Profit before tax was £165.3 million, £10.4 million up on 2007/08, an increase of 6.7%.

Taxation

The UK corporation tax charge for the year was £30.7 million, including £1.7 million tax relief on restructuring costs (2007/08 £25.0 million, including £0.7 million of relief on restructuring costs). Additional employer pension contributions to defined benefit schemes resulted in corporation tax relief of £10.7 million (2007/08 £5.7 million). No further such employer contributions are expected in 2009/10.

The Group has a strong liquidity and funding position, £205 million debt facilities established/renewed during 2008/09. The deferred tax charge for the year was £36.9 million (2007/08 a credit of £9.0 million). This included a non-recurring charge of £24.9 million relating to the abolition of industrial buildings allowances (2007/08 a non-recurring credit of £21.0 million reflected the reduction of UK corporation tax from 30% to 28% from 1 April 2008).

Earnings per share

Earnings per share increased by 3.5% to 38.2p. Statutory earnings per share decreased from 38.2p to 26.3p as a result of the £45.9 million movement in non-recurring deferred tax items noted above.

The weighted average number of shares in issue during the year was 348.1 million (2007/08 349.7 million). Net assets per share at book value at 31 March 2009 were 171p.

Dividends and retained earnings

The statutory net profit of £91.5 million has been transferred to reserves.

The Directors recommend the payment of a final dividend of 14.25p per share for the year ended 31 March 2009. Together with the interim dividend of 6.75p per share paid on 8 April 2009, this gives a total dividend for the year of 21.0p per share, an increase of 6.0% compared with 2007/08. The Retail Prices Index fell by 0.4% over the period 1 April 2008 to 31 March 2009,

but on a month-by-month basis the index was on average 3% higher than the previous year.

Proposed dividends of £73.4 million (2007/08 £69.1 million) are covered 1.8 times (2007/08 1.9 times) by net profit. Dividends are charged against retained earnings in the year in which they are paid.

Dividend policy

The Group is committed to a progressive dividend policy of 3% per annum increase above inflation in dividend per share until the end of 2009/10.

FUNDING POSITION

The Group had a strong liquidity and funding position as at 31 March 2009:

- cash and deposits of £353 million
- committed undrawn facilities of £204 million
- committed funding in place for South West Water to at least 2011.

During the year the following finance initiatives have been implemented:

- £100 million 15-year EIB funding for South West Water
- successful renewal of £55 million revolving credit facilities for both Pennon Group Plc and South West Water
- £25 million finance lease facility for South West Water
- £25 million 5-10 year finance lease facility for Viridor.

£235 million loan repayments are required by March 2010 of which £43 million is due by December 2009. The further refinancing of existing facilities is being progressed.

The fair value benefit (i.e. the difference between the book value and fair value of Group debt) has increased over the year from £170 million to £221 million at 31 March 2009 as a result of the Group having a high proportion of its debt at fixed credit margins, while market credit margins have increased. The Group's average debt maturity is now 23 years.



Chris Loughlin
Chief Executive
South West Water Limited

South West Water

Another successful year
for South West Water
with improvements
to both operational
efficiency and
customer service

CHIEF EXECUTIVE'S OVERVIEW

Against an uncertain global economic background, South West Water has had a strong performance this year, improving customer service, delivering further operational efficiency and achieving sound financial results.

South West Water has a clear vision, 'Pure Water, Pure Service and Pure Environment', which was at the heart of our Strategic Direction Statement published in December 2007. Underpinning the vision is the strategy of striking the right balance between investing to improve our services, financeability and, importantly, customer affordability.

It is now over a year since the company's vision was launched. The vision and strategy have been used to focus delivery in what has been the penultimate year in this regulatory cycle 2005-2010 and as the basis for our detailed plans which have been developed for the next five-year cycle 2010-2015.

Significant preparation has been undertaken this financial year ahead of the Price Determination due in November 2009 by Ofwat for the 2010-2015 regulatory period:

- in August 2008 we submitted our draft business plan detailing targeted improvements to customer services and a modest number of water and environmental quality improvement projects
- in April 2009 following the feedback from the public consultation on our draft plan and a comprehensive review of our proposals, we submitted our Final Business Plan to Ofwat.

Given the current economic conditions, our strategy of striking the right balance is key; our plans are mindful of the impact further investment in our assets has on the level of bills when customers are least able to afford higher charges. We have also ensured that overall funding requirements are minimised at a time when the cost of new financing is expected to be at a premium. We have targeted our plan to reflect customer priorities, whilst challenging ourselves to deliver increased efficiencies.

This strategy has also worked well during this financial year. South West Water has made excellent progress by:

- improving service to customers, tackling affordability issues and levels of customer debt
- completing required investment in our assets and infrastructure for the benefit of our customers and the environment
- delivering further operating efficiencies
- ensuring there is efficient financing in place secured into the next 2010-2015 regulatory period.

Some of our key operational results and achievements in the last 12 months have demonstrated the benefits of our focused approach through our 'Pure Water, Pure Service and Pure Environment' vision.

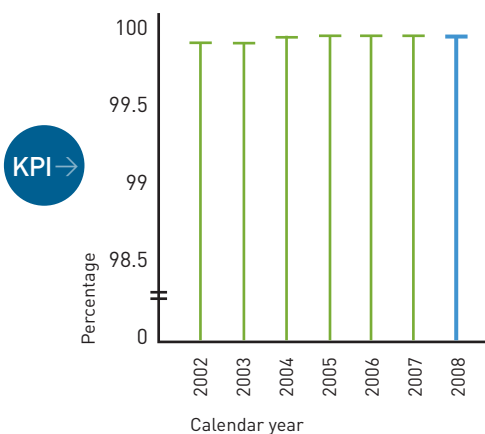
↑
Operating efficiencies achieved ahead of schedule

↑
Strategy and plan for 2010-2015 submitted to Ofwat

PURE WATER

Drinking water quality overall compliance for the calendar year 2008, as monitored by the Drinking Water Inspectorate (DWI), maintained a consistently high percentage of 99.96%.

DRINKING WATER QUALITY



This has been our 12th consecutive year without water restrictions. The company has put in place a comprehensive strategy to help ensure a continued secure supply of water for the region. During 2008 the use of two new reservoirs for Cornwall was secured. The reservoirs were previously disused china clay pits; a much more cost-effective alternative compared with building new reservoirs. Both lakes are on Bodmin Moor and will become the fourth and fifth largest in South West Water's service area.

In 2008/09 South West Water abstracted 163,792 Megalitres (Ml) of raw water from its 82 licensed abstraction locations which have a total licensed volume of 388,366Ml. The abstraction sources are reservoirs and rivers, accounting for 93% of supplies, with the remaining 7% drawn from groundwater aquifers.

Despite a very cold winter causing a series of burst pipes both for customers and for our own network, we achieved our target leakage performance of 84 Megalitres per day (Ml/d). We have achieved or beaten our leakage targets every year since targets were introduced by Ofwat in 1999/00. Our leakage remains amongst the lowest in the industry at 5.6 cubic metres per kilometre of pipe per day.

One of the most significant elements of the current investment programme is water mains rehabilitation. A further 363km of water mains were replaced or relined during the year as part of the company's ongoing programme, agreed with the DWI for completion by 2010. Four key programme milestones have now been successfully achieved. Work to meet the fifth and final milestone is underway and is due to be completed this year with a significant project in Exeter finished ahead of schedule in 2008.

PURE SERVICE

Customers are benefiting from our focused approach to customer service. There has been an increase in first-time resolution of operational issues for customers. This has led to a reduction in the number of customer complaints received.

With the current adverse economic conditions, South West Water has further developed its range of measures to assist those customers with affordability issues:

- 'WaterCare', a ground-breaking customer care programme, was launched early in 2007 targeted at helping those most in need to pay their bills. Customers are advised on how to manage better both their water use and household budget, including claiming all the benefits to which they are entitled. Some customers benefit from moving on to a special payment plan which enables them to make regular affordable payments, thereby reducing the company's outstanding debt. In 2008/09 the number of customers receiving tangible benefits through the programme has doubled
- an innovative water tariff trial was approved by Ofwat at the beginning of 2009. The tariff, being trialled with a random sample of 1,000 customers, will incentivise customers to use less water by pricing water for essential use 27% lower than the standard tariff and for non-essential use at a premium rate. This will enable customers who conserve their water to make savings on their annual bills. We will review the data obtained at the end of the three-year trial period.

PURE ENVIRONMENT

Our continued focus on the proactive maintenance and operation of our assets has resulted in a step change improvement in waste water-related pollution incidents. This has been our 10th consecutive year without a Category 1 incident, and the number of Category 2 and 3 incidents has almost halved (see Glossary for descriptions).

A new sewage treatment works for Sennen Cove and Porthcurno in West Cornwall was formally opened by Andrew George MP in May 2009, completing a significant final piece in South West Water's 'Clean Sweep' waste water programme which has transformed the quality of the coastal and estuarine environment of the South West. Situated close to Britain's most westerly point, the works have been built to blend in with the surrounding Area of Outstanding Natural Beauty which is popular with residents, visitors, surfers and swimmers. The new sewage treatment works has ended the discharge of untreated sewage directly into the sea.

Compliance with the mandatory EU bathing water standard was 93.1%, a marked contrast to a decade ago when compliance was only 47.5%. Although lower than the 2007 result of 97.9%, in the summer of 2008 the South West had in excess of 150% more rainfall than normal. During May to September (the bathing water season) the region also had more rain than anywhere else in England and Wales with the wet weather washing agricultural and other surface water pollutants into the sea. The Environment Agency has confirmed that none of the bathing water failures was attributable to South West Water's operations. In 2008 all but 10 of the region's 144 bathing waters achieved the EU mandatory standard and 72.2% achieved the more stringent EU Guideline standard (78.3% in 2007).

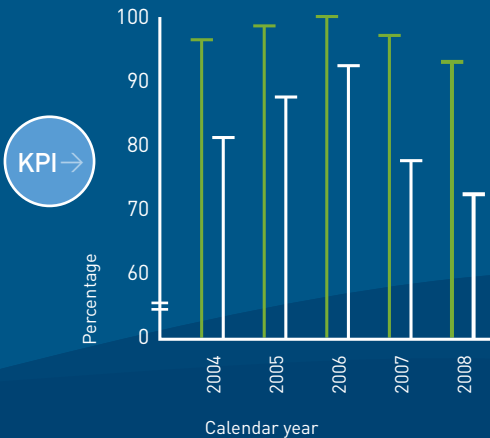
The percentage of population equivalent served by sanitary-compliant waste water treatment works in the calendar year 2008 was 99.54% (99.73% in 2007).

This performance contributes to South West Water's region having the highest percentage length of high quality rivers in England.

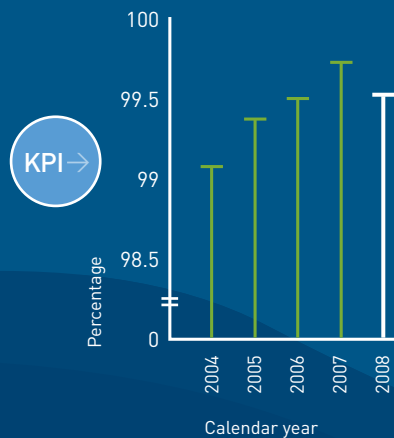
In November 2008 South West Water overcame strong competition to claim a National Gold Green Apple Award for Environmental best practice. The award was presented by the Green Organisation in recognition of the efforts South West Water is making to help businesses save water and money.

BATHING WATER COMPLIANCE WITH:

— Current mandatory standard
 — Current guideline standard



POPULATION EQUIVALENT SANITARY COMPLIANCE





Waste water compliance above 99.5%



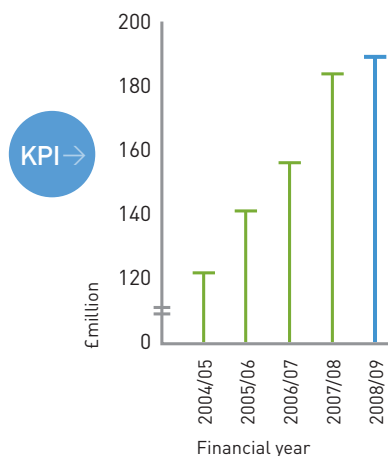
Operating profit up by 3.6% despite lower measured demand

To support the 'Pure' vision, South West Water is maintaining momentum in delivering further operational efficiencies and creating a platform to enable more improvements to operational and customer service performance:

- due to the continuing pressure of rising energy prices, energy management is increasingly important and we have been driving a major programme of energy efficiency throughout our operations. During 2008/09 the 'Megawatt Challenge' has focused employees' attention on reducing energy use
- continued investment has been made this year in our infrastructure to move the organisation towards a more centralised operational structure employing increased levels of automation and remote working
- as part of our ongoing drive for service improvement and operational efficiency, a significant programme of organisational restructuring across the business has been ongoing throughout the year costing £5 million
- we continue to work with our service partners, including our extended supply chain, to deliver an improved service to customers. This year we have delivered a specific project on the clean water distribution network which has led to more innovative ways of working
- we achieved the Investor in People (IIP) Silver Status in March 2009 as part of our IIP reaccreditation, valid for a period of three years.

This has been a successful year for South West Water. Significant improvements have been made to deliver service excellence and achieve new operational efficiencies. It is a testimony to the professionalism of our employees that we have maintained the momentum for a major improvement in customer service whilst delivering significant change across the business.

OPERATING PROFIT



FINANCIAL REVIEW

Against an uncertain global economic background, South West Water has had a strong performance this year, improving customer service, delivering further operational efficiency and achieving sound financial results.

Operating profit up by £6.6 million (3.6%) to £191.6 million, despite a £9.8 million (4.2%) fall in measured demand. For the five-year period 2004/05 to 2008/09 operating profit is shown in the graph below.

The company's revenue increased by £10.7 million to £431.7 million:

- increases: tariff increases approved by Ofwat (£27.7 million) and 7,000 new customer connections (£3.6 million)
- decreases: customers switching to metered tariffs (£9.5 million) and a 4.2% fall in measured demand (£9.8 million).

66% of our domestic customers now receive a metered supply.

Operating costs, excluding depreciation, reduced by £0.7 million to £150.3 million:

- efficiency savings were £3.9 million in the year; a £15.1 million cumulative base cost reduction since 2005
- additional costs from new capital schemes were £0.8 million
- inflation was £5.6 million
- other costs reduced by £3.2 million including income from property disposals
- the company is on track to deliver the demanding efficiency targets set by Ofwat at the last price determination over the 2005-2010 period, with operating cost efficiencies being delivered ahead of schedule.

Despite the downturn in the property market, property disposals in the year contributed £1.7 million to profit (2007/08 £0.1 million loss).

Average percentage rate of cash collection of debt from customers is in line with previous years.

Capital expenditure was £147.8 million of which £101 million was invested in water supply improvements including water mains rehabilitation and water treatment works enhancement.

Further contributions of £28.8 million were made to the defined benefit pension schemes.

South West Water has committed funding in place to at least 2011.

Restructuring costs were £5 million in 2008/09 and a further £5 million is expected to be provided in 2009/10.

Viridor



Colin Drummond
Chief Executive
Viridor Limited

Viridor traded strongly in 2008/09, building further on the growth achieved over the previous seven years

CHIEF EXECUTIVE'S OVERVIEW

Viridor is one of the UK's leading waste management and renewable energy companies. We have core competencies in landfill disposal, recycling and generation of electricity from landfill gas. The company has a waste collection fleet focusing primarily on the industrial and commercial market and also operates materials recycling facilities (MRFs), waste transfer stations, treatment plants, household waste recycling sites (HWRS) and composting facilities in a number of regions in the UK.

Continuing developments in the UK's waste management and renewable energy policies, driven by climate change and environmental awareness, create major opportunities for Viridor.

In 2008/09 Viridor delivered another year of strong profit growth despite the difficult economic conditions in the UK and worldwide which came into play in the second half of the year. At the same time we progressed various major strategic initiatives, including in particular the Greater Manchester waste and renewable energy project (the largest of its kind in the UK), which are expected to significantly further enhance our business in future years. This reflects our focused strategy of:

- capitalising on our strong position in landfill waste disposal
- maximising landfill gas renewable energy generation
- exploiting opportunities arising from the Government's landfill diversion and recycling targets including:
 - Public Private Partnership (PPP) and Private Finance Initiative (PFI) contracts;
 - recycling operations; and
 - energy from waste plants and other power generation plants.

Further detail on the climate change and environmental drivers behind the Government's policies and Viridor's strategy is given in the sections on main trends and business and strategy on pages 12 and 13.

Viridor traded strongly in 2008/09, building further on the growth achieved over the past seven years. Revenue was up 15% (up £67.6 million to £522.7 million), of which acquisitions accounted for £41.9 million and existing business £25.7 million. The total increase included landfill tax of £19.1 million.

Viridor's earnings before interest, tax, depreciation and amortisation of intangibles (EBITDA) rose 6.8% from £101.0 million to £107.9 million. Profit before interest, tax and amortisation of intangibles (PBITA) for the year increased by 13% (£7.4 million) to £65.5 million, compared with £58.1 million in 2007/08. The increase reflected a full year's contribution from last year's Grosvenor and Shore acquisitions and 14.8% organic growth. Viridor has achieved PBITA compound growth of 22% per annum since 2000/01.

Profit before tax (PBT) at £40.8 million was up 15% on the previous year. Capital expenditure for the year was £92.0 million (2007/08 £59.0 million) of which £41.8 million was on a range of growth projects which are expected to contribute to profits in future years.

PBITA, PBT AND RETURN ON EQUITY

PBITA and PBT are key overall measures of Viridor's performance and are set out in the table below for the nine-year period 2001 to 2009. The table also sets out the Compound Annual Growth Rate (CAGR) for these measures, being the rate of growth between 2001 and 2009 expressed as a single annual average figure over the period.

Return on equity is also a key measure of Viridor's performance and is calculated as PBT expressed as a percentage of Pennon Group's equity investment in Viridor (£207 million at 31 March 2009).

Year ended 31 March	2001*	2002*	2003*	2004*	2005	2006	2007	2008	2009	CAGR
	£m	£m	£m	£m	£m	£m	£m	£m	£m	2001 - 09
PBITA	13.1	15.2	19.1	22.7	30.0	35.9	46.8	58.1	65.5	22%
PBT	11.7	13.8	15.7	17.2	21.5	23.5	29.4	35.5	40.8	17%
Return on equity investment	6.1%	7.2%	8.2%	8.8%	11.0%	11.3%	14.2%	17.1%	19.7%	-

*UK GAAP

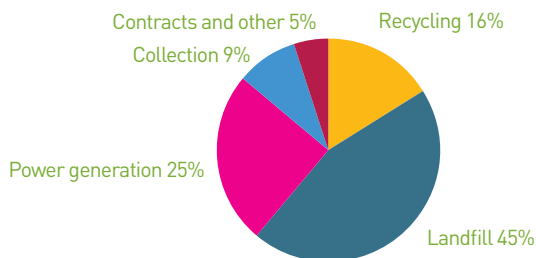


Viridor delivered another year of strong profit growth in 2008/09

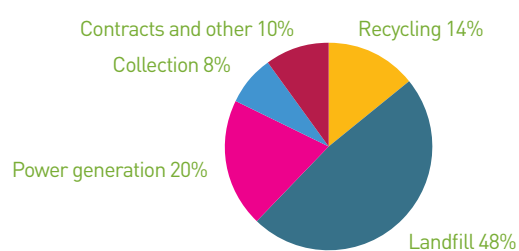
VIRIDOR PROFIT CONTRIBUTION BY SEGMENT

The pie charts below provide a breakdown of Viridor's profit contribution by segment (before amortisation of intangibles and central overhead costs including pensions). In 2008/09 landfill accounted for 45% and landfill gas power generation 25% of Viridor's profit contribution, compared with the previous year's 48% and 20% respectively. Recycling and contracts (the third element of the strategy) accounted for 21% (last year 24%).

FINANCIAL YEAR 2008/09



FINANCIAL YEAR 2007/08



LANDFILL

Total landfill disposal volumes decreased by 0.6 million tonnes (11%) to 4.6 million tonnes in the year. The decrease was entirely due to a reduction in third party industrial and commercial volumes, and included the impact of 0.2 million tonnes of non-recurring items in the previous year. Volumes from domestic customers and Viridor's own inputs were maintained over the period. Average revenue per tonne increased by 11% (to £21.48 per tonne) more than offsetting increased fuel and leachate removal costs. Operating margins per tonne increased by circa £1 per tonne to around £7 per tonne. Consented landfill void reduced from 84 million cubic metres at 31 March 2008 to 81 million cubic metres at 31 March 2009, reflecting 6 million cubic metres usage during the period offset by planning gains totalling 3 million cubic metres. As planned, Beddingham landfill in East Sussex closed in May 2009 (2008/09 profit contribution: £4.4 million).

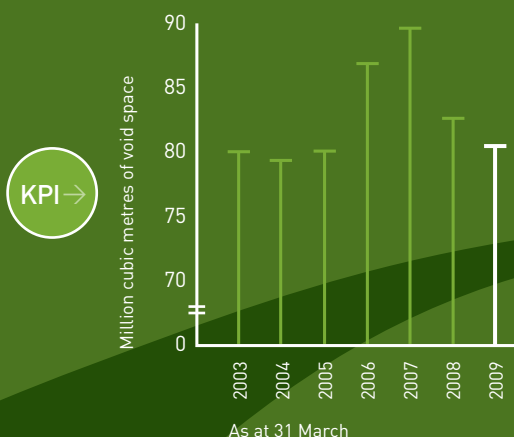
LANDFILL GAS

Viridor's landfill gas power generation output increased by a further 6% to 504 Gigawatt hours (GWh) during the year. Viridor's average revenues per Megawatt hour (MWh) grew by 23% to £74 reflecting the growth in energy contract prices eligible for Renewable Obligation Certificates (ROCs). Taking advantage of favourable market conditions in May 2008, Viridor sold forward the brown element of its 'ROC-able' electricity to March 2010.

At 31 March 2009 Viridor's landfill gas power generation capacity was 101 Megawatts (MW) compared with 84MW at the previous year-end (both figures exclude a small amount of sub-contract capacity). All of the increase is accredited for full ROCs in advance of the banding change. At 31 March 2009 62% of Viridor's power generating capacity was eligible for ROCs and 38% for the Non Fossil Fuel Obligation (NFFO).

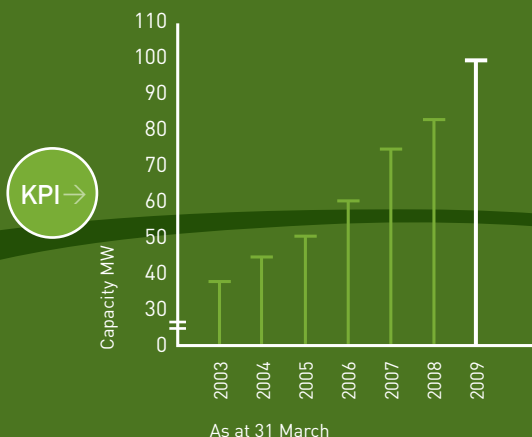
CONSENTED LANDFILL VOID

As at 31 March 2009 Viridor had a consented void capacity of 81 million cubic metres.



POWER GENERATION CAPACITY

Electricity generated is sold to electricity suppliers, usually under NFFO contracts or under shorter term contracts with ROCs. As at 31 March 2009 Viridor had 101 MW of generating capacity, an increase of 17 MW over the year. These figures exclude 3MW of sub-contract capacity in Suffolk.



RECYCLING

The UK is required under the EU Landfill Directive to reduce the amount of biodegradable municipal waste going to landfill sites. Municipal waste accounts for around one third of Viridor's landfill market. The alternatives to landfill sites for final waste disposal in the UK are currently limited. In order to meet the requirements of the Landfill Directive, local authorities have been set statutory targets by the Government for the diversion of biodegradable municipal waste from landfill. There are also national targets for recycling and recovery of household waste. In addition the Chancellor's Budget announcement of April 2009, continuing the increase in landfill tax of £8 a year from £40 currently to £72 per tonne in 2013/14, will further increase the cost competitiveness of recycling.

Of Viridor's total traded recycling and composting segment volume of around 1.4 million tonnes, 35% is in paper, plastics and metals where prices are set by international trading conditions. Prices for these products were high in the first half of the year and low in the second half reflecting world economic conditions. The remaining 65% of volumes were sold to a range of customers in the UK. Viridor's recycling revenues are currently derived from gate fees (42%) as well as recycle sales (58%). Total recycling profits grew 27% year on year. Reflecting price movements noted above, 73% of profits were in the first half year and 27% in the second half.

CONTRACTS AND COLLECTION

Contracts profits were down reflecting poor performance on two sludge contracts. Along with other major municipal contracts, the Somerset PPP and West Sussex PFI continue to perform well. Profits from the collection business were up with enhanced margins and a £1 million non-recurring credit from a landfill tax claim more than offsetting the impact of reduced volumes resulting from current UK economic conditions.

PUBLIC PRIVATE PARTNERSHIPS AND PRIVATE FINANCE INITIATIVES

PPP and PFI contracts are also a key part of Viridor's strategy and Viridor will continue to bid selectively for further such contracts.

Financial Close on the Greater Manchester Waste PFI was achieved just after the financial year-end, on 8 April 2009. It is the UK's largest ever combined waste and renewable energy project, managing 1.3 million tonnes of waste per year.

The total potential energy generation will be approaching 130MW (including Phases I and II of the Runcorn energy from waste (EfW) and combined heat and power (CHP) plant and the four planned anaerobic digestion facilities), in addition to the existing 9MW from the EfW Bolton plant. The PFI is a joint venture between Viridor and John Laing (Infrastructure) Limited (Laing). Operation of the associated facilities will be carried out on a sub-contract basis by Viridor. The EfW CHP facility (Runcorn Phase I) is a joint venture between INEOS Chlor Vinyls Limited (Ineos), Viridor and Laing. Total capital expenditure on the PFI is projected to be £405 million with an additional £235 million for the associated EfW/CHP plant (Runcorn Phase I). Viridor's total contribution will be £85 million plus further possible mezzanine debt of up to £40 million in 2010. In addition to winning the PFI contract itself, Viridor has also secured 100% of Phase II of the planned EfW/CHP facility at Runcorn. This will be targeted at the North West market more generally and is a significant addition to the initial project given the rising landfill tax, the increasing reliance of waste disposal authorities on the Landfill Allowance Trading Scheme and the shortage of competing capacity in the North West. Planning permission was achieved by Ineos for the EfW/CHP plant at Runcorn in September.

Viridor's other PFI/PPP contracts at West Sussex and Somerset are performing well. In September 2008 it also won a 450,000 tonnes per annum, 14-year contract for recycling, anaerobic digestion (AD) and disposal for the South London Waste Partnership (a consortium of four London boroughs). In addition to the above contracts, Viridor continues to bid selectively for other projects. It is one of the last two bidding for the Oxfordshire PPP and the Cheshire PFI and is in the bidding for other contracts.

OTHER RENEWABLE ENERGY OPPORTUNITIES

Viridor is pursuing a number of other energy from waste opportunities. The Lakeside joint venture with Grondon Waste Management Limited comprises a 410,000 tonnes per annum and up to 37MW EfW plant at Colnbrook near Heathrow. It involves capital expenditure of £160 million financed by 86% non-recourse debt with the balance split equally between the two joint venture partners. Construction is nearly complete and a profit contribution is expected in 2009/10.

In 2007 Viridor achieved planning permission for a 60,000 tonnes per annum and 3MW EfW plant in Exeter.

It is also pursuing other possible long-term EfW opportunities in Cardiff, Oxfordshire, South Devon and Dunbar. The company has also received planning permission for AD plants located at Beddington (near Croydon), Walpole (Somerset) and four in Greater Manchester. The latter have a total capacity of 430,000 tonnes per annum and up to 8MW of electricity (included in the Greater Manchester figure of 130MW above).

MAIN TRENDS AND FACTORS LIKELY TO AFFECT THE FUTURE DEVELOPMENT, PERFORMANCE AND POSITION OF THE COMPANY'S BUSINESS

The waste management and renewable energy business is heavily impacted by environmental and climate change considerations and associated Government policies. Viridor's strategy reflects this. Our belief is that being green is good for business, as is demonstrated by the company's financial performance.

Government policies are designed in the first instance to minimise the amount of waste generated, then to maximise reuse and recycling, followed by treatment and energy recovery via EfW facilities and other technologies. This is underpinned by final safe disposal in landfills. The Government is implementing the EU Landfill Directive and reducing the amount of waste to go to landfill. This Directive was initiated in part because of the methane generated by landfills, although in fact the bulk of this is now captured for renewable energy generation.

The Government's target of diverting municipal waste away from landfill up to 2020 is leading to a decline in the landfill market. However, with only around six or seven years' consented capacity in the UK as a whole (according to Environment Agency estimates) and with new consents difficult to achieve, Viridor's 81 million cubic metres is regarded as a very valuable resource.

At the same time it is increasingly recognised that waste is a major renewable energy source, accounting for approximately 30% of current UK renewable energy or roughly 1.5% of total UK electricity production; principally this is currently from landfill gas utilisation, which has grown by 600% over the past 10 years.



There is scope for a major increase in the amount of energy recovered from waste in the UK particularly in EfW facilities (especially with CHP) as well as in developing technologies such as AD.

The Institution of Civil Engineers has estimated that waste could theoretically account for up to 17% of total UK electricity production. The Institution of Mechanical Engineers has recently published a similar estimate. Even if these are over-estimates it is still clear that waste can make a major contribution to the UK's future energy needs. As the UK increasingly relies on imports of energy and seeks to grow its output of renewable energy, Viridor's growing power generation business is expected to become an increasingly valuable asset.

The need for councils to avoid steeply increasing landfill tax and to achieve their landfill diversion targets creates attractive opportunities for PFI/PPP contracts. Examples include Viridor's contracts with West Sussex, Somerset, Greater Manchester and the South London Waste Partnership, facilities such as the Lakeside EfW plant and the Runcorn EfW/CHP plants and recycling operations such as Viridor's resource management and electrical and glass recycling services.

Overall, Viridor is well positioned in the face of the economic uncertainties in the UK and abroad on account of its diversified business mix. However it is by no means immune to the unfavourable economic conditions pertaining since the second half of the past year. Year-on-year performance will be affected by the closure of Beddingham landfill site as well as the £1 million non-recurring credit in 2008/09 noted above. However, Viridor has sold its 'ROC-able' power generation forward to 31 March 2010 at the favourable 'brown energy' prices seen in the summer of 2008. The company will also see revenue contributions from the Lakeside and Greater Manchester projects coming on stream during 2009/10.

BUSINESS AND STRATEGY

Our strategy is to add value by:

- capitalising on our strong position in landfill waste disposal;
- maximising landfill gas renewable energy generation; and
- exploiting opportunities arising from the UK Government's landfill diversion and recycling targets including:
 - PPP & PFI contracts;
 - recycling operations; and
 - EfW and other power generation plants.

Viridor's landfill market consists of municipal, commercial and industrial wastes, along with certain other special types of waste. Landfill is currently the major final disposal route for these wastes.

Viridor is a major landfill site operator within the UK with a total consented landfill capacity of approximately 81 million cubic metres as at 31 March 2009. Viridor is at present filling this at a rate approaching six million cubic metres per annum, which results in an average remaining life of fourteen years at current rates of fill, which is significantly longer than for the industry as a whole.

Gas produced from decomposing waste on landfill sites is increasingly used to generate electricity. It is a form of renewable energy and now represents 24% of the UK's total renewable energy generation with EfW representing a further 6% according to Defra. The Government's stated strategy is to increase the percentage of electricity generated from renewable sources from the current figure of around 5% to a target of 10% in 2010 and 15% in 2015. The UK has an EU target of generating 15% of total energy from renewable sources by 2020, which is likely to require over 30% of electricity to be generated from renewable sources. Historically, renewable energy projects were supported by the Government through the NFFO scheme. Under this fixed price Retail Prices Index (RPI) contracts with terms of up to 15 years were awarded to the most competitive renewable projects in five tranches of bidding. In April 2002 the NFFO regime was replaced by the Renewable Obligation (RO) regime. Under the RO, eligible generators receive the brown energy price plus the value of the associated Renewable Obligation Certificate as described on page 23.

The overall price for electricity supplied under the RO regime is currently substantially higher than that achieved under the most recent NFFO scheme. This has facilitated the increase of Viridor's total landfill gas power generation capacity to 101 MW at 31 March 2009, compared with 28 MW in March 2002. Of this power generation capacity, 38% is under NFFO and 62% is under the RO regime. Viridor's existing NFFO contracts end in calendar years 2011 and 2013 after which the capacity can transfer to ROCs.

To take advantage of opportunities presented by the Government's developing waste strategy, Viridor is pursuing EfW schemes (including where feasible CHP) and a range of recycling or related treatment opportunities, including materials recycling facilities, mechanical-biological treatment, anaerobic digestion, composting and household waste recycling sites. These facilities may be combined in integrated waste management contracts.

In pursuing its strategy, Viridor seeks to grow its waste management business, both organically and through acquisition. It has continued to be an active participant in the consolidation of the UK waste market to date and, between October 2001 and March 2009, has made 14 acquisitions in the waste sector for an aggregate consideration of over £290 million which have been integrated into the Viridor group. On 5 June 2009 Viridor acquired London Recycling Limited for £11 million.

About our businesses – South West Water

REGULATORY AND COMPETITIVE ENVIRONMENT

South West Water is the licensed water and sewerage service provider for Devon, Cornwall and parts of Dorset and Somerset. The company serves a region of nearly 10,300 square kilometres with 1.65 million residents and in excess of 10 million annual visitors. On average each day it distributes over 440 Megalitres (ML) of treated water and disposes of around 250ML of waste water through an asset base comprising:

Water distribution mains.....	15,041km
Sewers.....	9,221km
Impounding reservoirs.....	15
Water treatment works.....	40
Waste water treatment works, including 54 works with ultra-violet treatment and three with membrane filtration	633
Intermittent discharges, including 1,041 combined sewer overflows	1,686

Since privatisation in 1989 the company has successfully delivered the largest capital programme per capita of any of the water and sewerage companies with an initial focus on improving coastal waste water treatment and disposal. The region currently has 144 EU designated bathing waters, almost one third of the total in England and Wales, and 132 of these have benefited over the last 18 years from the company's marine investment programme. The emphasis has now moved to completing a 15-year programme of improving the quality of drinking water and providing better customer service.

South West Water expects to create value through delivering the regulatory contract agreed with Ofwat. The contract scope is reviewed every five years. As well as determining outputs, Ofwat sets prices to enable efficient companies to earn a reasonable rate of return on their assets.

In the current regulatory period Ofwat assumed that the equity cost of capital for all companies would be 7.7% real after tax with an overall weighted average cost of capital of 5.1% real after tax.

Customers using more than 50ML of water per year can contract with alternative suppliers for water supply. South West Water has 45 customers in this category, whose aggregate water charges account for approximately 2.5% of its total revenue. No single customer accounts for more than 1% of revenue.

Legislation will be required for any further extension of competition in the water and sewerage markets. In May 2008 Ofwat published the second part of its review of competition which sets out its recommendations for reform of the competition framework, looking beyond the assumptions of the existing Water Supply Licensing regime. Those recommendations included the establishment of water companies' retail service businesses as separate legal entities and the extension of competition to household customers.

During the year Ofwat also published two consultation documents on accounting separation, a project designed to lead to a better understanding of costs in the water sector with the aim of developing future competitive frameworks. Ofwat states that it would like to be able to introduce vertically separated price controls by the time it begins to set price limits for the period after 2015. The company has worked with Ofwat as part of a pilot group of water and sewerage companies to explore the development of these ideas.

The Government's independent review of competition and innovation in the water industry led by Professor Martin Cave published its final recommendations in April 2009. The Government welcomed the review's findings on competition and innovation. South West Water is assessing the review's recommendations and proposed legislation to implement the recommendations supported by Government is awaited.

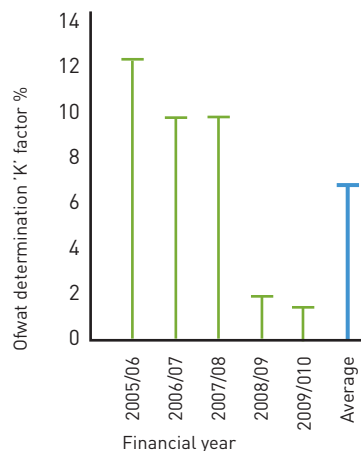
The review into fairer water charges commissioned by Defra, known as the Walker Review, is expected to be concluded later in the year. The company hosted a consultation event in Plymouth in December 2008 for the review team attended by stakeholders including MPs, business and domestic customers and representatives from Ofwat and the Consumer Council for Water. The chairman of the Walker Review took the opportunity to meet a customer who has benefited from the 'WaterCare' scheme and to see how it operates.

PRICE CAP REGULATION

Ofwat regulates water and waste water charges by determining the maximum increase in charges which a company can impose in any year. The water regulator conducts a Periodic Review and sets price limits every five years. Prices are set by reference to inflation as measured by the Retail Prices Index (RPI) plus an adjustment factor known as 'K' which is specific for each company.

The 'K' factors for the period 2005 to 2010 for South West Water were determined by Ofwat in its Final Determination in December 2004 and are:

'K' FACTORS FOR THE PERIOD 2005-2010



↑
Key capital investment outputs met for the year

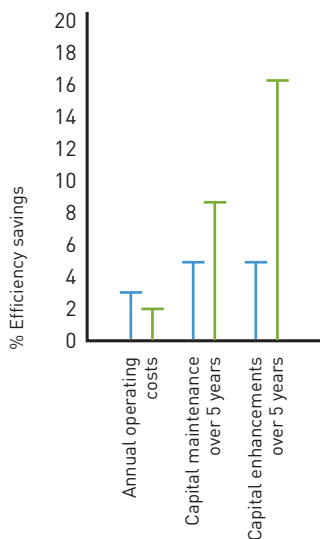
↑
Continued growth in Regulatory Capital Value

In setting price limits for South West Water for 2005 to 2010 Ofwat assumed the following efficiency improvements:

The 2004 Final Determination provided for total capital expenditure of £762 million (2002/03 prices on a UK Generally Accepted Accounting Principles basis) over the five-year period. Good progress has been made against the required customer service and infrastructure outputs at 31 March 2009, including:

EFFICIENCY IMPROVEMENTS

— Water
— Sewerage



Activity	2005-2010	Status at 31 March 2009
Adequacy of water resources	Security of Supply Index to be maintained at 100	Security of Supply Index was 97. No water restrictions for the 12th consecutive year
Leakage control based on three year rolling average	Maintain at 84ML/d	84ML/d achieved
Asset condition above ground	Maintain stable	Stable
Asset condition below ground	Maintain stable	Stable
Meet Drinking Water Inspectorate milestones for water mains rehabilitation	Complete five milestone packages of improvements	Four milestones met, fifth progressing to plan
Improvements to continuous discharges	Complete 95 schemes by 31 March 2010	Completed 83
Improvements to intermittent sewage overflows	Complete 113 schemes by 31 March 2010	Completed 111

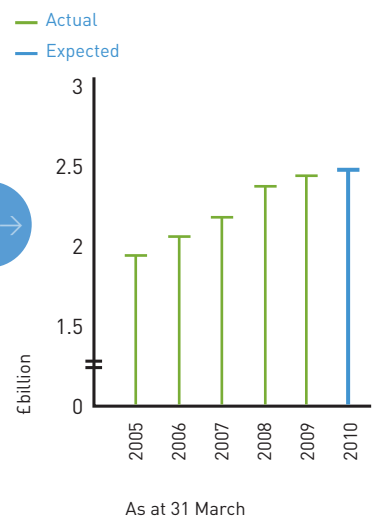
GROWTH IN REGULATORY CAPITAL VALUE

Regulatory Capital Value (RCV) is the financial base used by Ofwat to allow a rate of return and set prices at each Periodic Review. The RCV at 31 March 2009 amounted to £2.461 billion. This compares with £2.408 billion at 31 March 2008, an increase of 2.2%. This is a lower growth than the previous year because of the movement in year-end RPI being minus 0.4% in 2008/09 compared with positive 3.8% in 2007/08. From 31 March 2005 to 31 March 2010 the company is expecting a 25.7% growth in RCV, the highest percentage increase of any quoted UK water company. Lower values for RPI, the movement on which is one of the elements of the annual uplift in RCV, have led to lower expected growth than that reported last year. The RCV is £78 million lower than the estimate made at this time last year because of the year-end RPI falling to -0.4%.

Net debt increased by £115.9 million to £1,571.1 million, with the gearing ratio in relation to year-end Regulatory Capital Value of £2,461.0 million moving to 63.8% from 60.4%.

The RCV for 2009/10 is based on Ofwat's projections. It was set out in 'Future Water and Sewerage Charges 2005-10' published in December 2004 and has been adjusted by South West Water's estimate of outturn prices. The growth in RCV adds directly to shareholder value as the allowed return is attributed to South West Water's asset base by Ofwat.

REGULATORY CAPITAL VALUE



KPI →

PERIODIC REVIEW 2009

Following submission of South West Water's Draft Business Plan in August 2008, the company's Final Business Plan was completed and provided to Ofwat on 3 April 2009. Summary information on the final plan is available on the company's website southwestwater.co.uk

Key dates for the current Periodic Review:

Date	Activity
April 2008	Ofwat published information requirements
April 2008 - May 2008	Companies' draft water resources plans published for consultation
August 2008	Companies submitted and published draft business plans
August 2008 - January 2009	Public consultation on draft business plans
December 2008	Ofwat published draft baseline, outputs package and 'menu'
January 2009	Ofwat issued final business plan reporting requirements
April 2009	Companies submitted and published final business plans
23 July 2009	Ofwat publish Draft Determinations for comment
July - August 2009	Companies publish final water resources plans
26 November 2009	Ofwat publish Final Determinations
January 2010	Decisions made by companies to accept Determinations or seek Competition Commission referral
1 April 2010	New price limits take effect for period 2010 to 2015

LEGISLATIVE DRIVERS

The water industry in the UK is subject to substantial national and EU regulation. This places significant statutory obligations on South West Water with regard to, amongst other things, the quantity of water abstracted, and the quality and quantity of waste water discharged. Examples of relevant EU directives include the Drinking Water Directive, the Habitats Directive, the Urban Waste Water Treatment Directive and the updated Bathing Water Directive.

The Water Framework Directive was incorporated into UK law in 2003. It provides a framework for the protection and improvement in the quality of water resources, together with the promotion of sustainable water consumption. To comply with the Water Framework Directive, EU member states will have to achieve the challenging target of 'good' status for groundwater, rivers, estuarine waters and coastal waters, in three six-year cycles, the first running from 2009 to 2015. The Draft River Basin Management Plan, published by the Environment Agency in December 2008, confirms that the plan's implications are unlikely to be significant for South West Water's assets at least until 2015, following the successful delivery of a wide range of river, estuarine and coastal water environmental improvements by the company since 1989.

Further significant legislative developments are expected for the water industry following publication of the Flood and Water Management Bill in April 2009. Many of the proposed legislative changes are designed to implement the recommendations of the Pitt Report which was commissioned after the severe UK flooding in summer 2007.

CLIMATE CHANGE

South West Water is working closely with many organisations to assess the implications of climate change for water supply and waste water services. Adaptation and mitigation plans are being developed which will involve innovative approaches and new methods of influencing catchment behaviour upstream of its water supply systems, in sewered areas and downstream of its waste water systems to protect the wider environment.

The company's final Water Resources Plan for the next 25 years is due to be published this summer following receipt of Defra's approval. It will include the latest information on rainfall and temperature alterations and allowances for demand changes associated with climate change. Predictive models are in place to address uncertainty. Infrastructure developments have been identified, the timing of which can be adjusted if the expected rate of climate change alters. Increasing efficient and careful use of water plays a major part in adapting to the expected effects.

INCIDENTS

There were no Category 1 incidents for the 10th year in succession. Three Category 2 (significant pollution) events and 64 Category 3 events were recorded by the Environment Agency in 2008 which were deemed non-compliant with discharge consents. This compares with four Category 2 incidents and 114 Category 3 incidents in 2007. The total number of pollution incidents in 2008 was 92 (2007 166).

PROSECUTIONS

During the year the company was convicted on four occasions for environmental offences and fined a total of £28,000 (2007/08 eight convictions and £36,100 in fines), as described in the following table:

↑
Pollution incidents reduced by 45%

ENVIRONMENTAL PROSECUTIONS FOR POLLUTION INCIDENTS

Environmental prosecutions 2008/09				
Date of conviction	Date of offence	Location	Reason for conviction	Fine (+ costs)
14/05/2008	09/07/2007	Liskeard stream, tributary of East Looe River	Allowing sewage effluent to enter controlled waters	£8,000 (+ £3,265)
06/08/2008	06/07/2007	Brixham Harbour	Allowing sewage effluent to enter controlled waters	£10,000 (+ £1,400)
19/08/2008	10/07/2007	River Venn, near Landkey	Illegal discharge	£5,000 (+ £940)
19/08/2008	10/07/2007	River Venn, near Landkey	Breach of consent	£5,000 (+ £940)

The company always self-reports incidents it becomes aware of and co-operates fully with any investigation undertaken by the relevant regulatory authority. After each pollution incident, including incidents leading to prosecution, the company takes such steps as are necessary to ensure that the incident will not be repeated and also seeks to ensure that lessons learned are widely disseminated throughout the company.

CUSTOMERS, COMMUNITY AND EMPLOYEES

HEALTH AND SAFETY PERFORMANCE

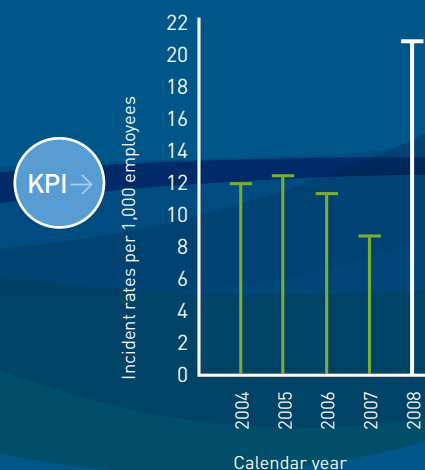
The health, safety and welfare of South West Water's employees remain paramount in all its activities. The company has developed a health and safety strategy which focuses on providing strong leadership, engaging with employees, building competence and measuring performance. These principles are promoted by a health and safety steering group comprising a cross-section of directors, managers and employee representatives.

Occupational health and safety are key elements of South West Water's risk management and internal control processes. We continue to pursue initiatives to improve further the health and safety of the company's employees through the provision of training and promotion of health and safety.

The total number of accidents has remained stable during the last three years with an average of 113 per annum. A more rigorous system of accident and incident recording was introduced in 2008. It shows an increase in incidents which it is believed reflects better reporting compared with previous years and a new arrangement whereby all potential reportable dangerous occurrences are referred to the Health and Safety Executive's Reporting Line for advice whenever there is any doubt over classifying an incident as reportable under RIDDOR. Data for 2007 and earlier years has been provided on the previous method of recording, consistent with South West Water's previous June Returns.

The RIDDOR rates reported for the years 2004 to 2007 set out below cannot be directly compared with the rates reported for 2008 due to the introduction of the different system of recording.

RIDDOR ACCIDENT AND INCIDENT RATES



CUSTOMERS

South West Water has consulted with customers about its priorities for 2010-2015 and has used their feedback for the development of its customer service improvement plans.

The company leads the industry in the provision of priority services to vulnerable customers and has helped thousands of customers in 2008/09 with reading their meter or by providing extra help in an emergency.

'WaterCare', the company's industry-leading programme to support customers who have difficulty in paying their bills, completed a second successful year. Since the start of the programme a total of 4,548 customers have been helped with benefit entitlement checks, tariff advice and water-saving measures.

The 'WaterCare' programme has been commended by the Government.

Customers are kept informed about our services through 'WaterLevel', our company newspaper, leaflets, the media and our website southwestwater.co.uk. Detailed research and consultation has been undertaken with customers and stakeholders in relation to the Periodic Review process.

The company meets regularly with the Consumer Council for Water (CCWater), which champions the interests of water customers. It regularly consults with CCWater and other stakeholders such as pensioners' forums and citizens' advice bureaux, prior to major changes or initiatives.

CUSTOMER SATISFACTION OVERALL

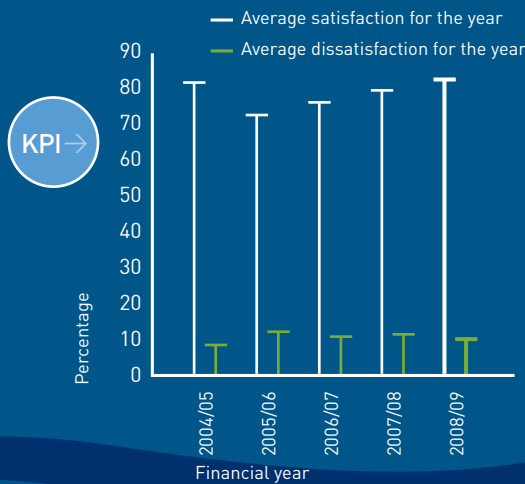
South West Water's 'Customer Plus' programme is aimed at transforming its customer service and making it amongst the best in the industry.

Working with Accenture (South West Water's customer service and billing partner) the company is investing £4 million in improving customer services. The company's monthly customer satisfaction survey shows rising satisfaction with South West Water's customer service.

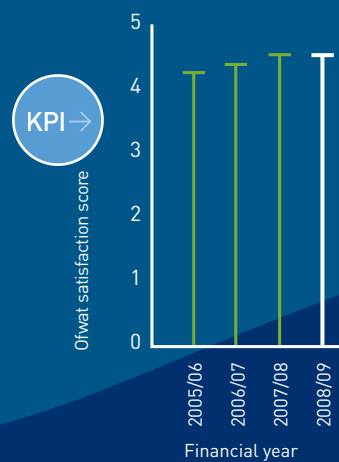
CUSTOMER SATISFACTION CALL HANDLING

In April 2005 Ofwat introduced a new measure for the overall manner in which a customer call was handled. The measure is obtained by quarterly tracking surveys undertaken by an independent company engaged and managed by Ofwat. The data has been averaged for the year to assess a performance trend. For 2008/09 the satisfaction score was 4.5 (2007/08 4.5). The maximum score is 5.0.

CUSTOMER SATISFACTION OVERALL



CUSTOMER SATISFACTION CALL HANDLING



Accenture has made significant steps in transforming billing and contact management in its first year with new systems and processes which include scanning and electronic processing of all incoming customer mail; workflow management; bill production with a specialist sub-contractor; and implementing improved reporting, quality management and audit.

Against this background of significant change, service levels have been maintained making for a successful first year and delivering a sound basis for improvements in the future.

The company continues to promote the efficient use of water with advice and practical support for householders and non-domestic customers. As part of the 'WaterCare' programme and to investigate customers' high water consumption queries, 3,088 audits were completed in 2008/09.

South West Water continues to support business customers through water efficiency reviews, waste minimisation projects, providing advice for water management plans and by highlighting opportunities for reduction, re-use or alternative sources of supply.

Business customers continue to have access to a secure online system which tracks and displays consumption on their sites. South West Water's 'Business Accounts Online' also offers a water efficiency calculator with a free water audit. Since the launch of the calculator tool in November 2007, 182 businesses with over 6,200 accounts have registered to use the water efficiency element of the service.

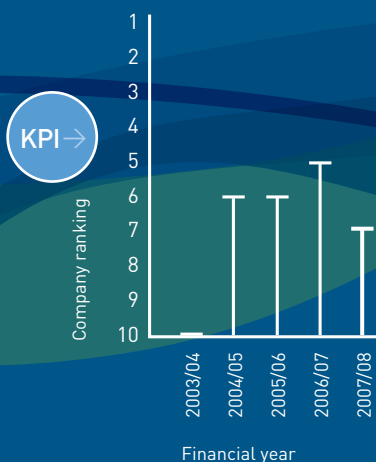
OVERALL PERFORMANCE ASSESSMENT

The Overall Performance Assessment (OPA) index is maintained by Ofwat as a comparative tool to measure companies' performance. The OPA is based on performance in areas such as customer service and complaint handling, billing, debt collection, asset serviceability, environmental compliance and quality of drinking water delivered. In 2007/08 South West Water's performance dipped to seventh place amongst the 10 water and sewerage companies (fifth in 2006/07).



↑
Customer satisfaction overall rising for the third successive year

OVERALL PERFORMANCE ASSESSMENT



COMMUNITY AND SPONSORSHIP

South West Water concentrates its sponsorship on community projects and organisations within its service area which are linked to water, benefit the environment or promote youth participation.

Highlights in 2008/09 included the company's sponsorship of the 2008 Falmouth Tall Ships Race, with a competition for young customers to win a trip of a lifetime on board one of the tall ships racing to Porto.

For the second year the company also co-sponsored South West Tourism's annual awards and funded the sustainable tourism prize to demonstrate how its 'Clean Sweep' project has helped underpin the renaissance of the region's number one industry since 1989. This proved particularly successful when the winner of the award went on to win first place at national level.

Youth participation projects included sponsoring national junior championships in Cornwall run by the Surf Life Saving Association of Great Britain and the Plymouth-based Drake Trust. The company is proud to continue to support the water industry charity, WaterAid, through sponsorship and many other fund-raising activities. In total, 45 organisations and individuals across the region were sponsored during the year.

EMPLOYEES

South West Water has developed a clear and coherent strategy concentrating on recruitment and the development and performance of its employees. The strategy is aimed at supporting the company's 'Pure vision' values enabling the delivery of a high quality service to customers and the achievement of operational outputs and cost efficiencies through its employees.

Continuity of the business is vital to its future success and the focus on management and graduate development programmes continues to provide employees with opportunities to develop their managerial and organisational skills. A range of other learning programmes support the development of customer, technical and operational skills.

We achieved the 'Investor in People' (IIP) Silver Status, which represents the achievement of a high standard in IIP evidence requirements, in March 2009 as part of our IIP reaccreditation, valid for a period of three years. Particular areas of strength include the company's approach to leadership and succession planning; and the production of new corporate values which employees understand and to which they can relate.

Employee involvement and participation in all aspects of business and organisational change is encouraged and supported through the Staff Council, and craft and industrial consultative forums.

KEY RELATIONSHIPS

REGULATORS AND OTHERS

Relationships with regulators, Government and its agencies, customer representative organisations and its customers are central to South West Water's operations. The company maintains a continuing dialogue with Ofwat, the Environment Agency and the Drinking Water Inspectorate. It contributes to national policy on developing issues through its membership of Water UK, the industry trade body. The company works with the Consumer Council for Water to ensure that customers' issues and concerns are addressed and a full understanding of the company's activities is maintained.

PROCUREMENT AND SUPPLIERS

South West Water's procurement strategy is focused on partnering and strategic alliances with 60 key suppliers who account for the large majority of expenditure. Regular meetings are held to manage performance, encourage sustainable business activity and to identify and deliver continuous improvement opportunities for reducing costs further whilst improving performance and service levels.

The company is also in the process of setting up a new 'Alliance' structure for delivery of its 2010-15 capital programme. This will enable the company to work closely with suppliers, particularly small and medium-sized businesses across the South West, ensuring value-for-money for customers and supporting the regional economy.

No single customer accounts for more than 1% of revenue. No supplier (revenue) accounts for more than 4% of the turnover and South West Water sources all its purchases from competitive markets.



South West Water sponsors the 2008 Falmouth Tall Ships Race

↑

Successfully re-accredited 'Investor in People' Silver Status

RISKS AND UNCERTAINTIES

Risk	Commentary and mitigation
Tighter price controls over the revenue of the company's regulated business	South West Water has met Ofwat's efficiency expectations in the last two Periodic Review periods and is on track to meet them in the current period.
Failure to deliver the capital investment programme	The company has a track record of delivering its capital programme in accordance with regulatory requirements. The current capital programme is on track and progress is regularly monitored and reviewed.
The company may be unable to raise sufficient funds to finance its functions	Pennon Group and the company have robust treasury policies in place. These include policies that there are always pre-drawn or committed facilities to cover at least one year's estimated cashflow and that no more than 20% of borrowing matures in any one year. Treasury policies and risk management are described in more detail on pages 30 to 33.
Failure to deliver operating cost savings implicit in the regulatory review	In line with its track record, the company remains confident of delivering the assumed operating cost savings. A major restructuring programme is currently being implemented.
Environmental regulations and quality standards could increase the company's costs	These issues are addressed through the five year regulatory review mechanism.
Climate change	The company has plans ready and will adapt the way it conducts its business to respond effectively to the hotter, drier summers and wetter winters that are anticipated.
Contamination of water supplies	The company has established procedures and controls in place, as well as contingency plans and incident management procedures. It also maintains insurance policies in relation to these risks, although there can be no assurance that all or any of the costs associated with these risks would be covered or that coverage will continue to be available in the future.
Non-recovery of customer debt	In addition to existing strategies, South West Water has implemented new initiatives to improve and secure cash collection, including the use of property charging orders. Stretching debt and collection targets – with incentives – have been agreed with the customer service contractor. The accounts of major customers are kept under close review. Provision was made in the last Periodic Review for companies to make an application for an Interim Determination of K in the event of bad debts being significantly above the amount allowed for by the water regulator.
Energy cost volatility	South West Water mitigates rising energy costs through careful system operation, by maximising renewable energy generation and by purchasing all forms of energy in the most efficient way.
Pension costs may increase due to factors outside the company's control	All defined benefit schemes have been closed to new entrants and replaced by defined contribution arrangements.
Poor investment performance may affect the defined benefit pension scheme assets and increase the pension scheme deficit	Employee and employer contributions are kept under review and have been increased. Further employer contributions of £28.8million were made in the year. Pension trustees keep investment policy under review and use professional investment advisers.
Water resource adequacy	The company has a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs) and promotes conservation measures. In particular, South West Water prepares a new Water Resources Plan every five years and reviews it annually for a range of climate change and demand scenarios. The draft Water Resource Plan indicates that no new reservoirs are required before the planning horizon of 2035. However, investment is needed to develop the overall trunk main infrastructure, to expand treatment capacity and to enhance certain pumped storage facilities.
Operational failures	The company is able to monitor its significant assets by automated and remote operation and has routine controls and operating procedures in place that are constantly kept under review. Asset management techniques are employed to pre-empt the failure of assets.
Reduced revenue from falling customer demand for water	The reduced demand experienced in the current five-year regulatory period will be taken into account by the regulator in setting a baseline turnover level for the next period. The water regulator is proposing a form of revenue cap regulation from 2010, which would allow water companies to recover a shortfall in income for a five-year regulatory period in the next period.
Meter option take-up greater than forecast, resulting in reduced revenues	An Interim Determination of K may be used to fully or partially recover revenue losses if they exceed the prescribed materiality threshold.
Financial loss arising from the insolvency of a major supplier or contractor	The company does not have material exposure to making payments before receipt of goods and services. The company uses a third party credit monitoring service for changes to suppliers' financial status and creditworthiness to supplement an annual risk review of key and strategic suppliers.
Impact of competition in the industry	South West Water is assessing the implications of the Cave Report published in April 2009 in order to prepare for an extension of competition for non-household customers in the water industry. Legislation will be required for any further extension of competition in the water and sewerage services markets.

About our businesses – Viridor

REGULATORY AND COMPETITIVE ENVIRONMENT

The UK is required under the EU Landfill Directive to reduce the amount of biodegradable municipal waste going to landfill sites as follows:

- to 75% of 1995 level by 2010
- to 50% of 1995 level by 2013
- to 35% of 1995 level by 2020.

The Pre-Treatment Regulations 2007 require all waste going to landfill to have undergone some form of pre-treatment (including recycling).

At the same time the UK Government has set targets for recycling and composting of municipal waste to increase from the current level of around 35% to 40% by 2010, 45% by 2015 and 50% in 2020. The Government is promoting recycling by various measures including encouraging councils to provide separate collection of recyclables which enhances the recycling rate obtainable at MRFs. There are specific targets for recycling of all packaging with financial incentives in the form of Packaging Recovery Notes (PRNs) and Packaging Export Recovery Notes (PERNs). Specific regulations affect waste electrical and electronic equipment (WEEE) which has its own system of Evidence Notes that are tradable.

In order to meet the requirements of the Landfill Directive, individual local authorities have been set statutory targets for the diversion of biodegradable municipal waste from landfill. Each waste disposal authority has been allocated an allowance of the amount of biodegradable waste it may dispose of to landfill for the years 2005 to 2020. These allowances are designed to ensure that the UK as a whole achieves the requirements of the EU Landfill Directive. Subject to some constraints, local authorities can carry forward or trade allowances under the Landfill Allowance Trading Scheme (LATS).

Any authority exceeding its allocation without such an allowance faces a penalty of £150 per tonne in addition to the cost of disposing of the waste. This is expected to result in the introduction of alternative treatment and disposal processes at higher cost than current routes.

The Government introduced landfill tax as a further incentive to divert waste away from landfill sites. Landfill tax applies to all waste disposed of at a licensed landfill site, unless the waste is specifically exempt, such as soil from historically contaminated sites up to 2012. Landfill tax is chargeable by weight. For inert waste, landfill tax was chargeable at £2.50 per tonne from 1 April 2008 and this will be frozen to 2010/11. A standard rate of £40 per tonne applies to all other taxable waste (up from £32 in 2008/09) which is due to rise by a further £8 per tonne per annum to reach a level of £72 per tonne in 2013/14.

The Government is currently consulting on planned changes to Landfill Tax legislation, in particular to charge a higher rate for some materials currently considered inert and therefore charged at the lower rate.

Under the Environmental Permitting (England and Wales) Regulations 2007 all waste handling, treatment and disposal facilities previously operating under either a waste management licence or a Pollution Prevention and Control (PPC) permit require an Environmental Permit.

PLANNING FOR LANDFILL SITES AND WASTE AND RECYCLING INFRASTRUCTURE

All waste management facilities, including the development and expansion of landfill sites, are subject to planning permission from the relevant local authority. Major facilities such as EfW plants above 50MW must receive consent from the Secretary of State for Business, Enterprise and Regulatory Reform. In addition waste treatment and disposal facilities require an Environmental Permit from the relevant regulator.

Viridor believes that good environmental and operational management is important to winning future planning consents. It has now implemented its integrated Business Management System incorporating externally accredited environmental, quality and health and safety management standards (ISO 14001, ISO 9001 and OHSAS 18001).

Planning applications are subject to rigorous assessment by local authorities who will consider them against the backdrop of policies contained within the local development plan framework that has been adopted for their areas. Applications have to address a wide range of issues and the relevant regulators are statutory consultees in this process.

INTEGRATED MUNICIPAL WASTE MANAGEMENT CONTRACTS AND THE ROLE OF PRIVATE FINANCE INITIATIVES OR PUBLIC PRIVATE PARTNERSHIPS

To assist in meeting their landfill diversion targets, many local authorities are seeking to let integrated waste management contracts covering a range of activities often including household waste recycling sites (HWRS), composting, recycling and recovery, EfW, waste transfer and bulk transport and final disposal.

In a number of instances these will be financed under PFI arrangements where local authorities apply to the Government for the funding of capital projects which fall within the eligibility criteria. Successful applicants receive cash funds (known as PFI credits) which do not have to be repaid and can be used by the local authority to fund a proportion of the capital and operating expenditures needed for the project.

Councils may also choose to let long-term contracts using PPP arrangements. Under this they avoid the complexities of securing PFI credits. Viridor considers that the operational nature of the contract is very similar whether it is a PFI or a PPP. The Institution of Civil Engineers estimates that as much as £30 billion of investment will be required in the UK to meet municipal waste landfill diversion targets by 2020.



Viridor's focused strategy is expected to drive further growth

Viridor has been operating a 25-year PFI contract with West Sussex County Council since 2004, and a 25-year PPP contract with Somerset County Council since 2006. During the past year Viridor won a 14-year 450,000 tonnes PPP with the South London Waste Partnership. In early April 2009 the Viridor/Laing consortium reached financial close for the 25-year Greater Manchester Waste Disposal Authority PFI waste and renewable energy contract, the largest of its kind in the UK.

Viridor recognises that there is a range of risks associated with entering into such contracts, which are often for a 25-year term. However, subject to a careful assessment of the risks on a contract-by-contract basis, the company will continue seeking to secure such contracts.

WASTE REGULATION ENVIRONMENT

EU Directives and related UK legislation, as well as planning and licensing, have been referred to previously.

The Environment Agency (EA) and the Scottish Environment Protection Agency (SEPA) monitor performance against permit and licence conditions and general environmental law. Major breaches are subject to prosecution. The EA and SEPA can also require the operator to undertake upgrades to ensure future compliance and, where a pollution incident or permit or licence breach has occurred, for remedial action to be undertaken.

Waste facilities are also subject to the same regulations as other industries, including health and safety, Control of Substances Hazardous to Health (CoSHH) and the Working Time Directive. In addition the transport of waste and recycled materials is subject to specific regulation and controls.

RENEWABLES OBLIGATION (RO) & 2009 ORDER (ROO 2009)

Under the RO the Government has a target to generate 10% of UK electricity usage from renewables by 2010, and 15% by 2015 (compared with around 5% generation from renewables at present). The EU has set the UK a target of 15% of total energy, including heating, transport and other energy uses, to be generated from renewables. This potentially equates to over 30% of electricity from renewables in the UK.

Production of renewable energy is incentivised under the RO whereby renewable energy generators get a premium (ROC) in addition to the underlying 'brown energy' price for their production. This premium relates to the balance between actual UK output and target UK output. At present the UK is behind target and many believe it will remain so for some considerable time. In addition, ROO 2009 has introduced a mechanism so that such 'headroom' will be maintained. Eligibility for ROCs is governed by complex rules. Landfill gas, anaerobic digestion (AD) and certain other waste technologies including 'good quality' CHP are eligible.

A recent change in ROO 2009 was the introduction of the banding of ROCs. The impact of this change is that all landfill gas projects accredited by 1 April 2009 will continue to receive one ROC per Megawatt hour. This will also apply to any additional capacity provided it is commissioned by 1 April 2011. Those accredited after that date will only receive 25% of one ROC. Viridor ensured that the vast majority of its potential capacity was appropriately accredited by 1 April 2009. In addition certain technologies such as AD have been incentivised with double ROCs. Viridor is pursuing a number of AD opportunities and has currently secured six planning consents.

As noted above 38% of Viridor's output is under NFFO schemes. These contracts are due to end in 2011 and 2013 after which the output can transfer to the RO. Prior to the RO renewable energy generation was incentivised under the NFFO. Under this users of relevant technologies could sell their output on medium/long fixed price contracts rising in line with inflation. The overall price per MWh achievable under NFFO contracts is lower than currently under the RO.

Viridor waste collection services



CUSTOMERS, COMMUNITY AND EMPLOYEES

EMPLOYEES

The company employs a comprehensive range of technical and professional managerial staff and supervisory, administrative, clerical, semi-skilled and other personnel. Many are vocationally trained and have extensive operational experience. Membership of relevant trade unions or professional bodies is widespread and is encouraged.

Viridor's equal opportunities policies and procedures seek to ensure that bias and discrimination in the treatment of job applicants and employees are eliminated. Training and appropriate support are provided to implement this throughout the company. Every effort is made to accommodate any form of disability by the use of reasonable adjustments in the work place.

Viridor is pursuing a number of occupational health and safety initiatives, particularly focusing on reducing slip, trip and fall type accidents; continuing improvements in transport management; reducing vehicle/personnel

interface; and improving manual handling performance. Accreditation to the OHSAS 18001 international health and safety standard has been achieved across all sites with the exception of two electrical recycling sites which are planned to be certified by the end of this year. This accreditation is part of the company's integrated business management system (BMS), which provides the vehicle for delivering health and safety standards and procedures.

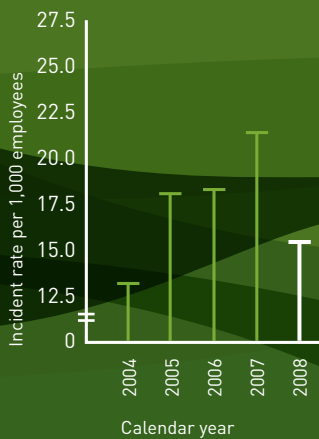
Viridor's reportable accident and incident rate per 100,000 employees is an important KPI and is set out below for the five-year period 2004 to 2008. The company is pleased to note that the rate dropped from 2,142 in 2008 to 1,505 per 100,000 employees in 2009. This reduction in reportable accidents was due primarily to an increased focus on reducing manual handling type injuries and slips, trips and falls. However these remain the company's largest cause of accidents and so the pressure to improve still further continues. Despite comparing favourably with industry averages, Viridor's focus on health and safety improvement and performance remains strong. The company has recruited additional health and safety professionals during the year and continues to raise the level of training and support available to its staff.

ENVIRONMENT

The most significant positive environmental impacts of Viridor's operations arise from the safe and efficient treatment and disposal of society's waste materials; increased resource and energy efficiency from its recycling and energy recovery operations; the capture of methane, a greenhouse gas 21 times as potent as Carbon Dioxide (CO₂); the generation of renewable energy; and the restoration of despoiled landscapes such as disused mineral workings through the controlled deposit of waste materials. Significant negative impacts include transportation and associated emissions, methane production (where not harnessed for energy generation or flared), leachate production and potential local impacts such as dust, noise, litter and odour.

Having led the industry in the development and implementation of an Environmental Management System, Viridor's integrated BMS now incorporates externally accredited environmental, quality and health and safety systems. This allows clear targets to be set and met to maximise benefits and positive impacts and reduce and prevent adverse impacts, resulting in continuous improvement in these key areas.

RIDDOR ACCIDENT AND INCIDENT RATES



KPI →



↑
Accreditation to OHSAS 18001 international health and safety standard planned across all sites



Viridor aims to maintain positive working relationships with regulators and communities

Accreditation to the BMS across all sites and operations has been achieved during 2008/09 (except for two sites from the most recent acquisition which are planned to be accredited in the current year). The company continues to report against the environmental performance indicators for the waste industry which it helped to develop and which are endorsed by the Green Alliance.

The amount of waste recycled by the company increased from 1.4 million tonnes to around 1.8 million tonnes over the year, of which 1.4 million tonnes were traded in recycling markets.

SOCIAL AND COMMUNITY ISSUES

A 'good neighbour' policy is implemented at all facilities managed by Viridor. This includes local liaison groups at major sites meeting regularly, enabling local community stakeholders to be consulted and informed about the company's plans and operating procedures. Liaison group members include locally elected representatives of the community as well as representatives of the regulator, the relevant planning and waste authority and other local stakeholders.

Viridor supports two 'adopted' charities, Scope and the Primary Immunodeficiency Association (PIA). The company match-funds anything raised by employees for these charities and also provides a 'payroll giving' facility enabling employees to directly donate to their chosen charity.

Viridor also fully participates in the Landfill Communities Fund, a scheme whereby a proportion of Landfill Tax can be claimed as credits and

distributed to qualifying community and environmental projects. During the year Viridor provided £9.7 million to Viridor Credits Environmental Company, an independent distributive environmental body. Funding is allocated at grassroots level by steering groups established to serve areas close to operational landfill sites.

KEY RELATIONSHIPS

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

Local authorities are the largest single customer group accounting in total for 22% of the company's revenue. No individual authority accounts for more than 4%. Viridor's ROC contracts account for 6% of revenue primarily with one customer. No supplier accounts for more than 1% of Viridor's revenue. The company sources from competitive markets.

Viridor Materials Recycling Facility



RISKS AND UNCERTAINTIES

Risk	Commentary and mitigation
<p>RISKS ASSOCIATED WITH CURRENT UK AND WORLD ECONOMIC CONDITIONS</p> <p>Landfill volumes may decline due to contraction in economy</p> <p>Landfill prices</p> <p>Recyclate prices</p> <p>Collection volumes (particularly industrial customers) are subject to economic conditions</p> <p>Bad debt collection more challenging in an economic downturn</p>	<p>Current UK and world economic conditions are highly uncertain. Though less affected than many companies, Viridor is by no means immune to general economic conditions.</p> <p>A full assessment of the key risks to Viridor's business arising from current economic uncertainties has been conducted, including the following:</p> <p>The majority of inputs are from long-term local authority contracts or Viridor's own collection fleet. This risk is most pertinent to the 40% of Viridor's volumes which are not either domestic landfill or landfill collected by Viridor's own fleet. These volumes have remained steady to date.</p> <p>To date, landfill prices in general have proved robust. In a prolonged recession such prices may be impacted by increased price competition.</p> <p>Recyclate prices are, like any commodity, volatile and are directly impacted by world economic conditions. The effect is most significant on the 35% of Viridor's recycling volumes of internationally traded commodities such as paper, card, plastics and metals.</p> <p>Currently margins are holding up, helped by lower fuel prices. Aggressive price competition has been avoided to date.</p> <p>Viridor's record of bad debts has been, and remains, good based on tight management controls and the ability to put customers 'on stop' and, for example, refusing to accept waste at its landfills if debts are not being paid.</p>
<p>INCREASES IN LANDFILL COSTS MAY NOT BE RECOVERED THROUGH PRICE INCREASES</p> <p>Aftercare costs levels</p> <p>Estimated compaction rates (tonnes per cubic metre)</p> <p>Recovery of costs of legislative change</p>	<p>The raising of environmental standards is leading to a gradual increase in landfill costs in general, including engineering (results in increased depreciation) and restoration and aftercare costs. Viridor, with landfills engineered to modern standards with good environmental control systems, should incur lower than average increases in costs.</p> <p>Costs which are assessed over 30 years are best estimates based on Viridor's own experience and are updated at each stage of the capital expenditure programme.</p> <p>These are best estimates, based on current information, which are reviewed every year based on actual compaction rates assessed by external consultants.</p> <p>Municipal contracts typically last for up to seven years. They usually have provision for price increases under set formulae related to inflation and some include legislative or technical changes. Prices for other types of waste depend more on local markets and competitive conditions. Prices, as a long-term trend, have risen fast enough at least to cover cost increases.</p>
<p>THE UK GOVERNMENT'S WASTE STRATEGY, STEMMING FROM THE LANDFILL DIRECTIVE, WILL LEAD TO A REDUCTION IN VOLUMES OF WASTE BEING DISPOSED TO LANDFILL.</p>	<p>Government initiatives are having an impact and the amount of municipal waste being disposed of to landfill is declining. Assuming Landfill Directive targets are met, the total amount of municipal solid waste which will be landfilled from 2020 will be five to 10 million tonnes per annum. If there is no change in other waste streams, this would still leave a substantial total landfill market in 2020.</p> <p>Scarcity of landfill will ensure available voidspace remains a valuable asset. Generally, Viridor has seen its underlying landfill volumes holding steady, with a small increase in 2007/08, probably reflecting a greater share of the landfill market.</p>
<p>NOT ALL LANDFILLS MAY MEET THE STANDARDS OF THE INTEGRATED POLLUTION PREVENTION AND CONTROL DIRECTIVE AND THE LANDFILL DIRECTIVE AND/OR REQUIREMENTS MAY BE IMPOSED WHICH WOULD IMPACT ADVERSELY ON THE ECONOMICS OF LANDFILL</p> <p>Residual contamination</p>	<p>Any existing landfills that fail to obtain an Environmental Permit would need to be subject to a closure plan with the EA or SEPA. All but one of Viridor's operational landfills have achieved PPC permits, though in some cases Viridor is appealing against certain of the conditions proposed, which might have cost or other implications for the landfills. The operational landfill which had not yet received a PPC permit closed in May 2009 as planned.</p> <p>Viridor's landfill aftercare management includes restoration, maintenance, supervision, monitoring and management of gas and leachate levels after the landfilling activities have ceased. The EA or SEPA will only grant a full or partial permit surrender of the permit once it is satisfied that the landfill no longer poses any environmental risk.</p>

Risk	Commentary and mitigation
<p>PRICING AND OTHER RISKS RELATING TO RENEWABLE ENERGY:</p> <p>Fluctuating 'brown energy' prices</p> <p>Impact of oil prices</p> <p>Changes in ROC pricing mechanism</p> <p>UK renewable energy generating capacity & licensed electricity suppliers</p> <p>Volume of gas generated</p>	<p>Viridor's 'brown energy' prices have been fixed through to the end of March 2010. Brown energy prices will continue to be determined by the world and UK energy market and may go down as well as up.</p> <p>Viridor's power generation business may be positively affected by increases in oil prices, other parts of the business (in particular collection) may be adversely affected.</p> <p>The Government has made a strong commitment to renewables which are key to meeting the long-term carbon reduction strategy set out in the energy white paper and the UK's targets for carbon dioxide reductions under the Kyoto Protocol. To date, the Government has stressed its commitment to 'grandfather' rights under current ROC schemes, which are not subject to retrospective changes. Renewables are also important in minimising the UK's increasing reliance on imported energy.</p> <p>The value of ROCs is increased by the sharing of the buy-out price monies among holders of ROCs. The value of a ROC depends on the supply of renewable electricity relative to the UK's annual increasing targets. It is also dependent on the financial strength of those suppliers who opt to pay the buy-out price. The insolvency of a licensed electricity supplier could lead to a drop in the value of the ROCs which Viridor sells.</p> <p>Current and future waste composition (including BMW diversion due to Landfill Directive and calorific value) is assessed against costs on each landfill gas project.</p>
<p>LAKESIDE ENERGY FROM WASTE (EfW) CONSTRUCTION AND TECHNICAL RISKS</p> <p>Mix of waste throughput</p>	<p>The plant is a modern conventional waste to energy facility. As a result of a competitive procurement procedure it is being supplied by the Japanese consortium Itochu/Takuma on a fixed price basis.</p> <p>86% of the project is funded by non-recourse bank debt which also limits the risk to the Group. The remainder is funded by the joint venture, of which Viridor has 50% of the equity.</p> <p>Efficiencies and output of the plant will be affected by the precise calorific value of the waste throughput. The plant is well proven and it is a robust conventional technology designed to take the currently projected waste mix.</p>
<p>THE CURRENT PLANNING REGIME MAY RESTRICT THE AVAILABILITY OF FUTURE WASTE TREATMENT FACILITIES</p>	<p>Achievement of the Government's targets for waste management is critically dependent on the planning system delivering sufficient waste treatment facilities. Viridor employs best practice throughout the planning process.</p>
<p>RISKS ASSOCIATED WITH LONG-TERM INTEGRATED CONTRACTS (RISK TRANSFER IS A KEY PART OF GOVERNMENT PFI PROCUREMENT GUIDELINES)</p>	<p>Risks include waste volumes and mix, planning, technology, input costs and recycle prices. A careful assessment of the risks and apportionment of them between client, main contractor, technology and equipment suppliers, and sub-contractors is a key part of the process of bidding and finalising a contract.</p> <p>Extensive due diligence conducted so that risks are correctly identified.</p> <p>Viridor will then seek to protect itself through contractual documentation with its client, sub-contractors and sub-suppliers.</p> <p>Viridor takes a robust approach on this issue. If it cannot mitigate the risks satisfactorily or cannot get a reasonable commercial return for taking such risks, its policy is to accept the loss of such a contract rather than win it on unsatisfactory terms.</p>
<p>RECYCLATE PRICE RISKS</p> <p>World economic conditions impact</p> <p>Currency impact (Non-European export prices and freight costs for recycle are set in US dollars)</p>	<p>Recyclate prices are driven by global supply/demand trends among manufacturing reprocessors who wish to use the recyclate and national and European legislation setting targets for landfill diversion, recovery and use based on 'polluter pays' principles. Reprocessing capacity in the UK is finite with limited growth forecast, whilst increasing amounts of recyclate are being sought by, and exported to, the rapidly expanding major manufacturing locations in China and elsewhere.</p> <p>As with any commodity, recyclate prices are very sensitive to world economic conditions. Prices in the first half of 2008/09 were well above historical trends for recyclate prices but, in the second half of 2008/09, have fallen significantly below historical trend levels for recyclate prices.</p> <p>Costs are expected to vary with world and regional economic cycles and with the environmental impact and increasing cost of sourcing and processing raw materials. Costs also expected to adjust over time for movements in the value of the US dollar.</p> <p>Viridor may mitigate any recyclate price risk by sharing downsides/upside with both its clients and customers. Viridor Resource Management is implementing a long-term national and international materials marketing and sales strategy through volatile market conditions.</p>

↑

The Group has substantial cash resources and committed funding

About our businesses – Pennon Group

OTHER FINANCIAL INFORMATION

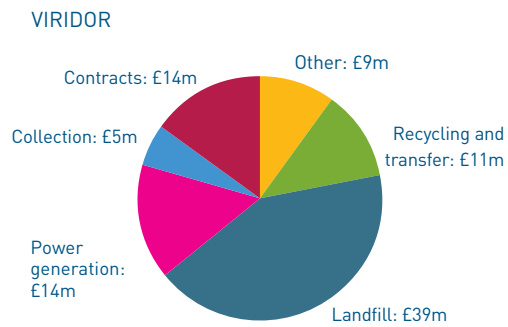
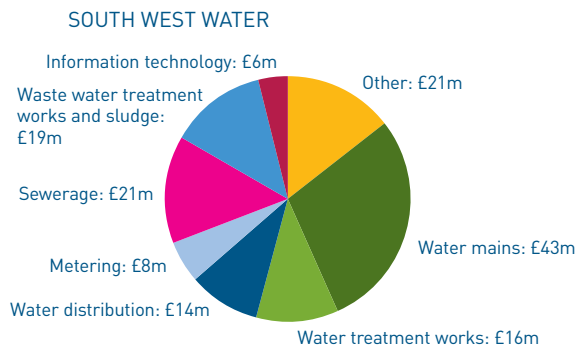
OPERATING COSTS

Group operating costs for the year totalled £694 million and included the following major categories of expenditure:

	£m
Landfill tax	143
Depreciation	132
Manpower	109
Transport	46
Property	26
Power	19
Raw materials and consumables	14
Abstraction and discharge consents	9
Lease rentals – plant and machinery	7
Statutory operating licences and royalties	7

GROUP INVESTMENT

Capital expenditure by the Group on property, plant and equipment was £239.8 million (2007/08 £228.8 million). The major categories of expenditure were:



ASSET VALUE OPINION

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

↑

Finance leasing provides long maturity and secured credit margins

CASH FLOW

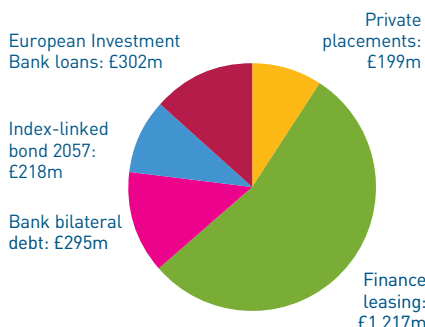
In 2008/09 the Group once again had a strong operating cash flow, but net borrowing increased primarily due to capital expenditure payments.

Summarised cash flow	2008/09 £m	2007/08 £m
Cash inflow from operations	347	356
Pension contribution	(39)	(19)
Net cash inflow from operations	308	337
Net interest paid	(80)	(80)
Dividends and tax paid	(100)	(86)
Capital expenditure payments	(243)	(218)
Acquisitions/disposals	(3)	(89)
Net cash outflow	(118)	(136)
Shares issued	2	2
Own shares acquired	-	(50)
Debt acquired with acquisitions	-	(16)
Debt indexation/interest accruals	(13)	(6)
Increase in net borrowings	(129)	(206)

DEBT PROFILE

During the year new borrowings and financial lease drawdowns, less debt repayments, amounted to £118 million. At 31 March 2009 loans and finance lease obligations were £2,245 million and the Group held cash and deposits of £353 million, giving net debt of £1,892 million. In addition the Group also had committed undrawn facilities of £204 million.

The major components of debt finance as at 31 March 2009 were:



Despite the general shortage of funds in the debt markets which has made both refinancing and the availability of new facilities more challenging, the following financing initiatives were implemented during the financial year 2008/09:

- £100 million 15-year EIB funding for South West Water
- successful renewal of £55 million committed revolving credit facilities for both Pennon Group Plc and South West Water
- £25 million finance lease facility for South West Water
- £25 million 5 -10 year finance lease facility for Viridor.

Pennon Group debt has a maturity of 0-48 years with an average maturity of 23 years.

South West Water has approximately 25% of its debt index-linked to 2041-2057.

South West Water held cash and deposits of £252 million at 31 March 2009 as a result of the prudent pre-funding of the capital programme.

Over 50% of gross debt relates to finance leasing which provides a long maturity profile and secured credit margins.

The fair value of borrowings, based on the market value of equivalent instruments at the balance sheet date, is detailed in note 26 to the financial statements and amounted to a £221 million benefit compared with book value as at 31 March 2009 (2008 £170 million).

The interest payable on the Group's finance leases benefits from the fixed credit margins secured at the inception of the lease.

The above measures and financing structure have ensured that the Group has the appropriate financing in place to:

- meet its current requirements from existing borrowing facilities without breaching covenants or other borrowing restrictions
- give sufficient flexibility to implement the Group's strategic objectives and thereby maximise shareholder value.



£221 million
future benefit
from fair value
of debt

CAPITAL STRUCTURE – OVERALL POSITION

With year-end net debt of £1,892 million, the Group year-end ratio of net debt to (equity plus net debt) was 76.0% (31 March 2008 73.4%).

South West Water's debt to Regulatory Capital Value (RCV) was 63.8% at 31 March 2009 (2007/08 60.4%), within Ofwat's 'optimum range' of 55% - 65%.

Viridor is funded by a combination of Pennon Group equity and debt (raised by Pennon Group) and direct borrowing by Viridor. At the year-end, Viridor's net debt stood at £443 million (2008 £383 million), equivalent to 4.1 times EBITDA (2007/08 3.8 times).

The borrowing limit on net debt for the Directors is limited to two-and-a-half times adjusted capital and reserves, as defined in the Company's Articles of Association. At 31 March 2009 the limit was £2,233 million.

TREASURY POLICIES

The Group's treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs, maintain reasonable headroom for contingencies and manage interest rate risk. It operates within policies approved by the Board and does not undertake any speculative trading activity.

The Board regularly monitors the Group's expected financing requirements for the next 12 months. These are expected to be met from existing cash balances, loan facilities and operating cash flows for the coming year.

The Group has considerable financial resources together with a broad spread of business activities. Consequently the Directors believe that the Group is well positioned to manage its business risks successfully despite the current uncertain economic outlook.

INTERNAL BORROWING

For regulatory purposes, South West Water funding is treated as effectively ring-fenced. Funds raised by, or for, South West Water are used in the appointed business (provision of water and sewerage services) and are not available as long-term funding for the rest of the Group.

KEY RELATIONSHIPS

The key relationships and contractual arrangements for the Group are with its debt providers which include a number of financial institutions.

The majority of the Group's debt is raised by:

- finance leasing
- European Investment Bank loans
- bank bilateral facilities
- private placements
- index-linked bonds.

Contract terms include financial and legal covenants as outlined in the covenant compliance risk section on page 33.

GOING CONCERN

Having considered the Group's funding position and financial projections as outlined above, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.



TAXATION OBJECTIVES AND POLICIES

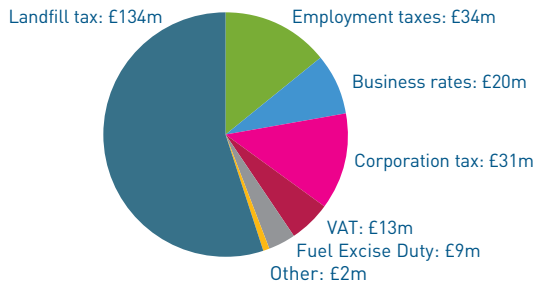
Pennon Group’s tax strategy is to enhance shareholder value by legally minimising taxes whilst having regard to the longer-term relationships with the taxing authorities. The Group will consider bona fide business arrangements which qualify for tax exemption or tax relief.

The Group has a taxation policy which has been reviewed and approved by the Board with the guidance of the Group Director of Finance. A material tax risk for the Group is the possibility that the capital expenditure qualifying for capital allowances is mis-allocated or categorised incorrectly, resulting in under-claims or over-claims of tax reliefs. This risk is managed by employing professional tax consultants with experience of analysing the types of specialist assets involved.

The UK corporation tax charge of £31 million was less than the charge which would have arisen from the accounting profit of £159 million taxed at the statutory corporation tax rate of 28%. A reconciliation is provided in note 8 to the financial statements.

The Group’s total tax contribution extends beyond the corporation tax charge. A variety of taxes are incurred by the Group:

TOTAL TAX CONTRIBUTION 2008/09



Total taxes amounted to £243 million, of which £38 million was collected on behalf of the authorities for net VAT and employee payroll taxes.

The most significant taxes involved and their profit impact were:

- Landfill tax of £134 million was accounted for by the Group on behalf of the taxation authorities. Landfill tax is an operating cost which is chargeable to customers in turnover. A landfill tax credit of £1.0 million was received during the year and increased profit before tax
- Value Added Tax (VAT) of £13 million (net) was collected by the Group and paid to the taxation authorities. VAT has no material impact on profit before tax

- business rates of £20 million were paid during the year to local authorities. These are a direct cost to the Group and reduce profit before tax
- employment taxes of £34 million contained employees’ ‘Pay As You Earn’ (PAYE) and total National Insurance Contributions (NICs). Employer NICs of £9 million were expensed around 93% to operating costs and around 7% to property, plant and equipment
- Fuel Excise Duty of £9 million related to transport costs. This reduced profit before tax.

PENSIONS

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

Employee contributions for defined benefit members increased in April 2008 to reflect the results of the March 2007 actuarial valuation.

The Group pension schemes had net liabilities (before deferred tax) at 31 March 2009 of £66 million (31 March 2008 £26 million). The deficit increase was due mainly to reduced equity values impacting fund assets, partially offset by a further £39 million employer contributions made during the year. No further employer contributions are anticipated in 2009/10.

The net liabilities (after deferred tax) of £48 million represented under 4% of the Group's total market capitalisation at 31 March 2009.

INSURANCE

The Group manages property and third party risks by the purchase of insurance policies. The main insurance policies cover property, business interruption, public liability, environmental pollution and employers' liability.

There are three tiers of insurance covering operating risks. The first tier is self-insurance in the form of a moderate deductible. The second tier is covered by the Group's subsidiary, Peninsula Insurance Limited, which insures the layer of risk between the deductible and the cover provided by external insurers. The third tier of risk is placed with the external insurance market. The Group's insurance brokers assist in sourcing appropriate insurance cover from insurance companies which have good credit ratings.

RISKS AND UNCERTAINTIES

Risk	Commentary and mitigation
<p>EARNINGS GROWTH/SHAREHOLDER VALUE</p> <p>It may not be possible to continue to sustain the same level of earnings and growth of the Group as in the past</p> <p>There is a risk to shareholder value if the Group is not able to continue to grow its key businesses and produce sustainable earnings growth</p>	<p>This is dependent upon the correct strategies being pursued by strong and able management within the Group as well as on external factors.</p> <p>The Group has maintained earnings and has successfully grown both South West Water and Viridor and intends to continue to create shareholder value through its strategic focus on water and waste water services and waste management.</p>
<p>TREASURY</p> <p>The Company may be unable to raise sufficient funds to finance its activities through:</p> <p>Liquidity risk</p>	<p>Pennon Group has robust treasury policies in place. These include:</p> <p>Ensuring that the Group has cash and committed loan facilities equivalent to at least one year's forecast requirements at all times. Borrowing repayment commitments are expected to be met as required during the coming period.</p>

RISKS AND UNCERTAINTIES *continued*

Risk	Commentary and mitigation
<p>TREASURY <i>continued</i> Refinancing risk</p> <p>Covenant compliance risk</p> <p>Counterparty risk</p> <p>Interest rate risk</p>	<p>Ensuring that no more than 20% of Group net debt is permitted to mature in any one financial year.</p> <p>At 31 March 2009 the Group had cash and deposits of £353 million, and undrawn committed bank facilities of £204 million, giving access to total cash resources of £557 million.</p> <p>Loan repayments falling due by 31 March 2010 amount to £235 million, of which £192 million is in the period January to March 2010.</p> <p>Pennon Group and South West Water have entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on South West Water's Regulatory Capital Value and Viridor's EBITDA) and interest cover.</p> <p>Redemption penalties included in the facility documentation can be invoked if debt facilities are redeemed early. The redemption penalties vary in each facility.</p> <p>The financial covenants included in the Group's debt facilities are monitored on a regular basis. The financial covenants offered by the Group include a provision to re-test the covenants applying frozen GAAP accounting standards. This is to protect the Group from changes in accounting standards which may have a detrimental impact on the financial covenant testing methodology.</p> <p>Surplus funds of the Group are usually placed in short-term fixed interest deposits or the overnight money markets. Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments.</p> <p>The Board has agreed a policy for managing such risk, which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures. All deposits are with counterparties which have a credit rating approved by the Board (A1 Moody's/ AA Standard & Poor's).</p> <p>The Group's exposure to interest rate movements is managed by the use of interest rate derivatives. The Board's policy is that in any one year at least 50% of net debt is fixed. Interest rate swaps are used to manage the mix of fixed and floating rates. The Group has fixed approximately 60% of existing net debt up to 31 March 2010.</p> <p>At 31 March 2009 the Group had interest rate swaps to convert floating rate liabilities to fixed rate, and hedge financial liabilities, with a notional value of £760 million and a weighted average maturity of 2.4 years (2008 £634 million, with 2.1 years). The weighted average interest rate of the swaps for their nominal amount was 4.5% (2008 4.8%). 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 more detail in note 22 to the financial statements.</p> <p>In addition South West Water has index-linked approximately 25% of its current net debt up to 2041 – 2057. South West Water's total index-linked debt of £353 million has an average real interest rate of 1.66%. The interest rate for index-linked debt is based upon an RPI measure which is also used in determining the tariff increase for South West Water customers.</p>
<p>PENSIONS</p> <p>The future costs of defined benefit schemes are subject to a number of risks including:</p> <ul style="list-style-type: none"> • the returns achieved on pension fund investments • movements in interest rates and inflation • pensioner longevity 	<p>The Group operates defined benefit schemes for certain existing staff. These schemes closed to new entrants on or before 1 April 2008. New employees have been offered defined contribution arrangements.</p> <p>Pension trustees keep investment policy under review and use professional investment advisers.</p> <p>The pension trustees review the investment strategy to improve the match of investments and liabilities. Employee and employer contributions are also kept under review and have been increased. Further employer contributions of £39 million were made in the year.</p> <p>Independent actuaries have identified scheme-specific mortality experience which is reflected in liabilities.</p>

OUR CORPORATE RESPONSIBILITY

CORPORATE RESPONSIBILITY OBJECTIVES

We have the following corporate responsibility objectives, to which the targets of South West Water and Viridor are aligned:

- to manage Pennon Group as a sustainable and successful business for the benefit of shareholders
- to aim to ensure that all our business activities have a positive economic, social and environmental impact on the communities in which we operate
- to engage with all our stakeholders and to foster good relationships with them
- to strive for the highest standards of health and safety in the workplace so as to minimise accidents, incidents and lost time
- to develop and motivate our employees, to treat them fairly and to ensure that they are fully engaged in all aspects of the Group's objectives
- to comply with all legislative environmental standards and to exceed them where appropriate
- to aspire to leadership in minimising emissions that contribute to climate change, and to develop climate change adaptation strategies
- to aspire to leadership in all aspects of waste prevention and resource efficiency.

WE OPERATE ENVIRONMENTALLY SENSITIVE AND SUSTAINABLE BUSINESSES

Our objectives demonstrate that we are committed to exemplary engagement with society and to the conservation and enhancement of the natural environment. Our social and environmental policy ensures that these activities are pursued, paying particular attention to:

- operating through best practice to ensure the sustainability of our activities by maximising the efficiency of its resource uses; effective project and programme delivery; and minimising waste

- ensuring compliance with all health and safety and environmental legislation, regulations and codes of practice so that our conduct is of the highest possible standard
- undertaking our activities in a way that minimises potential adverse effects on society, the environment and those living or working in proximity to the Group's sites
- procuring goods and services through approved suppliers and contractors whose products and services meet the Group's requirements and whose quality and environmental practices correspond with our own
- undertaking longer-term strategic assessments of our activities and opportunities and adopting whole life assessment methods for approaches which are designed to benefit society; customers of the Group; suppliers and partners; all other stakeholders; and the environment
- the challenges of climate change. This will involve action to optimise energy and resource efficiency; maximising opportunities for renewable energy generation; and reducing the emissions of greenhouse gases
- reporting openly and transparently on Group performance; setting targets for continuous improvement and monitoring progress; and addressing risk and adopting policies related to wider sustainability considerations in relation to our key activities of water supply, waste water treatment, waste management and renewable energy
- regularly assessing the Group's built heritage and ensuring its long-term preservation
- making non-operational land accessible to the public where practicable to satisfy, as a minimum, the Group's obligations under the Countryside and Rights of Way Act. Wherever possible additional opportunities for conservation, access and recreation are provided, subject to health and safety and environmental considerations.

OUR ETHICAL BUSINESS POLICY

Alongside our social and environmental policy is our ethical policy. The preservation of a reputation for integrity and fair dealing is of paramount importance to the Group. Such a reputation is essential to the long-term well-being of the Group itself, its shareholders, employees, customers, suppliers and the communities in which it operates. To maintain this reputation, our Group companies are required to:

- conduct all transactions with fairness and honesty and in a professional manner
- build and maintain relationships with all parties based on trust and treat everyone with respect and dignity
- not make any promises and commitments which they do not have the intention to fulfil or which they do not believe they have the resources to meet
- carry out all financial transactions and financial reporting, with due observance of all relevant laws, regulations and financial standards
- avoid any activities that could involve or lead to involvement in any unlawful practice or any harm to the Group's reputation or image.

We have a 'whistleblowing' policy which supports our approach to ethical employment practices by encouraging employees to raise, in accordance with a formalised procedure, concerns which relate to potential unlawful conduct, financial malpractice, dangers to the public or damage to the environment. This policy is reviewed regularly.

Through our Corporate Responsibility Committee, we monitor performance against our ethical policy and our societal, environmental and health and safety policies and targets. Further details of the work of the Committee are set out on page 51.

Pennon Group Corporate Responsibility Target 2008/09

Status at 31 March 2009

Maintain corporate standing of Pennon Group Plc on sustainability credentials Continued inclusion in FTSE4Good index and success in Carbon Disclosure Project

CORPORATE RESPONSIBILITY HIGHLIGHTS

Green energy generation

Renewable energy is generated by both subsidiaries. Viridor's renewable power generation capacity from landfill gas continues to increase and at 31 March 2009 was 101MW compared to 84MW at the previous year-end. Viridor captures nearly 90% of the methane arising from its landfills and uses 70% of this for energy generation. Viridor's recently concluded Greater Manchester combined waste and renewable energy project has the potential to provide a further 130MW of power generation capacity. South West Water generates renewable energy from hydro-power and combined heat and power at waste water treatment works with a total installed capacity of 7MW.

Net electricity export

Since 1999/2000, the Group has exported more electrical energy each year than it has consumed. In 2008/09 Viridor and South West Water generated 524GWh renewable energy through their operations. This is 188% of the Group's on-site electricity consumption of 279GWh.

Both South West Water and Viridor have made significant advances in enhancing their environmental performance, and their engagement with the community, as detailed in our Corporate Responsibility Report, which will be available online in August at pennon-group.co.uk

Investor survey results

We are a member of the FTSE Environmental Opportunities All-Share Index.

We continue to be a constituent member of the FTSE4Good Index which measures Corporate Social Responsibility.

We boosted our environmental credentials by winning overall Best Commitment to Carbon Reduction in the South West Financial and Corporate Communications Awards 2008. In addition the Group was highly commended for Environmental Commitment and Social Engagement and won a further highly commended award for our 2008 Annual Report.

Carbon Disclosure Project

Our ability to log our carbon emissions and assess how climate change will affect our businesses has put us in a leading position amongst other corporations. We scored 85 points in the 2008 Carbon Disclosure Leadership Index, placing us 30th out of the companies in the FTSE350.

EMPLOYEES

Health and Safety Policy

The Pennon Group Board is responsible for establishing a health and safety policy to ensure the health, safety and welfare at work of all employees of the Pennon Group. This is reviewed annually. All subsidiary company boards have a responsibility to establish a similar health and safety policy for their respective companies and are required to comply with relevant statutory provisions.

In pursuance of this policy Pennon Group and its subsidiary companies take such action as necessary and which is reasonably practicable and pay particular attention to the:

- provision and maintenance of a working environment for our employees that is safe, prevents injury and ill health and is adequate as regards facilities and arrangements for welfare
- protection of members of the public who may be affected by our work
- promotion of an improved health and safety culture by consulting with and training the workforce and by making all employees and contractors aware of their individual responsibilities
- setting of health and safety objectives and targets within a continuous improvement framework that will be used to monitor and measure performance
- continual improvement of our health, safety and security performance through the revitalisation of our health and safety management systems.

The Chief Executives of South West Water and Viridor are responsible for arranging appropriate organisational and responsibility procedures for the health, safety and welfare of employees within their respective companies and other persons not employed by those companies but who may be affected by the policy e.g. contractors and consultants. The Group Director of Finance is responsible for such matters within Pennon Group Plc.

Pennon Group and each of its operating subsidiary companies:

- has prepared a statement on their organisation and responsibilities in respect of health and safety which, together with this policy statement, is brought to the attention of all employees and is displayed on notice boards and each company's intranet
- complies with all legislation, regulations and codes of practice relevant to their businesses and consults employees on measures for promoting health and safety at work
- requires all contractors and consultants working for each company within the Group to comply with each company's health and safety policy and each company communicates openly its policy, related objectives and performance to stakeholders.

International Labour Organisation core conventions

We support the principles of the International Labour Organisation's eight core conventions for the protection and safety of workforces. Details of our employment practices are set out on page 41.

PENNON ENVIRONMENTAL AWARDS

In 2008 the winning prize was awarded to the South West Water team that created the 'Water Calculator'. This tool helps customers compare their water usage against average water use and provides advice on water efficiency.

Jon Wood receives the award from Ken Harvey, Pennon Group Chairman



ENVIRONMENT

Climate change and sustainability

We take appropriate action to minimise emissions of greenhouse gases and adapt to the potential impacts of climate change. In addition we capitalise on the business opportunities from fully embracing the climate change agenda.

ELECTRICITY CONSUMPTION AND GENERATION

On-site electricity consumed			GWh
South West Water ⁽¹⁾			260
Viridor			19
Total consumed			279
Electricity generation			
	No of sites	Capacity MW	GWh
South West Water			
– Hydro	7	6	14
– Biogas from combined heat and power	7	1	5
Viridor			
– Landfill – biogas ⁽²⁾	30	101	505
Total generated			524
Generated/consumed ratio			188%
<small>(1) includes Pennon Group Plc and partners' related activity</small>			
<small>(2) includes sub-contracted sites in Suffolk</small>			

Climate change strategy

The Group seeks to optimise energy efficiency and maximise appropriate opportunities for renewable energy generation. The Group is taking appropriate action to reduce the emissions of greenhouse gases for which it is responsible, wherever this is possible. In planning for the future the Group works to ensure its readiness to meet the challenge of maintaining high quality levels of service in the face of a changing climate.

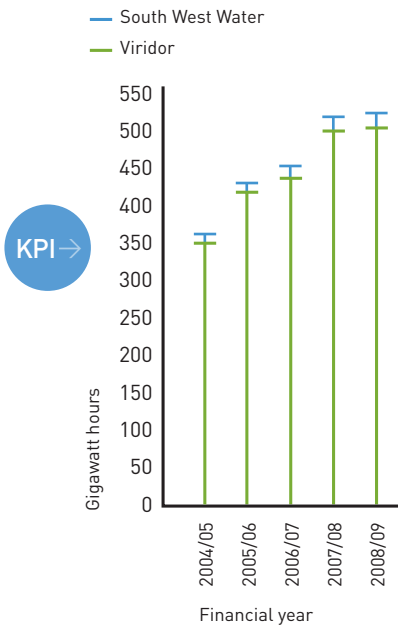
Carbon reduction commitment

Pennon Group is well prepared for the Government’s ‘Carbon Reduction Commitment’. This is a mandatory emissions trading scheme based on reductions in energy use for commercial and public sector organisations using annually over 6GWh of half-hourly metered electricity. The baseline year for energy use was the calendar year 2008, and the earliest the scheme will begin is 2010, with the capped phase beginning in 2013. Companies in the scheme will be placed in a league table: those which perform well will be rewarded and those at the bottom will face penalties.

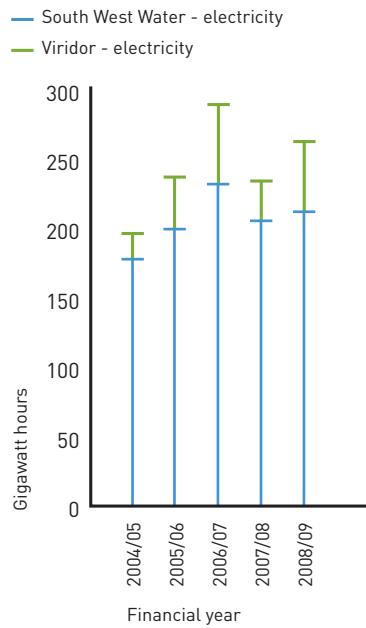
Group transport

South West Water and Viridor review their transport fleets regularly to meet their operational requirements. Environmental criteria such as clean engine technology, fuel efficiency, reliability and end-of-life recyclability are considered during the selection process.

‘GREEN ENERGY’ GENERATED



ON-SITE ELECTRICITY USE IN PENNON GROUP



NATIONAL GREEN HERO AWARDS

South West Water was given a National Green Heroes award by the Green Organisation for promoting water conservation with business customers.

Rob Wynn, South West Water (centre) receives the award for Environmental Best Practice from Warren Edmondson (left) of sponsors Nettoyer and Professor David Bellamy OBE (right)



SOCIAL AND COMMUNITY ISSUES

COMMUNITY ENGAGEMENT

Pennon Charitable Donations

In 2008/09 the Pennon Charitable Donations Committee provided a total of £65,624 of funding to over 200 good causes.



Decoy BMX Skate Park, Newton Abbot, Devon. Viridor Credits' grant: £10,000

Pennon Environmental Fund

The Pennon Environmental Fund awarded £47,404 to 11 projects in 2008/09, including church repairs, community amenities, and various habitat creation schemes to benefit wildlife.



RSPB Otmoor Nature Reserve, Oxfordshire. Viridor Credits' grant: £130,000

Viridor Credits Environmental Company

During the year Viridor donated £9.7million via the Landfill Communities Fund (LCF) to Viridor Credits Environmental Company (Viridor Credits), an independent charity established to distribute LCF funding in areas surrounding landfills. Decisions on funding use criteria of sustainability, value for money and proven need and are made at grass roots level by established local steering groups for each area. Projects supported during the year included creating, improving and restoring important habitats, new and improved village and amenity halls, and vital support for local museums and similar community assets. For further details see Viridor Credits' website at viridor-credits.co.uk

Vanessa's Playground Project, Hernhill, Kent.



STAKEHOLDER ENGAGEMENT

Pennon maintains a regular dialogue with institutional investors, City analysts, retail shareholders, local stockbrokers and the financial press through our proactive investor relations programme.

South West Water's Chief Executive chairs Water UK, the representative organisation which brings together all of the UK's water and waste water utilities. He represents the company on the Environment Agency's Regional Environmental Protection Advisory Committee.

Viridor's Chief Executive chairs the UK's Knowledge Transfer Network, which improves the competitiveness of UK environmental industries. He is a Director of Sustainability South West, Deputy Master of the Worshipful Company of Water Conservators, a senior visiting research fellow in Earth Sciences at Oxford University and a patron of Energy and Utility Skills.

He is also Chairman of the Government's Environmental Sector Advisory Group, which provides strategic advice to the Government on promotion of exports and inward investment in the UK environmental sector.

Pennon's Group Director of Finance is a member of the CBI Environmental Affairs Committee and the CBI South West Regional Council.

CORPORATE RESPONSIBILITY VERIFICATION

Pennon's corporate responsibility performance for 2008/09 has been audited by Acona Limited (an independent risk and compliance management company). The verification statements for Pennon, South West Water and Viridor are provided on their respective websites with their corporate responsibility reports.

INTERPRETATION

FORWARD-LOOKING STATEMENTS

This business review contains forward-looking statements regarding the financial position;

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

GLOSSARY

The following are descriptions of some of the terms used in this business review:

BMS	Viridor's integrated business management system
CAGR	Compound Annual Growth Rate, being the rate of growth over a period, expressed as a single annual average figure
Category 1 incident	A major water pollution incident as assessed by the Environment Agency
Category 2 and 3 incidents	Significant and less significant water pollution incidents as assessed by the Environment Agency
CHP	Combined Heat and Power
Defra	Department for the Environment, Food and Rural Affairs
Determination	The price limits and expenditure plans determined by Ofwat for South West Water for a five-year period
DWI	Drinking Water Inspectorate
EA	Environment Agency
EfW	Energy from waste
Financial year	Financial year of the Group ending 31 March
GWh	Gigawatt hours
HWRs	Household waste recycling sites
IFRS	International Financial Reporting Standards
IdoK	Interim Determination of K
ISO 9001	International quality management accreditation standard
ISO 14001	International environmental management accreditation standard
June Return	The annual return to Ofwat made by South West Water on its performance during the previous financial year
KPIs	Key Performance Indicators
LATS	Landfill Allowance Trading Scheme
ML	Megalitres
MW	Megawatts
NFFO	Non Fossil Fuel Obligation
Ofwat or water regulator	Water Services Regulatory Authority
OHSAS 18001	International occupational health and safety management system
Percentage population equivalent	Waste water treatment works loadings from domestic, industrial and diffuse sources, averaged and stated as a population equivalent load, expressed as a percentage
Periodic Review	The process of determining the water industry's price limits and expenditure plans for five-year regulatory periods
PFI	Private Finance Initiative
PPC	Pollution Prevention and Control
PPP	Public Private Partnership
RCV	Regulatory Capital Value
RO	Renewables Obligation
RIDDOR	Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (1995)
ROC	Renewables Obligation Certificate
RPI	The UK Government's Retail Prices Index
SEPA	Scottish Environment Protection Agency
UK GAAP	United Kingdom Generally Accepted Accounting Principles
Viridor	Viridor Limited (a subsidiary of Pennon Group Plc) or a Viridor operating subsidiary, depending on the nature of the activity described
WEEE	Waste electrical and electronic equipment

OTHER STATUTORY INFORMATION

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The principal activities of the Company and its subsidiaries ('the Group') are the provision of water and sewerage services, waste management and renewable energy. Information regarding the Group, including events and its progress during the year, events since the year-end and likely future developments is contained in the business review set out on pages 2 to 39 of this Directors' report.

In addition the business review contains a fair and balanced review of the business of the Group, including its position and prospects, Key Performance Indicators and a description of the principal risks and uncertainties facing the Group in accordance with the requirements of the Combined Code and Section 234ZZB of the Companies Act 1985 as well as further information on employee, environmental, social and community matters, reflecting the requirements of Section 417 of the Companies Act 2006. In addition in accordance with the ABI Corporate Social Responsibility Guidelines, statements are included on any significant environmental, social and governance (ESG) risks and the actions taken in mitigating these risks within the business review on pages 21, 26, 27, 32 and 33. Further information on ESG aspects of the Group's business are included in the corporate responsibility section of the business review on pages 34 to 38. The principal subsidiaries of the Company are listed in note 38 to the financial statements on page 105.

TAKEOVER CODE DISCLOSURES

The following disclosures are made pursuant to Part 7 of Schedule 7 of the Companies Act 1985 (as inserted by Section 992, Companies Act 2006 in accordance with the EU Takeover Directive 2004/25/EC). As at 31 March 2009:

(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 31 to the financial statements on pages 95 to 99. All of the Company's issued shares are fully paid up, rank equally in all respects and are listed on the Official List and traded on the London Stock Exchange. The rights and obligations attaching to the Company's shares, in addition to those conferred on their holders by law, are set out in the Company's Articles of Association ("Articles"), copies of which can be obtained from Companies House in the UK or by writing to the Company Secretary at the Company's registered office. The holders of the Company's shares are entitled to receive the Company's reports and accounts and in relation to general meetings of the Company they have the right to attend and speak, exercise voting rights and appoint proxies;

- (b) there are no restrictions on the transfer of issued shares of the Company or on the exercise of voting rights attached to them, except where the Company has exercised its right to suspend their voting rights or to prohibit their transfer following the omission of their holder or any person interested in them to provide the Company with information requested by it in accordance with Part 22 of the Companies Act 2006 or where their holder is precluded from exercising voting rights by the Financial Services Authority's Listing Rules or the City Code on Takeovers and Mergers;
- (c) details of significant direct or indirect holdings of securities of the Company are set out in the shareholder analysis on page 110;
- (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 Memorandum of Association of the Company and the Articles in force from time to time. Changes to the Articles must be approved by the Company's shareholders by passing a special resolution;
- (e) the Directors have the power to make purchases of the Company's own shares in issue as set out in the section on page 41 'Purchase Of Own Ordinary Shares'. No such purchases have been made during the year. The Directors also have the authority to allot shares up to an aggregate nominal value of £30,448,075 which was approved by shareholders at the 2008 Annual General Meeting (AGM). In addition, shareholders approved a resolution giving the Directors a limited authority to allot shares for cash other than pro rata to existing shareholders. These resolutions remain valid until the conclusion of this year's AGM. Resolutions will be proposed at this year's AGM to renew these authorities. The Directors have no present intention to issue ordinary shares, other than pursuant to employee share schemes and a Scrip Dividend Alternative subject to approval by shareholders at this year's AGM; and
- (f) there are a number of agreements which take effect, alter or terminate upon a change of control of the Company following a takeover bid, such as bank loan agreements, Eurobond documentation, private placement debt and employees' share plans. None of these is considered to be significant in terms of their potential impact on the business of the Group as a whole except for agreements relating to £210 million of term loans and £85 million of drawn revolving credit facilities maturing on various dates up to and including 15 August 2010 which could become repayable upon a change of control of the Company. A change of control will be deemed to have occurred if any person or persons acting in concert (as defined in the City Code on Takeovers and Mergers) at any time is/are or become(s) interested in more than 50% of the issued

ordinary share capital of the Company or shares in the capital of the Company carrying more than 50% of the voting rights normally exercisable at a general meeting of the Company.

FINANCIAL RESULTS AND DIVIDEND

Statutory Group profit on ordinary activities after taxation was £91.5 million. The Directors recommend a final dividend of 14.25p per ordinary share to be paid to shareholders on the register on 14 August 2009, making a total dividend for the year of 21.0p, the cost of which will be £73.4 million, leaving a credit to reserves of £18.1 million. The business review on pages 4 and 5 and 28 to 33 analyses the financial results in more detail and sets out other financial information, including the Directors' opinion on asset values on page 29.

DIRECTORS

Colin Drummond and Dinah Nichols are due to retire at this year's AGM on 30 July 2009 and offer themselves up for re-election. Martin Angle, who was appointed a Non-executive Director by the Board on 1 December 2008, retires in accordance with the Company's Articles of Association and is therefore due to be elected as a Director at the AGM. In addition, as Ken Harvey has been a Director for over nine years, in accordance with the Combined Code he offers himself up for re-election annually. The Board continues to believe that Dinah Nichols, as a Non-executive Director standing for re-election, is independent and that she makes an effective and valuable contribution to the Board, demonstrating continued commitment to the role. The Board also believes that Martin Angle is independent and that he makes an effective and valuable contribution to the Board demonstrating commitment to the role that he has now performed for some seven months. Ken Harvey, Martin Angle and Dinah Nichols do not have service contracts. Ken Harvey does have a contract for services which is terminable upon 12 months' notice. Colin Drummond has a service contract which is due to expire in two years' time, being upon his normal retirement date. Resolutions for the above Directors' re-election or election will be proposed at the AGM. The Directors' biographies are set out on page 42.

No Director has, or has had, a material interest, directly or indirectly, at any time during the year under review in any contract significant to the Company's business. A list of all the Directors during the year is set out in the emoluments table on page 46. Further details relating to the Directors and their service contracts or contracts for services are set out on pages 42 to 46 and details of the Directors' interests in shares of the Company are given on pages 47 to 49.

DIRECTORS' INDEMNITIES

The Company has entered into qualifying third party indemnity arrangements for the benefit of all its Directors in a form and scope which comply with the requirements of the Companies Act 1985 and 2006.

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

- (a) So far as each of the Directors in office at the date of the signing of the report is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- (b) each of the Directors has taken all the steps each Director ought to have taken individually as a director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

RESPONSIBILITY STATEMENT

Each of the Directors, whose names and functions are listed on page 42, confirm that, to the best of each person's knowledge and belief:

- (a) the financial statements, prepared in accordance with International Financial Reporting Standards (IFRS) as adapted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and the Company's and
- (b) this Directors report includes a fair review of the development and performance of the business and position of the Company and the Group, together with a description of the principal risks and uncertainties they face.

FINANCIAL INSTRUMENTS

Details of the financial risk management objectives and policies of the Group and the exposure of the Group to price, credit, liquidity and cash flow risks are set out in the business review on pages 30 and 33.

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 disabled persons and special arrangements and adjustments as necessary are made to ensure that disabled applicants are treated fairly when attending for interview or for pre-employment aptitude tests. Wherever possible, the opportunity is taken to retrain people who become disabled during their employment in order to maintain their employment within the Group. Employees are consulted regularly about changes which may affect them either through their trade union appointed representatives or by means of the elected Staff Council which operates in South West Water for staff employees. These forums, together with regular meetings with particular groups of employees, are used to ensure that employees are kept up to date with the operating and financial performance of their employer.

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

Further information about employment matters relating to South West Water is set out on pages 17 and 20, and to Viridor on page 24 of the business review.

The Group encourages share ownership amongst its employees by operating both an HM Revenue & Customs (HMRC) approved Sharesave Scheme and Share Incentive Plan. At 31 March 2009 around 37% of the Group's employees participated in these plans.

RESEARCH AND DEVELOPMENT

Research and development activities within the Group involving water and waste treatment processes amounted to £0.2 million during the year (2007/08 £0.2 million).

PENNON GROUP DONATIONS

During the year donations amounting to £74,781 (2007/08 £64,300) were made. Further details are included on pages 20, 25 and 38 of the business review. Additional information relating to charitable and other donations will be set out in the 2009 Corporate Responsibility Report which will be available for viewing on the Company's website at pennon-group.co.uk in August. No political donations were made (2007/08 Nil).

TAX STATUS

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

PAYMENTS TO SUPPLIERS

It is the Group's payment policy for the year ending 31 March 2010 to follow the Code of The Better Payment Practice Group on supplier payments. Information about the Code can be obtained from the website payontime.co.uk. The Company will agree payment terms with individual suppliers in advance and abide by such terms. The ratio, expressed in days, between the amount invoiced to the Company by its suppliers during 2008/09 and the amount owed to its trade creditors at 31 March 2009, was 48 days.

PURCHASE OF OWN ORDINARY SHARES

The Company has authority from shareholders to purchase up to 10% of its own ordinary shares (as renewed at the AGM in 2008) which was valid as at 31 March 2009 and remains currently valid. Of the 6,411,406 shares held in Treasury at 31 March 2008, 687,275 were subsequently re-issued under the Company's Sharesave Scheme for proceeds of £1.6 million.

AUDITORS

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

APPOINTED BUSINESS

South West Water Limited is required to publish additional financial information relating to the 'appointed business' as water and sewerage undertaker in accordance with the Instrument of Appointment from the Secretary of State for the Environment. A copy of this information will be available from 15 July 2009 upon application to the Company Secretary at Peninsula House, Rydon Lane, Exeter EX2 7HR or on the website southwestwater.co.uk

ANNUAL GENERAL MEETING

The twentieth Annual General Meeting of the Company will be held at the Sandy Park Conference Centre, Sandy Park Way, Exeter, Devon EX2 7NN on 30 July 2009 at 11.00am. In addition to routine business, resolutions will be proposed at the Annual General Meeting to:

- renew the existing authorities to issue a limited number of shares and to purchase up to 10% of the issued share capital of the Company
- seek authority to make political donations under the Political Parties, Elections and Referendums Act 2000, as amended. (It is not the Group's policy to make political donations. This is a precautionary measure which is followed by many companies to ensure that there is no inadvertent breach of the law)
- re-elect Mr K G Harvey, Mr C I J H Drummond and Ms D A Nichols and also elect Mr M D Angle as Directors of the Company
- approve the renewal of the Pennon Group Sharesave Scheme (an HMRC approved all-employee share scheme) for a further 10 year-period
- seek authority to continue to call general meetings other than an annual general meeting on not less than 14 clear days' notice (pursuant to the EU Shareholder Rights Directive (effective in August 2009), shareholder authority is required to continue to call meetings on at least 14 clear days' notice)
- seek authority to authorise Directors to offer shareholders a Scrip Dividend Alternative as a replacement to the current Dividend Re-investment Plan.

Details of the resolutions are set out in the separate Notice of Annual General Meeting which is circulated to shareholders with this Annual Report or provided by electronic communication via the Company's website at pennon-group.co.uk

By Order of the Board
KEN WOODIER, Group General Counsel & Company Secretary
25 June 2009

**Kenneth George Harvey BSc, CEng, 68
Chairman**

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

**Colin Irwin John Hamilton Drummond
MA, MBA, LTCL, CCMl, 58
Chief Executive, Viridor Limited**

Appointed on 1 April 1992. Prior to joining the Company Colin was a divisional chief executive of Coats Viyella, having previously been corporate development director of Renold plc, a strategy consultant with the Boston Consulting Group and an official of the Bank of England. He is chairman of the Government's Environmental Sector Advisory Group and chairman of the Environmental Knowledge Transfer Network; a senior visiting research fellow in Earth Sciences at Oxford University; an adviser to Beehive Water and Waste Holdings LP; and for the past year has been Deputy Master of the Worshipful Company of Water Conservators.

**David Jeremy Dupont MA, MBA, 55
Group Director of Finance**

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

**Christopher Loughlin BSc Hons,
MICE, CEng, MBA, 56
Chief Executive, South West Water Limited**

Appointed on 1 August 2006. Chris was most recently chief operating officer with Lloyd's Register and previously was an executive director of British Nuclear Fuels Plc and executive chairman of Magnox Electric Plc. Chris started his career as a chartered engineer and subsequently held a number of senior positions with British Nuclear Fuels. He was appointed chairman of Water UK with effect from 1 April 2008.

**Gerard Dominic Connell MA, 51
Senior Independent Non-executive Director**

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

**Martin David Angle BSc Hons, FCA, 59
Non-executive Director**

Appointed on 1 December 2008. Martin currently holds non-executive directorships with Savills plc, JSC Severstal, Dubai International Capital llc and The National Exhibition Centre where he is chairman. Until July 2008, he was also chairman of Celerant Consulting, an international operational management consultancy. In addition, he sits on the Board of the Warwick Business School. Formerly he held senior positions with Terra Firma Capital Partners and various of its portfolio companies, including the executive chairmanship of Waste Recycling Group Limited. Before that he was the Group Finance Director of TI Group plc and held a number of senior investment banking positions with SG Warburg & Co Ltd, Morgan Stanley and Dresdner Kleinwort Benson.

**Dinah Alison Nichols CB, BA Hons, 65
Non-executive Director**

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



David Dupont

Chris Loughlin

Colin Drummond

Ken Harvey

Dinah Nichols

Ken Woodier

Martin Angle

Gerard Connell

COMMITTEES OF THE BOARD

Audit

Gerard Connell (Chairman)
Martin Angle
Dinah Nichols

Corporate Responsibility

Dinah Nichols (Chairman)
Martin Angle
Gerard Connell
Colin Drummond
Chris Loughlin

Nomination

Ken Harvey (Chairman)
Martin Angle
Gerard Connell
Dinah Nichols

Remuneration

Martin Angle (Chairman)
Gerard Connell
Dinah Nichols

Group General Counsel & Company Secretary

Ken Woodier, Solicitor

Registered office

Peninsula House,
Rydon Lane,
Exeter
EX2 7HR
Registered in England No 2366640

THE REMUNERATION COMMITTEE

The Remuneration Committee comprises three Non-executive Directors: Martin Angle, Chairman of the Committee, Gerard Connell and Dinah Nichols (who are all regarded by the Company as independent). The Chairman of the Company, Ken Harvey, was a member of the Committee until 27 February 2009. Whilst the Combined Code specifically recognises that a company chairman may also be a member of a remuneration committee (provided he was considered independent on appointment as chairman) the Board agreed he should step down as a member following the appointment of Martin Angle to the Committee. This was because there would then be three non-executive directors on the Committee considered to be independent and because certain institutional shareholder advisory groups had expressed the opinion that the Chairman should not be a member of the Remuneration Committee when he has been Chairman of the Company for in excess of nine years.

The Committee's terms of reference include advising the Board on the framework of executive remuneration for the Group and having responsibility for determining the remuneration and terms of engagement of the Chairman, the Executive Directors and senior management of the Group. No Director or any other attendee participates in any discussion on, or determination of, his or her own remuneration.

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

- Ken Woodier, Group General Counsel & Company Secretary, on remuneration and share scheme matters. He also provides legal advice and company secretarial services to the Company;
- Hewitt Associates Limited, pensions and remuneration consultants, on calculating Total Shareholder Return for the Company's Restricted Share Plan. Hewitt also provide actuarial and investment pensions advice to the Trustees of the Group's pension schemes.

GROUP REMUNERATION POLICY

Last year it was reported that the policy of the Group in respect of remuneration was subject to review later in the year. Due to the sad death of the then Chairman of the Remuneration Committee, Kate Mortimer, the review has been postponed until September 2009 to enable it to be conducted under the lead of the new Committee Chairman, Martin Angle. Subject to this review the policy of the Group, which will be applied by the Remuneration Committee in 2010/11 and is also currently intended to be applied in each subsequent year, continues to be to provide for Executive Directors a remuneration package which is adequate to attract, retain and motivate good quality executives and which is commensurate with the remuneration packages provided by companies of similar size and complexity. The policy in respect of Non-executive Directors is set out on page 45 in the Non-executive Directors' remuneration section.

In respect of the current year (2009/10) Executive Directors' salaries were reviewed by the Remuneration Committee in February 2009. Whilst the Group's businesses were well positioned in the current economic slowdown, the Committee decided that it was appropriate to freeze salaries for the year for Executive Directors. It was also considered appropriate not to review the Chairman's annual fee. The Board supported this approach and it was agreed, in addition, that Non-executive Directors' fees would not be reviewed in the current year. These decisions were taken having regard to the pay and employment conditions of employees in the Group which are reviewed by the Committee annually. The Committee, taking account of employment market conditions, seeks to ensure that there are coherent pay and benefit structures across the Group which are consistent with Executive Directors with regard to their respective business areas and senior management remuneration packages. From summary reports on workforce remuneration and terms and conditions of employment by the Executive Directors with regard to their respective business areas, the Committee has regard to the general levels of responsibility, qualifications and experience required throughout the Group in setting salary and other benefits of the Executive Directors and senior management. The Committee also ensures that the incentive structures do not raise environmental, social or governance risks by inadvertently motivating irresponsible behaviour.

EXECUTIVE DIRECTORS

The remuneration package of the Executive Directors is summarised below. It comprises salary, annual bonus, long-term incentives, pensions (or benefit in lieu), car benefit and health cover. In 2009/10 (subject to fluctuations in the Company's share price) it is expected that around two-thirds of Directors' potential direct remuneration (i.e. excluding pensions, car benefit and health cover) will be performance-related (two-thirds in 2008/09). It is intended that this balance between performance-related and that which is not related to performance will continue.

None of the Executive Directors currently serve as non-executive directors elsewhere and therefore do not receive any fees for such services.

The Committee applies a shareholding guideline to Executive Directors and senior management as they are expected to have a substantial personal shareholding in the Company to demonstrate their commitment to the future success of the Group. In particular, Executive Directors are encouraged to build up their shareholding over a five-year period to a value which is at least equivalent to their basic salary.

(i) Basic salary and benefits – These are set out on page 46 for each Executive Director and are not related to performance. The Committee determines revised salaries, usually on an annual basis, for Executive Directors based upon surveys generally available conducted by independent remuneration consultants and the performance of the individual Executive Directors which the Committee assesses with the advice of Ken Harvey, Chairman of the Company. As already stated, for 2009/10 a pay freeze has been introduced. Other benefits, not mentioned below, include contributory pension provision (or a cash alternative), four times salary life assurance cover, a fully expensed car (or a cash alternative) and health cover.

(ii) Performance-related bonus – Annual performance-related bonuses are awarded in accordance with an Annual Incentive Bonus Plan for Executive Directors and based on the achievement of overall corporate and individual objectives established by the Committee. The maximum bonus achievable under the Plan for Executive Directors for 2008/09 was 100% of basic salary. To achieve the maximum percentage bonus allocated in respect of the corporate targets of earnings per share and profit before tax it is necessary for the Company to achieve a specified level of superior outperformance. Half of any bonus awarded is in the form of ordinary shares in the Company which must usually be held for a period of three years before release. During this period the Directors, in respect of these shares, are entitled to receive

(ii) Performance-related bonus (continued)

any dividends declared by the Company. No additional performance conditions applicable to the release of these shares, apart from maintaining continuous service with the Company, are considered appropriate by the Committee in view of the stretching performance conditions applicable to achieve the initial award of the shares. The Committee, in setting the performance objectives for Directors, is able to consider corporate performance on environmental, social and governance (ESG) issues. Objectives set embrace appropriate ESG parameters which are important to the success of the Group and which seek to ensure that the Group meets a number of its ESG targets as set out in the Group's Corporate Responsibility Report (referred to on pages 34 to 38 of the business review). The Committee in setting such objectives and in determining its remuneration policy overall, does ensure that the relevant incentives to Directors and senior management raises no ESG risks by inadvertently motivating irresponsible behaviour. In addition, the Committee will take into account ESG issues in determining the vesting of any awards under the Company's Performance and Co-investment Plan, as referred to in section (iii) 'Long-term incentive plan' below.

The following corporate and individual objectives of the Executive Directors applicable to the performance related bonus award for 2009/10 were determined by the Committee as appropriate, having regard to the activities of the Group that each individual Director could most influence and also to the overall performance of the Group, all of which seek to align the interests of the Directors with those of shareholders (the references to a percentage bonus relate to a percentage of the annual basic salary of each Executive Director in 2009/10):

Colin Drummond

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

David Dupont

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

Chris Loughlin

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

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

(iii) Long-term incentive plan –

A Performance and Co-investment Plan (PCP) was operated by the Company during the year for Executive Directors and senior management.

The purpose of the PCP is to award shares to participants subject to the achievement of stretching performance conditions measured over three years. Awards under the PCP, in the form of a conditional right over ordinary shares in the Company, were made by the Committee in July 2008 and, for Executive Directors, the award was over shares worth 100% of basic salary. In accordance with its discretion pursuant to the rules of the PCP, the Committee made the vesting of the awards also subject to the fulfilment of a co-investment condition whereby Executive Directors were required to invest and hold shares in the Company equal to 20% of the value of their award over the Restricted Period (being a period of three years from the date of the award). The percentage requirement for senior management was suitably scaled back. The number of shares subject to each award in the event of vesting will be increased by such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on those shares prior to vesting or exercise.

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

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

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

These are the Company's key listed sector comparators.

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

In addition to this TSR condition, before any award is capable of vesting, the Committee will also need to be satisfied that the underlying operational and economic performance of the Company is at a satisfactory level. This will include consideration of sustainability and environmental factors and safety performance, as well as financial performance.

For the first PCP awards made in August 2007 (following shareholder approval at the Annual General Meeting in July 2007) the same performance measures were used as set out above save that the sector comparator group included Biffa and Kelda Group (instead of Séché and Suez). As these companies have now de-listed, the Committee in respect of the 2007 award at the end of the three-year Restricted Period will have discretion to include them in the calculation of the index up to the date of de-listing (or other earlier date at its discretion) and exclude them from that date onwards or adopt an alternative approach.

Whilst the Committee intends currently to apply similar performance conditions to those set out above to any future PCP awards, they will be reviewed on an annual basis to ensure that they remain appropriate and suitably stretching for future awards.

(iii) Long-term incentive plan (continued)

Between 1997 and 2006 the Company operated a Restricted Share Plan (RSP). The final award made in September 2006 reaches the end of its three-year restricted period in September 2009 with the TSR performance of the Company against a comparator group being measured over the three-year period ended on 31 March 2009 (details of the performance condition are set out in the notes to table (b) 'Restricted Share Plan' on page 48). Over this period the Company achieved the position equivalent to the 50th percentile of the comparator group which results in no shares vesting from the award. For at least part of the award to have vested the Company had needed to achieve a position at least above the position of the company at or nearest to (but not above) the 50th percentile position of the comparator group. For the 2004 RSP award which vested in 2007 85% of the award vested and for the 2005 award which vested in 2008 70% of the award vested. Any awards which do not vest at the end of the relevant Restricted Period lapse and therefore 15% and 30% of the awards which vested in 2007 and 2008 respectively lapsed and 100% of the 2006 award will lapse in September 2009.

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

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

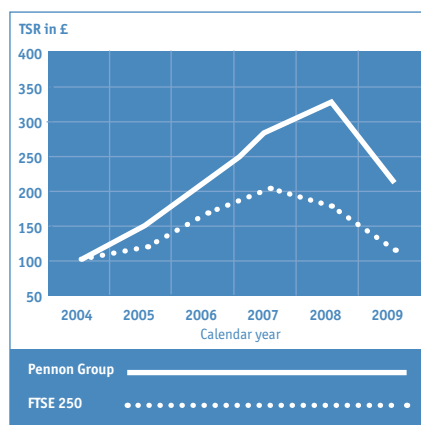
Colin Drummond	5 March 1992
David Dupont	2 January 2003
Chris Loughlin	16 May 2006

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

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

The pensionable pay for Executive Directors consists of the highest basic salary in any consecutive 12-month period of service within five years of retirement. Bonuses are not included in pensionable pay. In lieu of the provision of pension benefits, Chris Loughlin receives an annual payment equivalent to 30% of his annual basic salary.

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



This graph shows the value, over the five-year period ending on 31 March 2009, of £100 invested in Pennon Group on 31 March 2004 compared with the value of £100 invested in the FTSE 250 Index. The other points plotted are the values at intervening financial year ends. This Index is considered appropriate as it is a broad equity market index of which the Company has been a constituent over most of the period covered.

The graph has been produced in accordance with Schedule 7A of the Companies Act 1985.

NON-EXECUTIVE DIRECTORS AND THE CHAIRMAN

Non-executive Directors' remuneration (excluding that of the Chairman, Ken Harvey) consisting of fees only as set out below, is determined by the Board of Directors, including the Chairman, but in the absence of the other Non-executive Directors. It is usually reviewed each year to take account of market changes in non-executive directors' fees but, as already stated above, Non-executive Director fees are not due to be considered this year in view of the pay freeze applied to the members of the Board. The level of fees was last reviewed in September 2008. In reviewing the fees, the Board takes into account market information on non-executive directors' fees, most recently from the Monks Partnership. Non-executive Directors receive a base fee of £35,000 per annum, the Audit, Remuneration and Corporate Responsibility Committee chairs are paid fees of £10,000, £7,000 and £7,000 per annum respectively and Committee members of these Committees receive £4,000 each. In 2010/11 and for subsequent years the policy expected to be applied in respect of Non-executive Director fees will be to set fees around the median level compared with the market, which the Board believes is appropriate to attract and retain suitably experienced non-executive directors.

The Chairman's remuneration is set by the Remuneration Committee and was reviewed in March 2008. Again, as stated above, the Chairman's fee has been frozen for 2009/10.

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

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

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

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

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

Director	Date of contract	Expiry date of contract
Gerard Connell	30 September 2003	30 September 2009
Dinah Nichols	10 June 2003	11 June 2012
Martin Angle	28 November 2008	30 November 2011

The above contracts do not contain any notice periods.

Kate Mortimer who sadly died on 15 July 2008 was also a Non-executive Director during the year until that date. Her contract was dated 19 March 2005 and had an expiry date of 30 April 2009.

The information set out below and on the remaining pages of this remuneration report (pages 47 to 49) has been audited by the Group's independent auditors, PricewaterhouseCoopers LLP.

EMOLUMENTS OF DIRECTORS

The emoluments of individual Directors are shown in the table below:

Director	Salary/fees £000	Performance related bonus payable* £000	Other emoluments† £000	Payment in lieu of pension†† £000	Total 2009 - Year to 31 March £000	Total 2008 - Year to 31 March £000
<i>Chairman:</i>						
Ken Harvey	220	–	26	–	246	223
<i>Executive Directors:</i>						
Colin Drummond	330	79	23	–	432	464
David Dupont	330	85	20	–	435	450
Chris Loughlin	315	93	24	95	527	497
<i>Non-executive Directors:</i>						
Martin Angle (appointed 1 Dec 2008)	17	–	–	–	17	
Gerard Connell	50	–	–	–	50	47
Kate Mortimer (until 15 July 2008)	15	–	–	–	15	44
Dinah Nichols	48	–	–	–	48	44
Total	1,325	257	93	95	1,770	1,769

† Other emoluments are car benefit and health cover.

* In addition to the performance-related cash bonus, Executive Directors are due to receive a conditional award of shares as referred to in a note to (c) 'Annual Incentive Bonus Plan – Deferred Shares (long-term incentive element)' on page 49.

†† In lieu of any pension provision by the Company, Chris Loughlin receives a cash payment equivalent to 30% of his annual basic salary.

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

DIRECTORS' PENSIONS

Defined benefit pensions accrued and payable on retirement for Directors holding office during 2008/09 are shown in the table below:

Director	Increase in accrued pension during 2008/09 (net of inflation) £000 <i>a</i>	Increase in accrued pension during 2008/09 £000 <i>b</i>	Accrued pension at 31 March 2009 £000 <i>c</i>	Transfer value at 31 March 2009 £000 <i>d</i>	Transfer value at 31 March 2008 £000 <i>e</i>	Increase in transfer value (net of Directors' contributions) £000 <i>f</i>	Transfer value of Column a (net of Directors' contributions) £000 <i>g</i>
Colin Drummond	26	27	138	2,930	2,319	581	518
David Dupont	23	24	122	2,319	2,009	280	398

Column *a* above is the increase in accrued pension during 2008/09 (net of inflation). It recognises:

- i* the accrual rate for the additional period's service based upon the pensionable pay at the end of the period; and
- ii* the effect of pay changes in real terms (net of inflation) upon the accrued pension at the start of the year.

Column *b* is the actual increase in accrued pension during 2008/09.

Column *c* is the accrued pension at 31 March 2009 payable at normal retirement age.

Column *d* is the transfer value of the accrued pension set out in column *c* as at 31 March 2009.

Column *e* is the transfer value of the accrued pension at the end of the previous financial year on 31 March 2008.

Column *f* is the increase in the transfer value during the year (column *d* minus column *e*) after deducting Directors' contributions.

Column *g* is the transfer value of column *a*, less Directors' contributions.

Columns *d*, *e*, *f* and *g* have been calculated in accordance with Actuarial Guidance Note GN11.

Under the Company's pension salary deduction arrangements, the Company pays all pension scheme members' contributions to the Group pension schemes and salaries are reduced by the same amount. The figures quoted above have not been adjusted to reflect this arrangement.

Until 31 March 2006 the Company operated a Supplementary Pension Scheme which mainly funded pension provision above the Earnings Cap and provided benefits in tax-paid lump sum form at retirement. Appropriate figures have been included in the accrued pension totals shown above. Since 1 April 2006 pension service benefit above the Earnings Cap level has been provided in the Pennon Group Executive Pension Scheme as described in (vi) 'Provision for pensions' on page 45.

Directors have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table shown above.

DIRECTORS' SHARE INTERESTS**(a) Shareholdings**

The number of ordinary shares of the Company in which Directors held beneficial interests at 31 March 2009 and 31 March 2008 were:

Director	2009 Ordinary shares (40.7p each)	2008 Ordinary shares (40.7p each)	Director	2009 Ordinary shares (40.7p each)	2008 Ordinary shares (40.7p each)
Martin Angle	–	–	Ken Harvey	13,209	7,209
Gerard Connell	–	–	Chris Loughlin	20,166	18,987
Colin Drummond	216,363	188,277	Kate Mortimer	–	1,974
David Dupont	193,819	166,063	Dinah Nichols	4,549	–

365 additional ordinary shares (40.7p each) have been acquired by Chris Loughlin since 31 March 2009 as a result of participation in the Company's Dividend Re-investment Plan and the Company's Share Incentive Plan.

There have been no other changes in the beneficial interests or the non-beneficial interests of the Directors in the ordinary shares of the Company between 1 April 2009 and 3 June 2009.

DIRECTORS' SHARE INTERESTS *continued*
(b) Restricted Share Plan and Performance and Co-investment Plan (Long-Term Incentive Plans)

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

Director and date of award	Conditional awards held at 1 April 2008	Conditional awards made in year	Market price upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2009	Date of end of period for qualifying condition to be fulfilled
Colin Drummond							
27/9/05 †#	40,140	–	356.67p	28,098	166	–	–
18/9/06#	41,363	–	498.62p	–	–	41,363	17/9/09
29/8/07*	53,859	–	557.00p	–	–	53,859	28/8/10
10/7/08*	–	51,764	637.50p	–	–	51,764	9/7/11
David Dupont							
27/9/05 †#	40,140	–	356.67p	28,098	166	–	–
18/9/06#	41,363	–	498.62p	–	–	41,363	17/9/09
29/8/07*	53,859	–	557.00p	–	–	53,859	28/8/10
10/7/08*	–	51,764	637.50p	–	–	51,764	9/7/11
Chris Loughlin							
18/9/06#	36,099	–	498.62p	–	–	36,099	17/9/09
29/8/07*	49,371	–	557.00p	–	–	49,371	28/8/10
10/7/08*	–	49,411	637.50p	–	–	49,411	9/7/11

† The amount of the awards (and the market price upon award) for the awards made on 27 September 2005 have been adjusted in the ratio three-for-one consequent upon the Company's share capital split on 31 July 2006.

The awards marked # relate to the Company's Restricted Share Plan (RSP) and the awards marked * relate to the Company's Performance and Co-investment Plan (PCP) which succeeded the RSP in 2007. Details of the PCP and the performance conditions applicable to these Awards are set out in section (iii) 'Long-Term Incentive Plan' on page 44 of this report.

70% of the 2005 RSP Award vested on 26 September 2008 at a market price of 592.13p per ordinary share as the performance criterion had been partially met. The balance of the share awards of 30% lapsed on 26 September 2008. Bob Baty, a former director of the Company who retired on 31 July 2006, also received on 26 September 2008 8,586 ordinary shares of a total value of £51,000 at that date (market price of 592.13p each) which vested from a total original award of 12,266 ordinary shares (adjusted – as referred to below) made on 27 September 2005 at a market price of 356.67p each pursuant to the provisions of the RSP. The balance of the shares awarded to Bob Baty lapsed on 26 September 2008. As reported in last year's annual report the number of shares awarded to him had been adjusted pro rata to his period of employment with the Company during the Restricted Period of the award.

The performance criterion applicable to the 2005 and 2006 RSP Awards was: *the total shareholder return (TSR) achieved by the Company in the performance period must be greater than that of the company at or nearest to (but not above) the 50th percentile position of the comparator group.* If the TSR performance condition is met then 50% of an award will vest with 100% vesting if the Company achieves the position equal or closest to, but not above, the 75th percentile position of the comparator group. The achievement of a position between the 50th and the 75th percentile positions will result in vesting in steps reflecting the number of companies within that third quartile of the comparator group. The comparator group currently consists of nine of the water only, water and sewerage, electricity and gas companies in the FTSE Utilities Index and quoted on the London Stock Exchange. The TSR of each company in the comparator group is measured by Hewitt Associates Limited assuming that all dividends are reinvested and is calculated by taking the average market value of each company's shares for the whole of March before the beginning of the relevant three-year performance period and comparing this to the average market value of the same shares for the whole of March at the end of the three-year period. Based upon independent remuneration consultant's advice this method of measurement is considered to be fair and transparent to participants in the scheme and also an accurate measure of actual performance. The above performance criterion was chosen by the Remuneration Committee because it was considered to be an appropriate measure of the Group's performance which also aligned itself to the interests of shareholders.

None of the 2006 RSP Award will vest in September 2009 as the performance criterion has not been met.

During the year the Directors received dividends on the above shares in accordance with the conditions of the RSP as follows: Colin Drummond £16,146; David Dupont £16,146; Chris Loughlin £7,151.

DIRECTORS' SHARE INTERESTS *continued***(c) Annual Incentive Bonus Plan – Deferred Shares (long-term incentive element)**

The following Directors also have or had a contingent interest in the number of 40.7p ordinary shares 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 Plan) at the end of the relevant qualifying period:

Director and date of award	Conditional awards held at 1 April 2008	Conditional awards made in year	Market price upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2009	Date of end of period for qualifying condition to be fulfilled
Colin Drummond							
10/8/05 †	18,843	–	328.00p	18,843*	119*	–	–
26/7/06 †	16,527	–	486.00p	–	–	16,527	25/7/09
26/7/07	17,798	–	599.50p	–	–	17,798	25/7/10
27/6/08	–	22,838	620.00p	–	–	22,838	26/6/11
David Dupont							
10/8/05 †	18,606	–	328.00p	18,606*	118*	–	–
26/7/06 †	16,095	–	486.00p	–	–	16,095	25/7/09
26/7/07	17,018	–	599.50p	–	–	17,018	25/7/10
27/6/08	–	21,145	620.00p	–	–	21,145	26/6/11
Chris Loughlin							
26/7/07	8,767	–	599.50p	–	–	8,767	25/7/10
27/6/08	–	18,806	620.00p	–	–	18,806	26/6/11

* The August 2005 award shares vested on 12 August 2008 at a market price of 634.34p per ordinary share as the criterion had been met.

† The amount of the awards made on 10 August 2005 and 26 July 2006 have been adjusted in the ratio three-for-one consequent upon the Company's share capital split on 31 July 2006.

A further conditional award of shares will be made in 2009/10 to the value of the amount of the performance related cash bonus shown in the Emoluments of Directors table on page 46. (Paragraph (ii) 'Performance-related bonus' on pages 43 and 44 set out the provisions relating to the conditional award of shares pursuant to the Plan).

During the year the Directors received dividends on the above shares in accordance with the conditions of the Plan as follows: Colin Drummond £13,629; David Dupont £13,113; Chris Loughlin £4,287.

It is anticipated that all of the shares will vest under the July 2006 award in July 2009 as the criterion is expected to be met.

(d) Sharesave Scheme

Details of options to subscribe for shares of the Company under the all-employee Sharesave Scheme were:

Director and date of grant	Options held at 1 April 2008	Granted in year	Exercised in year	Exercise price per share	Market price on exercising	Value of each share at 31 March 2009	Options held at 31 March 2009	Exercise period/maturity date
Colin Drummond								
4/7/06 †	2,613	–	–	357.66p	–	405p	2,613	1/9/09 – 28/2/10
David Dupont								
3/7/07	3,136	–	–	522.00p	–	405p	3,136	1/9/12 – 28/2/13
Chris Loughlin								
3/7/07	3,136	–	–	522.00p	–	405p	3,136	1/9/12 – 28/2/13

† The options held and the exercise price have been adjusted in the ratio three-for-one consequent upon the Company's share capital split on 31 July 2006.

(f) Share price

The market price of the Company's 40.7p ordinary shares at 31 March 2009 was 405.00p (2008 647.50p) and the range during the year was 380.75p to 663.00p (2007/08 547.50p to 699.00p).

By Order of the Board

KEN WOODIER, Group General Counsel & Company Secretary

25 June 2009

COMPLIANCE

The Board is committed to the highest standards of corporate governance with the aim of continuing to enhance its effectiveness. The Annual Report is the principal means of reporting to shareholders on the Board's governance policies. This section sets out how the main and supporting principles of good corporate governance contained in Section 1 of the Combined Code (June 2006 version and also latest June 2008 version) have been applied by the Company in practice.

With the following exceptions between 15 July and 30 November 2008 inclusive, due to the sad death of Kate Mortimer (Independent Non-executive Director), the Company considers that it has complied with the provisions of the Code throughout the year:

- only two Directors of the Board out of five, (excluding the Chairman), rather than at least half, were Non-executive Directors determined by the Board to be independent (Code provision A.3.2)
- the Remuneration Committee's membership consisted of only two, rather than at least three, independent Non-executive Directors (Code provision B.2.1)
- the Audit Committee's membership consisted of only two, rather than at least three, independent Non-executive Directors (Code provision C.3.1).

THE BOARD AND ITS COMMITTEES

THE BOARD

The Board of Directors at the end of the year comprised the Chairman, three Executive Directors and three Non-executive Directors. All of the Non-executive Directors are considered to be independent as none of the relationships or circumstances set out in paragraph A.3.1 of the Combined Code apply to these Non-executive Directors. They are also considered to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations. Gerard Connell is the Senior Independent Non-executive Director. The biographies on page 42 demonstrate a broad range of business and financial experience. There is a clear division of responsibilities between the roles of Chairman and the Chief Executives of South West Water and Viridor as recorded in the descriptions of the roles approved by the Board. All Directors are subject to re-election when they have held office for three years.

The Directors on the Board during the year were as listed in the emoluments table on page 46 (Directors remuneration report). The Board met in accordance with its schedule of meetings

on ten occasions. All Directors were present at each meeting they were eligible to attend with the exception of Kate Mortimer who was absent on two occasions out of a possible attendance at three meetings. In accordance with Group policies the Board has a schedule of matters reserved for its decision and delegates more detailed consideration of certain matters to Board Committees; to the subsidiary boards of South West Water and Viridor; to the Executive Directors; and to the Group General Counsel & Company Secretary, as appropriate. Recognising this policy, the matters reserved to the Board include the approval of financial statements; acquisitions and disposals; major items of capital expenditure; authority levels for other expenditure; risk management; and approval of the Strategic Plan and annual operating budgets.

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

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

The Board has an internal procedure to evaluate the performance of the whole Board, each Committee, the Chairman, each individual Director and the Group General Counsel & Company Secretary. This evaluation procedure was administered for the year by the Group General Counsel & Company Secretary seeking all participants' views on a range of questions which are reviewed each year and are designed to ensure objective evaluation of performance. The participants' responses were then summarised and evaluated by the Group General Counsel & Company Secretary for the Board to consider and determine whether any changes were necessary for the Board to be more effective. Overall performance was considered to be satisfactory but a number of minor issues were identified where changes could be made to improve performance including, for example, reducing through delegation the number of administrative type matters that need to be addressed by the Board to enable the Board to concentrate more on strategic matters. The Chairman's performance was evaluated separately by the Non-executive Directors, led by the Senior Independent Non-executive Director. The Chairman's other significant commitments outside the Group have not changed during the year and the Board is satisfied that such commitments do not prejudice the Chairman's performance in relation to his Group role.

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

During the year the Board put in place a procedure for the consideration and authorisation of conflicts or possible conflicts with the Company's interests. This was introduced in accordance with Directors' interests provisions in the Companies Act 2006 which came into force from 1 October 2008 and followed changes made to the Company's Articles of Association at last year's Annual General Meeting granting Directors authority to approve such conflicts subject to appropriate conditions.

Group policies allocate the tasks of giving detailed consideration to specified matters, to monitoring executive actions and to assessing reward, to the Board Committees as set out below:

AUDIT COMMITTEE

The Audit Committee was chaired by Gerard Connell, who has current and relevant financial experience, and the other members of the Committee were Kate Mortimer (until 15 July 2008), Martin Angle (from 1 December 2008) and Dinah Nichols. During the year the Committee met on six occasions and all members were present at each meeting they were eligible to attend with the exception of Kate Mortimer who was absent on one occasion out of a possible attendance at two meetings. In discharging its Terms of Reference the Committee receives reports and meets regularly in particular to:

- monitor the integrity of the financial statements of the Group, including a review of significant reporting judgements, prior to approval by the Board;
- keep under review the effectiveness of the Group's internal controls, including all material financial, operational and compliance controls and risk management systems;
- monitor and review the effectiveness of the Group's internal audit function and approve the annual internal audit plan;
- review the findings of the internal audit function and review and monitor management's responsiveness to such findings;
- oversee the relationship with the external auditors including their appointment; remuneration; re-appointment; removal; the monitoring of their independence and objectivity particularly having regard to the supply of any non-audit services by the auditors; and

AUDIT COMMITTEE (continued)

- receive internal control reports from the external auditors and meet with them in the absence of management at least once a year to discuss their remit and any issues arising from the audit.

In addition the Committee periodically reviews the arrangements for and the effectiveness of the Group's 'whistleblowing' policies (details of which are set out on page 34 of the business review).

The Committee pays particular attention to the independence and objectivity of the auditors. Periodically a review of the provision of external audit services is undertaken in accordance with guidance issued by the Committee. The last review was undertaken in 2006 when the current auditors were appointed following the carrying out of a detailed competitive tender process. The Committee has an established policy for the engagement of the auditors for non-audit work by the Group. This involves the Group Director of Finance setting out in a report to the Committee reasons for appointing the auditors for any material work and obtaining the approval of the Committee to such appointment which the Committee will only grant if it is satisfied that the auditors' independence and objectivity are safeguarded. This is achieved by reviewing the appointment with the auditors as considered appropriate and receiving from the auditors at the year-end a letter setting out how the auditors believe their independence and objectivity have been maintained. In addition the Company's current auditors ensure that the senior partner responsible for the external audit of the Group remains responsible for such audit for no more than five years and that there is an independent partner who is involved in planning the audit and in the reviewing of the final accounts of the Company including assessing any critical matters which may be identified in the audit.

It is recognised by the Committee that on occasion it is necessary to appoint the auditors to do non-audit work in view of their specialist knowledge on such matters as the financial modelling of Private Finance Initiative (PFI) projects. There are a limited number of other audit firms with appropriate PFI project knowledge and they are often engaged by other parties to the projects. They would therefore be unable to act for the Company due to conflicts of interest. The Company's current auditors were engaged to provide non-audit financial advice in connection with the Greater Manchester waste PFI, the fees for which of approximately £1.2 million will be reflected in the total non-audit fees to be paid for 2009/10. The auditors are also being considered for other non-audit work during 2009/10. The Committee will be keeping the balance between audit and non-audit work under close review and will ensure, as stated above, that it is satisfied the auditors' independence and objectivity are safeguarded before granting permission for non-audit work to be carried out by the auditors.

Details of the audit and non-audit fees for 2008/09 are contained in note 6 to the financial statements on page 72.

The Executive Directors, South West Water and Viridor Finance Directors, the Group Financial Controller, the Group Internal Auditor and the external auditors attend meetings of the Committee by invitation. Both the external and internal auditors have the right of direct access to the Committee without the presence of any Executive Director or other senior management.

In addition to its usual business during the year the Committee considered the guidance from the Financial Reporting Council on challenges for audit committees arising from current economic conditions and also received advice from the Group Director of Finance on how to manage such risks. The Committee came to the conclusion that through the application of the Group's risk management policy and with the internal controls in place the Group was well positioned to manage the risks identified.

REMUNERATION COMMITTEE

The Remuneration Committee was chaired by Kate Mortimer until 15 July 2008 and also comprised Gerard Connell (who was acting Chairman from 15 July until 30 November 2008), Martin Angle (who was appointed to the Committee as chairman on 1 December 2008 following his appointment to the Board), Ken Harvey (until February 2009) and Dinah Nichols. The Committee met on five occasions during the year. All members were present at each meeting they were eligible to attend. The Committee is responsible for determining the Group's remuneration policy, remuneration and terms of engagement of the Chairman and the remuneration and terms of employment of the Executive Directors and senior management of the Group. Members of the Remuneration Committee do not participate in decisions concerning their own remuneration. The Directors' report on remuneration, which also provides more information on the activities of the Remuneration Committee, appears on pages 43 to 49.

NOMINATION COMMITTEE

The Nomination Committee was chaired by Ken Harvey and also comprised Kate Mortimer (until 15 July 2008), Martin Angle (from 1 December 2008), Gerard Connell and Dinah Nichols. It meets as and when required to select and recommend to the Board suitable candidates for appointment as Executive and Non-executive Directors, determine the nomination process and review succession plans. During the year it met on four occasions to consider the annual performance evaluation results for the Committee, to review succession planning for the Group and to agree and implement a selection process for a new Non-executive Director which involved on external search consultancy. All members were present at the meetings they were eligible to attend except Kate Mortimer on one occasion out of a possible attendance at one meeting.

CORPORATE RESPONSIBILITY COMMITTEE

The Corporate Responsibility Committee was chaired by Dinah Nichols and also comprised Gerard Connell, Kate Mortimer (until 15 July 2008), Martin Angle (from 1 December 2008) and the Chief Executives of South West Water and Viridor. It met on five occasions during the year at which all members were present at each meeting they were eligible to attend, except for Kate Mortimer on one occasion out of a possible attendance at two meetings. The Committee's duties, in the context of the requirement for companies to conduct their business in a responsible manner (including in relation to environmental, social and governance (ESG) matters), are to review the strategies, policies, management, initiatives, targets and performance of the Pennon Group of companies in the areas of occupational health and safety and security; environment; workplace policies; corporate policies; non-financial regulatory compliance and the role of the Group in society.

In reporting on corporate responsibility, the Company has sought to comply with the Association of British Insurers' Guidelines on Responsible Investment Disclosure. The business review on pages 34 to 38 contains details of ESG matters and additional information will be contained in the Group's annual Corporate Responsibility Report. The 2009 Report will be on the Company's website at pennon-group.co.uk in August 2009.

COMMITTEES' TERMS OF REFERENCE

The Terms of Reference of the Audit, Remuneration, Nomination and Corporate Responsibility Committees are available upon request to the Company Secretary and are also set out on the Company's website at pennon-group.co.uk

INTERNAL CONTROL**WIDER ASPECTS OF INTERNAL CONTROL**

The Board is responsible for maintaining the Group's system of internal control to safeguard shareholders' investment and the Group's assets and for reviewing its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group that has been in place throughout the financial year 2008/09 and up to the date of the approval of this Annual Report and Accounts.

WIDER ASPECTS OF INTERNAL CONTROL (continued)

The Board confirms that it continues to apply procedures in accordance with the Combined Code and the 'Guidance on Internal Control' (The Turnbull Guidance) which suggests means of applying the internal control part of the Code. As part of these procedures the Board has a formalised risk management policy which provides for the identification of key risks in relation to the achievement of the business objectives of the Group. This policy is applied by all business units within the Group in accordance with an annual timetable.

RISK IDENTIFICATION

A full risk and control assessment is undertaken annually by the management of each business to identify financial and non-financial risks and is continuously updated. Each business compiles (as part of its regular management reports) an enhanced and focused assessment of key risks against corporate objectives. The Board at each meeting receives from the Executive Directors details of any new high-level risks identified and how they are to be managed, together with details of any changes to existing risks and their management. The subsidiary Boards of South West Water and Viridor also receive at each meeting similar reports in respect of their own areas of responsibility. All Executive Directors and senior managers are required to certify on an annual basis that they have established effective controls to manage risks and to operate in compliance with legislation and Group procedures. All of these processes serve to ensure that a culture of effective control and risk management is embedded within the organisation and that the Group is in a position to react appropriately to new risks as they arise. Details of key risks affecting the Group are set out in the business review.

INTERNAL CONTROL FRAMEWORK

As well as the risk management policy of the Group there is an established internal control framework which comprises:

- (a) a clearly defined structure which delegates an appropriate level of authority, responsibility and accountability, including responsibility for internal financial control, to management of operating units;
- (b) a comprehensive budgeting and reporting function with an annual budget approved by the Board of Directors, which also monitors monthly results and updated forecasts for the year against budget;
- (c) documented financial control procedures. Managers of operating units are required to confirm annually that they have adequate financial controls in operation and to report all material areas of financial risk. Compliance with procedures is reviewed and tested by the Company's internal audit function; and

- (d) an investment appraisal process for evaluating proposals for all major capital expenditure and acquisitions, with defined levels of approval and a system for monitoring the progress of capital projects.

INTERNAL CONTROL REVIEW

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

In addition the Audit Committee regularly reviews the operation and effectiveness of the internal control framework and annually reviews the scope of work, authority and resources of the Company's internal audit function. The Committee reports and makes recommendations to the Board on such reviews. For 2008/09 and up to the date of the approval of the Annual Report and Accounts, both the Audit Committee and the Board were satisfied with the effectiveness of the risk management policy and the internal control framework and their operation within the Group.

GOING CONCERN

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

DIRECTORS' RESPONSIBILITIES STATEMENT

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Group and the Company and of their profits and cash flows for the year.

In preparing these financial statements the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and estimates which are reasonable and prudent
- state that the financial statements comply with IFRS as adopted by the European Union.

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

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and the Company and to enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 1985 and, as regards the Group financial statements, article 4 of the International Accounting Standards (IAS) Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

RELATIONS WITH SHAREHOLDERS

The Company maintains a regular dialogue with its institutional shareholders and has a comprehensive investor relations programme. During the year, meetings with institutional shareholders were held and attended by the Group Director of Finance and the Company's Investor Relations Manager. On certain occasions the Chairman, the Chief Executive of South West Water and the Chief Executive of Viridor also attended. The Board encourages the participation of shareholders at the Annual General Meeting and complies with the provisions of the Combined Code in respect of relations with shareholders. In particular, Non-executive Directors are invited to attend meetings with institutional shareholders and analysts' and brokers' briefings. The Group Director of Finance reports to the Board regularly on major shareholders' views about the Company. In addition, surveys of shareholder opinion conducted, usually on an annual basis, are evaluated and reported on to the Board.

By Order of the Board
KEN WOODIER, Group General Counsel
& Company Secretary
25 June 2009

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PENNON GROUP PLC

We have audited the Group and parent company financial statements (the "financial statements") of Pennon Group Plc for the year ended 31 March 2009 which comprise the Consolidated income statement, the Group statement of recognised income and expense, the Company statement of recognised income and expense, the Group balance sheet, the Company balance sheet, the Group cash flow statement, the Company cash flow statement and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Directors' responsibilities for preparing the Annual Report, the Directors' remuneration report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We also report to you whether, in our opinion, the information given in the Directors' Report is consistent with the financial statements. In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding the Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the Combined Code (2006) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' report, the unaudited part of the Directors' remuneration report, the corporate governance and internal control report and all of the other information listed on the contents page. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' remuneration report to be audited.

OPINION

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 March 2009 and of its profit and cash flows for the year then ended;
- the Company financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the Company's affairs as at 31 March 2009 and of its cash flows for the year then ended;
- the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and
Registered Auditors
Bristol
25 June 2009

	Notes	2009 £m	2008 £m
Revenue	5	952.9	875.0
Operating costs	6		
Manpower costs (excluding restructuring costs)		(108.6)	(100.4)
Raw materials and consumables used		(59.1)	(54.8)
Other operating expenses		(394.2)	(349.8)
Depreciation		(132.0)	(127.9)
Restructuring costs		(5.0)	(4.0)
Amortisation of intangibles		(1.2)	(1.3)
Operating profit	5	252.8	236.8
Finance income	7	43.5	42.0
Finance costs	7	(138.0)	(129.4)
Share of post-tax profit from joint ventures		0.8	0.2
Profit before tax	5	159.1	149.6
Taxation	8	(67.6)	(16.0)
Profit for the year		91.5	133.6
Profit attributable to equity shareholders		91.5	133.6
Earnings per share (pence per share)	10		
– Basic		26.3	38.2
– Diluted		26.2	37.9
Proposed dividend per share (pence per share)	11	21.0	19.81
Proposed dividend for the year (£m)	11	73.4	69.1

The notes on pages 58 to 108 form part of these financial statements.

	Notes	Group		Company	
		2009 £m	2008 £m	2009 £m	2008 £m
Profit for the year		91.5	133.6	140.1	74.2
Actuarial (losses)/gains on defined benefit pension schemes	28	(66.8)	5.1	(8.0)	(1.3)
Net fair value losses on cash flow hedges		(21.0)	(12.7)	(1.9)	(1.2)
Tax credit/(charge) on items taken directly to or transferred from equity	8, 29	18.7	(1.4)	2.2	0.4
Net losses recognised directly in equity	34	(69.1)	(9.0)	(7.7)	(2.1)
Total recognised income for the year		22.4	124.6	132.4	72.1
Attributable to equity shareholders		22.4	124.6	132.4	72.1

The notes on pages 58 to 108 form part of these financial statements.

	Notes	Group		Company	
		2009 £m	2008 (Restated note 37) £m	2009 £m	2008 £m
Assets					
Non-current assets					
Goodwill	14	236.5	235.9	–	–
Other intangible assets	15	5.4	6.6	–	–
Property, plant and equipment	16	2,774.2	2,665.8	0.2	0.2
Other non-current assets	18	10.6	10.4	271.3	259.6
Derivative financial instruments	22	0.2	4.0	–	0.5
Deferred tax asset	29	–	–	2.6	1.6
Investment in subsidiary undertakings	19	–	–	944.8	1,044.8
Investments in joint ventures	19	2.2	1.4	–	–
		3,029.1	2,924.1	1,218.9	1,306.7
Current assets					
Inventories	20	5.8	6.6	–	–
Trade and other receivables	21	178.3	164.7	70.2	70.4
Derivative financial instruments	22	–	11.9	–	–
Current tax recoverable	25	–	–	2.4	7.1
Cash and cash deposits	23	353.3	357.4	168.7	49.7
		537.4	540.6	241.3	127.2
Liabilities					
Current liabilities					
Borrowings	26	(262.9)	(57.7)	(486.0)	(297.3)
Derivative financial instruments	22	(3.6)	(17.0)	(1.4)	(17.0)
Trade and other payables	24	(166.8)	(204.0)	(7.6)	(18.9)
Current tax liabilities	25	(43.2)	(43.1)	–	–
Provisions	30	(18.8)	(18.1)	–	–
		(495.3)	(339.9)	(495.0)	(333.2)
Net current assets/(liabilities)		42.1	200.7	(253.7)	(206.0)
Non-current liabilities					
Borrowings	26	(1,982.4)	(2,062.8)	(189.5)	(394.7)
Other non-current liabilities	27	(3.7)	(4.0)	(8.7)	(8.7)
Derivative financial instruments	22	(16.5)	(0.5)	–	–
Retirement benefit obligations	28	(66.0)	(26.3)	(7.3)	(2.9)
Deferred tax liabilities	29	(326.3)	(306.7)	–	–
Provisions	30	(79.2)	(84.2)	–	–
		(2,474.1)	(2,484.5)	(205.5)	(406.3)
Net assets		597.1	640.3	759.7	694.4
Shareholders' equity					
Share capital	31	144.5	144.5	144.5	144.5
Share premium account	32	11.7	11.7	11.7	11.7
Capital redemption reserve	33	144.2	144.2	144.2	144.2
Retained earnings and other reserves	34	296.7	339.9	459.3	394.0
Total shareholders' equity		597.1	640.3	759.7	694.4

The notes on pages 58 to 108 form part of these financial statements.

The financial statements on pages 54 to 108 were approved by the Board of Directors and authorised for issue on 25 June 2009 and were signed on its behalf by:

K G HARVEY
Chairman

	Notes	Group		Company	
		2009 £m	2008 £m	2009 £m	2008 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	35	308.6	337.1	(5.8)	(108.9)
Interest paid		(103.9)	(96.7)	(48.4)	(15.8)
Tax (paid)/repaid		(30.8)	(21.0)	6.0	(1.3)
Net cash generated/(outflow) from operating activities		173.9	219.4	(48.2)	(126.0)
Cash flows from investing activities					
Interest received		23.8	17.0	22.6	21.5
Dividends received		-	-	128.6	85.7
Acquisition of subsidiary undertakings (net of cash acquired)	37	(3.4)	(89.0)	-	-
Investment in subsidiary undertakings		-	-	-	(101.0)
Proceeds from investment disposal		-	-	100.0	-
Return of loan from joint venture		-	0.1	-	-
Purchase of property, plant and equipment		(245.9)	(219.2)	-	(0.1)
Proceeds from sale of property, plant and equipment		2.6	1.1	-	0.1
Net cash (used in)/from investing activities		(222.9)	(290.0)	251.2	6.2
Cash flows from financing activities					
Purchase of ordinary shares subsequently cancelled		-	(5.9)	-	(5.9)
Purchase of ordinary shares held as treasury shares		-	(43.4)	-	(43.4)
Proceeds from treasury shares re-issued		1.6	1.6	1.6	1.6
Ordinary shares acquired by the Pennon Employee Share Trust	34	-	(0.3)	-	-
Return/(deposit) of restricted funds (net)		93.0	(106.7)	(0.3)	(0.6)
Net proceeds from new borrowing		100.0	473.5	304.9	516.0
Repayment of borrowings		(14.9)	(157.5)	(321.4)	(257.3)
Finance lease sale and lease back		49.8	110.4	-	-
Finance lease principal repayments		(16.8)	(20.4)	-	-
Dividends paid	11	(69.1)	(65.6)	(69.1)	(65.6)
Net cash received/(outflow) from financing activities		143.6	185.7	(84.3)	144.8
Net increase in cash and cash equivalents		94.6	115.1	118.7	25.0
Cash and cash equivalents at beginning of the year	23	227.4	112.3	49.1	24.1
Cash and cash equivalents at end of the year	23	322.0	227.4	167.8	49.1

The notes on pages 58 to 108 form part of these financial statements.

1. GENERAL INFORMATION

Pennon Group Plc is a company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given on page 42. Pennon Group's business is operated through two main subsidiaries. South West Water Limited holds the water and sewerage appointments for Devon, Cornwall and parts of Dorset and Somerset. Viridor Limited's business is waste treatment and disposal.

2. PRINCIPAL ACCOUNTING POLICIES

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

(a) Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union, with those parts of the Companies Act 1985 applicable to companies reporting under IFRS and the requirements of the Financial Services Authority. A summary of the principal accounting policies is set out below, together with an explanation where changes have been made to previous policies on the adoption of new accounting standards in the year.

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

IFRS 8	'Operating segments'
IAS 23	'Borrowing costs' (revised)
IAS 1	'Presentation of financial statements' (revised)
IFRS 2	'Share-based payment' (amendment)
IAS 27	'Consolidated and separate financial statements' (revised)
IFRS 3	'Business combinations' (revised)
IAS 32	'Financial instruments : presentation' (amendment) and consequential amendments to IAS 1
IFRS 1	'First-time adoption of IFRS' and amendments to IAS 27 'Consolidated and separate financial statements'
–	'Improvements to IFRS'
IAS 39	'Financial instruments : recognition and measurement' (amendment)
IAS 39	'Financial instruments : recognition and measurement' (amendment) and consequential amendments to IFRS 7
	'Financial instruments : disclosures'
IFRIC 12	'Service concession arrangements'
IFRIC 13	'Customer loyalty programmes'
IFRIC 14	'IAS 19 The limit on a defined benefit asset, minimum funding requirements and their interaction'
IFRIC 15	'Agreement for the construction of real estate'
IFRIC 16	'Hedges of a net position in a foreign operation'
IFRIC 17	'Distribution of non-cash assets to owners'
IFRIC 18	'Transfers of assets from customers'

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

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

(b) Basis of consolidation

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

The results of subsidiaries and joint venture undertakings are included from the date of acquisition or incorporation, and excluded from the date of disposal. The results of subsidiaries are consolidated where the Group has the power to control a subsidiary. The results of joint venture undertakings are accounted for on an equity basis where the Group exercised joint control under a contractual arrangement.

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

2. PRINCIPAL ACCOUNTING POLICIES *continued*

On acquisition the assets and liabilities and contingent liabilities of a subsidiary or joint venture acquired are measured at their fair values and any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Where the cost of acquisition is below the fair values of the identifiable net assets acquired a credit is recognised in the income statement in the year of acquisition.

(c) Revenue recognition

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

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

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

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

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

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

(d) Landfill tax

Landfill tax is included within both revenue and operating costs. It is determined by the Government and is a cost to the Group but is chargeable to customers.

(e) Segmental reporting

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

(f) Goodwill

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

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

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

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

(g) Other intangible assets

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

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(h) Property, plant and equipment

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

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

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

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

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

ii) Landfill sites

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

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

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

Other assets are included at cost less accumulated depreciation.

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

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

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

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

Asset lives and residual values are reviewed annually.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(i) Leased assets

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

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

(j) Impairment of non-financial assets

Assets with an indefinite useful life are not subject to amortisation and are tested annually for impairment, or whenever events or changes in circumstance indicate that the carrying amount may not be recoverable.

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

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

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

(k) Investment in subsidiary undertakings

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

(l) 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. Losses of a joint venture in excess of the Group's interest are not recognised unless the Group has a legal or constructive obligation to fund those losses.

(m) Cash and cash deposits

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

2. PRINCIPAL ACCOUNTING POLICIES *continued***(n) Derivatives and other financial instruments**

The Group classifies its financial instruments in the following categories:

i) Loans and receivables

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

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

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

ii) Derivative financial instruments and hedging activities

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

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

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

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

iii) Trade receivables

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

iv) 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.

Effective interest method

The effective interest method is used to calculate the amortised cost of a financial asset or liability and of allocating the interest income or expense over the relevant period. The effective interest rate is the rate which discounts estimated future cash payments or receipts through the expected life of the financial asset or liability or, where appropriate, a shorter period.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(o) Taxation including deferred tax

The tax charge for the year is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date. Deferred tax is provided in full using the liability method on temporary differences between the tax basis of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future for it to be utilised.

(p) Provisions

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

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

i) Landfill restoration costs

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

ii) Environmental control and aftercare costs

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

iii) Restructuring costs

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

Where the effect of the time value of money is material the current amount of a provision is the present value of the expenditures expected to be required to settle obligations. The unwinding of the discount to present value is included as a financial item within finance costs.

(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 Employee Share Trust and which have not vested by the balance sheet date. These are shown as a deduction from shareholders' equity until such time as they vest.

(r) Dividend distributions

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

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(s) Employee benefits

i) Retirement benefit obligations

The Group operates defined benefit and defined contribution pension schemes.

Defined benefit pension schemes

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

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

Changes in past service costs arising from changes in benefits are recognised immediately in income.

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

Defined contribution scheme

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

ii) Share-based payment

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

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

(t) Pre-contract costs

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

(u) Fair values

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

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

3. FINANCIAL RISK MANAGEMENT

(a) Financial risk factors

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

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

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

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

i) Market risk

The Group has a policy of maintaining at least 50% of interest bearing liabilities at fixed rates. The Group uses a combination of fixed rate and index-linked borrowings and fixed rate interest swaps as cash flow hedges of future variable interest payments to achieve this policy. At the year end 57% of net borrowings were at fixed rates and 19% index-linked. 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 26.

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

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

For 2008/09 if interest rates on net borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year would have decreased/increased by £2.0m (2008 £1.0m).

ii) Liquidity risk

The Group actively maintains a mixture of long-term and short-term committed facilities which are designed to ensure the Group has significant available funds for operations and planned expansions equivalent to at least one year's forecast requirements at all times. Details of undrawn committed facilities and short-term uncommitted facilities are provided in note 26.

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

The Group and South West Water Limited have entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on South West Water Limited's Regulatory Capital Value and Viridor Limited's EBITDA) and interest cover. More details are provided in the Director's report on page 33.

3. FINANCIAL RISK MANAGEMENT *continued*
(a) Financial risk factors *continued*
ii) Liquidity risk (continued)

Contractual undiscounted cash flows were:

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Over 5 years £m	Total £m
Group					
31 March 2009					
<i>Non-derivative financial liabilities</i>					
Borrowings excluding finance lease liabilities	232.8	194.1	73.3	997.4	1,497.6
Interest payments on borrowings	24.0	17.8	32.5	367.4	441.7
Finance lease liabilities	62.3	62.2	264.6	1,951.1	2,340.2
<i>Derivative financial liabilities</i>					
Derivative contracts – net payments	17.9	4.4	3.2	0.3	25.8
31 March 2008					
<i>Non-derivative financial liabilities</i>					
Borrowings excluding finance lease liabilities	34.1	219.1	246.3	918.5	1,418.0
Interest payments on borrowings	42.2	44.0	40.0	369.8	496.0
Finance lease liabilities	74.9	146.0	164.4	1,977.9	2,363.2
<i>Derivative financial liabilities</i>					
Derivative contracts – net receipts	4.0	2.5	0.5	–	7.0
Company					
31 March 2009					
<i>Non-derivative financial liabilities</i>					
Borrowings excluding finance lease liabilities	208.0	80.0	10.0	100.0	395.8
Interest payments on borrowings	11.3	7.2	0.1	–	18.6
<i>Derivative financial liabilities</i>					
Derivative contracts – net payments	1.5	–	–	–	1.5
31 March 2008					
<i>Non-derivative financial liabilities</i>					
Borrowings excluding finance lease liabilities	1.4	205.0	90.0	100.0	396.4
Interest payments on borrowings	23.2	22.2	7.6	–	53.0
<i>Derivative financial liabilities</i>					
Derivative contracts – net receipts	0.5	0.3	–	–	0.8

iii) Credit risk

Credit and counterparty risk arises from cash and cash deposits, derivative financial instruments and deposits with bank and financial institutions, as well as exposure to customers, including outstanding receivables. Further information on the credit risk relating to trade receivables is given in note 21.

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 usually placed in short-term fixed interest deposits or the overnight money markets. Deposit counterparties must meet a credit rating threshold set by the Board of A1 (Moody's) or AA (Standard and Poor's).

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.

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 36 and calculated as total borrowings less cash and cash deposits. Total capital is calculated as total shareholders' equity plus net borrowings.

The gearing ratios at 31 March 2009 and 2008 were:

	2009 £m	2008 (Restated) £m
Net borrowings (note 36)	1,892.0	1,763.1
Total shareholders' equity	597.1	640.3
Total capital	2,489.1	2,403.4
Gearing ratio	76.0%	73.4%

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

	2009 £m	2008 £m
Regulatory Capital Value	2,461.0	2,408.0
Net borrowings	1,571.1	1,455.2
Net borrowings/Regulatory Capital Value	63.8%	60.4%

(c) Determination of fair values

The fair value of financial instruments traded in active markets (such as trading and available-for-sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

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

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

4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

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

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

Underlying business performance

Underlying business performance is presented to provide more useful information on underlying trends. The term underlying is not a defined term under IFRS, and may not be comparable with similarly titled profit measurements reported by other companies. Reconciliations between underlying and reported measures are included in note 10 and in the Directors' report on page 4.

Environmental and landfill restoration provisions

Restoration and aftercare provisions are recognised in the financial statements at the net present value of the estimated future expenditure required to settle the Group's restoration and aftercare obligations. A discount is applied to recognise the time value of money and is unwound over the life of the provision. This is included in the income statement as a financial item within interest payable. As at 31 March 2009 the Group's environmental and landfill restoration provisions were £97.5m.

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

Capitalisation of borrowing costs

The Group capitalises material borrowing costs directly attributable to the construction of qualifying assets (assets necessarily taking a substantial period of time to be prepared for their intended use). At the balance sheet date only the assets under construction in the Lakeside Energy from Waste joint venture meet the criteria for capitalisation of related borrowing costs.

Retirement benefit obligations

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

The pension cost under IAS 19 is assessed in accordance with Directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on information supplied to the actuary, supplemented by discussions between the actuary and management. The principal assumptions used to measure schemes' liabilities, sensitivities to changes in assumptions and future funding obligations are set out in note 28 of the financial statements.

Cash-generating units

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The waste management segment is considered to be a single cash-generating unit as it is an integrated business.

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

Landfill costs

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

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

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

4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES *continued*

Carrying value of property, plant and equipment

The Group's accounting policy for property, plant and equipment assets is set out in note 2. The carrying value of property, plant and equipment as at 31 March 2009 was £2,774.2m. In the year ended 31 March 2009 additions totalled £239.8m and the depreciation charge was £133.5m. Estimated useful economic lives of property, plant and equipment are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of capital investment to the Group, variations between actual and estimated useful lives could impact operating results both positively and negatively. Historically, only minor changes to estimated useful lives have been required.

Defined benefit pension schemes

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

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

Mortality assumptions are set upon actuarial advice in accordance with published statistics using a "medium cohort" basis and scheme-specific experience.

A schedule showing the impact upon the schemes' liabilities of any change in the assumption made is included in note 28 to these financial statements.

Revenue recognition

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

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

Provision for doubtful debts

At each balance sheet date each subsidiary evaluates the collectability of trade receivables and records provisions for doubtful debts based on experience including comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of debt collected may differ from the estimated levels of recovery and could impact future operating results positively or negatively. As at 31 March 2009 the Group's current trade receivables were £154.9m, against which £43.1m was provided for impairment.

Impairment of intangible assets

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

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

5. SEGMENTAL REPORTING

The water and sewerage business comprises the regulated water and sewerage services undertaken by South West Water Limited. The waste management business is the waste treatment, recycling and disposal services provided by Viridor Limited. Other includes parent company financing of business acquisitions made before 1999. Segment assets include goodwill and other intangible assets, property, plant and equipment, inventories, trade and other receivables and cash and cash deposits. Segment liabilities comprise operating liabilities and exclude taxation. The other segment liabilities include the Company's financing of business acquisitions and Group taxation liabilities. Capital expenditure comprises additions to property, plant and equipment, including additions resulting from acquisitions through business combinations.

5. SEGMENTAL REPORTING *continued*

	2009 £m	2008 £m
Revenue		
Water and sewerage	431.7	421.0
Waste management	522.7	455.1
Other	8.7	8.4
Less intra-segment trading*	(10.2)	(9.5)
	952.9	875.0
Segment result		
Underlying operating profit before depreciation and amortisation (EBITDA)		
Water and sewerage	281.4	270.0
Waste management	107.9	101.0
Other	1.7	(1.0)
	391.0	370.0
Underlying operating profit		
Water and sewerage	191.6	185.0
Waste management	65.5	58.1
Other	1.9	(1.0)
	259.0	242.1
Operating profit		
Water and sewerage	186.6	181.0
Waste management	64.3	56.8
Other	1.9	(1.0)
	252.8	236.8
Underlying profit before tax		
Water and sewerage	121.9	120.5
Waste management	40.8	35.5
Other	2.6	(1.1)
	165.3	154.9
Profit before tax		
Water and sewerage	116.9	116.5
Waste management	39.6	34.2
Other	2.6	(1.1)
	159.1	149.6

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

Underlying measures exclude restructuring costs in South West Water and amortisation of intangibles in Viridor.

A full reconciliation between underlying and reported measures is included in the Directors' report on page 4 and in note 10 for earnings per share.

5. SEGMENTAL REPORTING *continued*

	Water and sewerage £m	Waste management (Restated note 37) £m	Other £m	Eliminations £m	Group £m
Balance sheet					
31 March 2009					
Assets (excluding investment in joint ventures)	2,684.9	841.0	809.6	(771.2)	3,564.3
Investment in joint ventures	–	2.2	–	–	2.2
Total assets	2,684.9	843.2	809.6	(771.2)	3,566.5
Liabilities	(1,959.7)	(706.5)	(1,074.4)	771.2	(2,969.4)
Net assets/(liabilities)	725.2	136.7	(264.8)	–	597.1
31 March 2008					
Assets (excluding investment in joint ventures)	2,632.6	775.8	794.5	(741.1)	3,461.8
Investment in joint ventures	–	1.4	–	–	1.4
Total assets	2,632.6	777.2	794.5	(741.1)	3,463.2
Liabilities	(1,829.8)	(647.0)	(1,087.2)	741.1	(2,822.9)
Net assets/(liabilities)	802.8	130.2	(292.7)	–	640.3

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

	Water and sewerage £m	Waste management £m	Other £m	Group £m
Other information				
31 March 2009				
Amortisation of other intangible assets (note 15)	–	1.2	–	1.2
Capital expenditure (including acquisitions)	147.8	95.4	–	243.2
Depreciation	89.8	42.4	(0.2)	132.0
31 March 2008				
Amortisation of other intangible assets (note 15)	–	1.3	–	1.3
Capital expenditure (including acquisitions)	169.7	148.0	0.1	317.8
Depreciation	85.0	42.9	–	127.9

The total number of employees at 31 March 2009 was 3,417 (2008 3,388).

Geographical segments

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

6. OPERATING COSTS

	2009 £m	2008 £m
Manpower costs (note 12)	108.6	100.4
Raw materials and consumables	59.1	54.8
Other operating expenses include:		
Profit on disposal of property, plant and equipment	(2.1)	–
Operating lease rentals payable:		
– Plant and machinery	6.9	5.9
– Property	5.2	5.2
Research and development expenditure	0.2	0.2
Trade receivables impairment	6.7	6.0
Depreciation of property, plant and equipment:		
– Owned assets	97.8	98.9
– Under finance leases	34.2	29.0
Amortisation of other intangible assets (note 15)	1.2	1.3

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

	2009 £000	2008 £000
Fees payable to the Company's auditors for the audit of the Company's accounts	47	46
<i>Fees payable to the Company's auditors for other services to the Group:</i>		
Audit of the Company's subsidiaries pursuant to legislation	316	297
Other services pursuant to legislation	130	23
Tax services	135	197
Services relating to corporate finance transactions	570	359
All other services	37	5
	1,235	927
<i>Fees payable to the Company's auditors in respect of Pennon Group pension schemes:</i>		
Audit	24	22

Expenses reimbursed to the auditors in relation to the audit of the Group were £31,000 (2008 £30,000).

A description of the work of the Audit Committee is set out in its report on pages 50 and 51 which includes an explanation of how auditor objectivity and independence are safeguarded when non-audit services are provided by the auditors.

7. NET FINANCE COSTS

	2009 £m	2008 £m
Finance income		
Interest receivable	21.1	21.0
Expected return on defined benefit pension schemes' assets (note 28)	22.4	21.0
	43.5	42.0

7. NET FINANCE COSTS *continued*

	2009 £m	2008 £m
Finance costs		
Bank borrowings and overdrafts	(48.9)	(47.6)
Interest element of finance lease rentals	(54.6)	(52.8)
Other finance costs	(1.5)	(1.4)
Interest cost on retirement benefit obligations (note 28)	(24.0)	(18.5)
Unwinding of discounts in provisions (note 30)	(4.5)	(4.3)
	(133.5)	(124.6)
Net gains/(losses) on derivative instruments:		
Ineffectiveness on derivatives designated as cash flow hedges (note 22)	0.4	0.3
On derivatives deemed held for trading (note 22)	(4.9)	(5.1)
	(138.0)	(129.4)
Net finance costs	(94.5)	(87.4)

8. TAXATION

	2009 £m	2008 £m
Analysis of charge in year		
UK corporation tax	30.7	25.0
Deferred tax – other	12.0	12.0
Deferred tax arising on abolition of industrial buildings allowances (2008 change of rate)	24.9	(21.0)
Total deferred tax (note 29)	36.9	(9.0)
Tax charge for year	67.6	16.0

UK corporation tax is calculated at 28% (2008 30%) of the estimated assessable profit for the year.

The deferred tax charge has been increased by a non-recurring charge of £24.9m arising from the phasing out of industrial buildings allowances over the three years commencing 1 April 2008.

The deferred tax charge for the year ended 31 March 2008 was reduced by a non-recurring credit of £21.0m arising from the reduction in the rate of UK corporation tax from 30% to 28% effective 1 April 2008.

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

	2009 £m	2008 £m
Profit before tax	159.1	149.6
Profit before tax multiplied by the standard rate of UK corporation tax of 28% (2008 30%)	44.5	44.9
Effects of:		
Expenses not deductible for tax purposes	2.1	2.7
Other	(0.9)	(2.3)
Capital gains reduced by capital losses	(0.7)	(4.2)
Tax relief no longer available on industrial buildings	24.9	–
Effect of reduction in the rate of UK corporation tax on deferred tax	–	(21.6)
Adjustments to tax charge in respect of prior years	(2.3)	(3.5)
Tax charge for year	67.6	16.0

The average applicable tax rate for the year was 42% (2008 11%).

In addition to the amount debited to the income statement, a deferred tax credit relating to actuarial losses on defined benefit pension schemes of £18.7m (2008 charge of £1.4m on actuarial gains) has been credited directly to equity. A deferred tax debit relating to share-based payments of £0.8m (2008 credit £0.2m) has been charged directly to equity.

9. PROFIT OF PARENT COMPANY

	2009 £m	2008 £m
Profit attributable to equity shareholders dealt with in the accounts of the parent company	140.1	74.2

As permitted by Section 230 of the Companies act 1985 no income statement is presented for the Company.

10. 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 34), which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to include all dilutive potential ordinary shares. The Group has two types of dilutive potential ordinary shares – those share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the year; and the contingently issuable shares under the Group's Performance and Co-investment Plan and the deferred shares element of the Incentive Bonus Plan, to the extent that the performance criteria for vesting of the awards are expected to be met.

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

	2009	2008
Number of shares (millions)		
For basic earnings per share	348.1	349.7
Effect of dilutive potential ordinary shares from share options	1.7	2.7
For diluted earnings per share	349.8	352.4

Underlying basic and diluted earnings per share

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

	2009			2008		
	Profit after tax £m	Basic p	Earnings per share Diluted p	Profit after tax £m	Basic p	Earnings per share Diluted p
Statutory earnings per share	91.5	26.3	26.2	133.6	38.2	37.9
Restructuring costs (net of tax)	3.3	0.9	0.9	3.3	0.9	0.9
Amortisation of intangibles	1.2	0.4	0.4	1.3	0.4	0.4
Deferred tax	36.9	10.6	10.5	(9.0)	(2.6)	(2.5)
Underlying earnings per share	132.9	38.2	38.0	129.2	36.9	36.7

11. DIVIDENDS

	2009 £m	2008 £m
Amounts recognised as distributions to equity holders in the year:		
Interim dividend paid for the year ended 31 March 2008 : 6.25p (2007 5.85p) per share	21.8	20.8
Final dividend paid for the year ended 31 March 2008 : 13.56p (2007 12.7p) per share	47.3	44.8
	69.1	65.6
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2009 : 6.75p (2008 6.25p) per share	23.6	21.8
Proposed final dividend for the year ended 31 March 2009 : 14.25p (2008 13.56p) per share	49.8	47.3
	73.4	69.1

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

The proposed interim dividend for 2009 was paid on 8 April 2009 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting.

12. EMPLOYMENT COSTS

	2009 £m	2008 £m
Wages and salaries	95.9	88.9
Social security costs	9.2	7.8
Pension costs	13.2	15.1
Share-based payments	2.7	1.9
Total employment costs	121.0	113.7
Charged:		
Manpower costs	108.6	100.4
Capital schemes	10.3	10.5
Restructuring costs	2.1	2.8
Total employment costs	121.0	113.7

Details of Directors' emoluments are set out in note 13. 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.

	2009	2008
Employees (average number)		
The average monthly number of employees (including Executive Directors) was:		
Water and sewerage	1,227	1,276
Waste management	2,154	2,059
Other	41	42
Group totals	3,422	3,377

The total number of employees at 31 March 2009 was 3,417 (2008 3,388).

13. DIRECTORS' EMOLUMENTS

	2009 £000	2008 £000
Executive Directors:		
Salary	975	875
Performance related bonus payable	257	390
Share-based payments	689	461
Other emoluments	67	63
Payment in lieu of pension provision	95	83
Non-executive Directors	376	358
	2,459	2,230

The cost of share-based payment represents the amount charged to the income statement, as described in note 31.

The aggregate gains on vesting of Directors' share-based awards amounted to a total of £569,000 (2008 £1,231,000).

Total gains made by Directors on the exercise of share options were nil (2008 £36,000).

Total emoluments include £995,000 (2008 £1,283,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2009 retirement benefits were accruing to two Directors under defined benefit pension schemes (2008 two). The accrued pension entitlement at 31 March 2009 under defined benefit schemes of the highest paid Director was £122,000 (2008 £111,000). No pension contributions were payable to defined contribution schemes but one Director received payments in lieu of pension provision.

More detailed information concerning Directors' emoluments (including pensions and the highest paid Director) and share interests is shown in the Directors' remuneration report.

14. GOODWILL

	(Restated note 37) £m
Cost:	
At 1 April 2007	137.5
Recognised on acquisition of subsidiaries	98.4
At 31 March 2008	235.9
Recognised on acquisition of subsidiaries (note 37)	0.6
At 31 March 2009	236.5
Carrying amount:	
At 31 March 2008	235.9
At 31 March 2009	236.5

14. GOODWILL *continued*

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

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

The recoverable amount of the waste management segment is determined from value in use calculations. The key assumptions in those calculations relate to discount rates, cash flows, price increases and for landfill, the compaction rate. Cash flow projections are based on approved budgets and plans for the next five years and beyond this period on long-term growth rates for the waste sector based on UK Gross Domestic Product. The cash flows have been discounted using a pre-tax discount rate of 12.5% which reflects the overall business risks associated with the waste management segment activities.

15. OTHER INTANGIBLE ASSETS

	Customer contracts (Restated note 37) £m	Patents £m	Total (Restated note 37) £m
<i>Acquired intangible assets</i>			
Cost:			
At 1 April 2007	12.5	0.2	12.7
At 31 March 2008	12.5	0.2	12.7
At 31 March 2009	12.5	0.2	12.7
Amortisation:			
At 1 April 2007	4.8	–	4.8
Charge for year	1.3	–	1.3
At 31 March 2008	6.1	–	6.1
Charge for year	1.2	–	1.2
At 31 March 2009	7.3	–	7.3
Carrying amount:			
At 31 March 2008	6.4	0.2	6.6
At 31 March 2009	5.2	0.2	5.4

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

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

16. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings (Restated note 37) £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers (Restated note 37) £m	Landfill restoration £m	Construction in progress (Restated) £m	Total (Restated note 37) £m
Group							
Cost:							
At 1 April 2007	303.5	1,196.9	570.8	1,082.2	43.6	92.2	3,289.2
Arising on acquisitions (restated)	0.9	–	–	9.2	–	–	10.1
Additions	33.1	50.0	1.6	62.6	–	81.5	228.8
Other	–	–	–	–	1.1	–	1.1
Grants and contributions	–	(2.7)	–	(0.1)	–	–	(2.8)
Disposals	–	(0.7)	–	(8.7)	–	–	(9.4)
Transfers/reclassifications (restated)	(5.7)	17.3	13.1	14.3	–	(39.0)	–
At 31 March 2008	331.8	1,260.8	585.5	1,159.5	44.7	134.7	3,517.0
Arising on acquisitions	2.4	–	–	0.7	–	–	3.1
Additions	40.3	53.7	1.7	35.9	–	108.2	239.8
Other (note 30)	–	–	–	–	1.4	–	1.4
Grants and contributions	–	(1.9)	–	–	–	–	(1.9)
Disposals	(0.3)	(0.7)	–	(6.6)	–	–	(7.6)
Transfers/reclassifications	11.9	34.0	10.5	38.9	–	(95.3)	–
At 31 March 2009	386.1	1,345.9	597.7	1,228.4	46.1	147.6	3,751.8
Depreciation:							
At 1 April 2007	115.2	39.2	132.0	438.1	5.8	–	730.3
Charge for year	22.1	16.9	10.3	76.1	3.8	–	129.2
Disposals	–	(0.7)	–	(7.6)	–	–	(8.3)
At 31 March 2008	137.3	55.4	142.3	506.6	9.6	–	851.2
Charge for year	19.5	18.7	10.8	81.5	3.0	–	133.5
Disposals	(0.1)	(0.7)	–	(6.3)	–	–	(7.1)
At 31 March 2009	156.7	73.4	153.1	581.8	12.6	–	977.6
Net book value:							
At 31 March 2008 (restated)	194.5	1,205.4	443.2	652.9	35.1	134.7	2,665.8
At 31 March 2009	229.4	1,272.5	444.6	646.6	33.5	147.6	2,774.2

Of the total depreciation charge of £133.5m (2008 £129.2m), £1.5m (2008 £1.3m) has been charged to capital projects and £132.0m (2008 £127.9m) against profits.

Asset lives and residual values are reviewed annually.

As at 31 March 2008 construction in progress has been re-analysed and comparatives have been restated accordingly.

16. PROPERTY, PLANT AND EQUIPMENT *continued*

Assets held under finance leases included above were:

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Landfill restoration £m	Construction in progress £m	Total £m
Cost:							
At 31 March 2008	–	324.0	432.3	306.8	–	37.8	1,100.9
At 31 March 2009	–	350.1	444.9	335.3	–	14.8	1,145.1
Depreciation:							
At 31 March 2008	–	10.5	66.5	153.8	–	–	230.8
At 31 March 2009	–	15.4	73.8	172.0	–	–	261.2
Net book amount:							
At 31 March 2008	–	313.5	365.8	153.0	–	37.8	870.1
At 31 March 2009	–	334.7	371.1	163.3	–	14.8	883.9

	Fixed and mobile plant, vehicles and computers £m
Company	
Cost:	
At 1 April 2007	0.3
Additions	0.1
Disposals	(0.1)
At 31 March 2008	0.3
At 31 March 2009	0.3
Depreciation:	
At 1 April 2007	0.1
At 31 March 2008	0.1
At 31 March 2009	0.1
Net book value:	
At 31 March 2008	0.2
At 31 March 2009	0.2

Asset lives and residual values are reviewed annually.

17. FINANCIAL INSTRUMENTS BY CATEGORY

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

	Note	Fair value		Amortised cost		Total (Restated note 37) £m
		Derivatives used for hedging £m	Derivatives deemed held for trading (Restated note 37) £m	Loans and receivables £m	Trade receivables and trade payables (Restated note 37) £m	
Group						
31 March 2009						
Financial assets						
Trade and other receivables	21	–	–	–	111.8	111.8
Derivative financial instruments	22	0.2	–	–	–	0.2
Cash and cash deposits	23	–	–	353.3	–	353.3
Total		0.2	–	353.3	111.8	465.3
Financial liabilities						
Borrowings	26	–	–	(2,245.3)	–	(2,245.3)
Derivative financial instruments	22	(17.9)	(2.2)	–	–	(20.1)
Trade and other payables	24	–	–	–	(77.2)	(77.2)
Total		(17.9)	(2.2)	(2,245.3)	(77.2)	(2,342.6)
31 March 2008						
Financial assets						
Trade and other receivables	21	–	–	–	113.4	113.4
Derivative financial instruments	22	4.0	11.9	–	–	15.9
Cash and cash deposits	23	–	–	357.4	–	357.4
Total		4.0	11.9	357.4	113.4	486.7
Financial liabilities						
Borrowings (restated)	26	–	–	(2,120.5)	–	(2,120.5)
Derivative financial instruments	22	(0.5)	(17.0)	–	–	(17.5)
Trade and other payables (restated)	24	–	–	–	(89.6)	(89.6)
Total		(0.5)	(17.0)	(2,120.5)	(89.6)	(2,227.6)
Company						
31 March 2009						
Financial assets						
Cash and cash deposits	23	–	–	168.7	–	168.7
Total		–	–	168.7	–	168.7
Financial liabilities						
Borrowings	26	–	–	(675.5)	–	(675.5)
Derivative financial instruments	22	(1.4)	–	–	–	(1.4)
Trade and other payables	24	–	–	–	(0.1)	(0.1)
Total		(1.4)	–	(675.5)	(0.1)	(677.0)
31 March 2008						
Financial assets						
Derivative financial instruments	22	0.5	–	–	–	0.5
Cash and cash deposits	23	–	–	49.7	–	49.7
Total		0.5	–	49.7	–	50.2
Financial liabilities						
Borrowings	26	–	–	(692.0)	–	(692.0)
Derivative financial instruments	22	–	(17.0)	–	–	(17.0)
Trade and other payables	24	–	–	–	(0.2)	(0.2)
Total		–	(17.0)	(692.0)	(0.2)	(709.2)

18. OTHER NON-CURRENT ASSETS

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Amounts owed by subsidiary undertakings	–	–	271.3	258.5
Amounts owed by joint ventures (note 42)	10.6	9.3	–	–
Other receivables	–	1.1	–	1.1
	10.6	10.4	271.3	259.6

Non-current receivables were due:

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Between 1 and 2 years	0.6	1.4	67.8	66.4
Between 2 and 5 years	2.1	1.4	203.5	193.2
Over 5 years	7.9	7.6	–	–
	10.6	10.4	271.3	259.6

The fair values of trade and other receivables were:

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Amounts owed by subsidiary undertakings	–	–	271.3	258.1
Amounts owed by joint ventures	17.3	15.1	–	–
Other receivables	–	1.1	–	1.1
	17.3	16.2	271.3	259.2

The fair value of amounts owed by joint ventures is based on cash flows using a rate based on the borrowings rate of 5.7% (2008 5.8%). The discount rate is equal to London Interbank Offered Rate plus an allowance to reflect an appropriate credit margin.

The effective interest rate on amounts owed by joint ventures was 15.0% (2008 13.4%).

19. INVESTMENTS

Joint ventures

	Shares £m	Loans £m	Total £m
Group			
At 1 April 2007	1.3	0.1	1.4
Share of profit	0.1	–	0.1
Part repayment of loans	–	(0.1)	(0.1)
At 31 March 2008	1.4	–	1.4
Share of profit	0.8	–	0.8
At 31 March 2009	2.2	–	2.2

Subsidiary undertakings

	£m
Company	
At 1 April 2007	943.8
Additions	101.0
At 31 March 2008	1,044.8
Disposals	(100.0)
At 31 March 2009	944.8

In 2008 the Company invested £100.0m in the preference shares of a subsidiary undertaking to benefit from the efficient deposit of surplus funds to September 2008, at which time the preference shares were sold.

Details of the Group's principal subsidiary and joint venture undertakings are set out in note 38.

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

	Assets		Liabilities		Revenues £m	Profit £m
	Non-current £m	Current £m	Current £m	Non-current £m		
2009						
Lakeside Energy from Waste Holdings Limited	76.4	8.4	(5.8)	(75.2)	3.9	0.8
2008						
Echo South West Limited	–	1.0	(1.0)	–	5.6	0.1
Lakeside Energy from Waste Holdings Limited	69.4	4.3	(1.9)	(68.8)	0.3	0.1
	69.4	5.3	(2.9)	(68.8)	5.9	0.2

The joint venture in Echo South West Limited ceased operation on 31 March 2008.

20. INVENTORIES

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Raw materials and consumables	5.4	5.2	–	–
Work in progress	–	0.1	–	–
Finished goods and goods for resale	0.4	1.3	–	–
	5.8	6.6	–	–

21. TRADE AND OTHER RECEIVABLES – CURRENT

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Trade receivables	154.9	149.6	–	–
Less: provision for impairment of receivables	(43.1)	(36.2)	–	–
Trade receivables	111.8	113.4	–	–
Amounts owed by subsidiary undertakings	–	–	68.9	69.4
Amounts owed by joint ventures (note 42)	–	2.1	–	–
Other receivables	23.3	6.9	1.3	1.0
Other prepayments and accrued income	43.2	42.3	–	–
	178.3	164.7	70.2	70.4

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

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

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

	2009 £m	2008 £m
Group		
Past due 1 – 30 days	25.2	37.6
Past due 31 – 120 days	10.2	18.0
More than 120 days	61.7	52.6

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

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

	2009 £m	2008 £m
At 1 April	36.2	29.7
Provision for receivables impairment	6.7	6.0
Receivables written-off during the year as uncollectible	(5.1)	(3.5)
Cumulative amounts previously excluded from debt	4.9	4.0
Arising on acquisitions	0.4	–
At 31 March	43.1	36.2

Other receivables and prepayments include pre-contract costs of £18.0m (2008 £7.4m).

22. DERIVATIVE FINANCIAL INSTRUMENTS

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
<i>Interest rate swaps – cash flow hedges</i>				
Non-current assets	0.2	4.0	–	0.5
Current liabilities	(1.4)	–	(1.4)	–
Non-current liabilities	(16.5)	(0.5)	–	–
<i>Derivatives deemed held for trading</i>				
Current assets	–	11.9	–	–
Current liabilities	(2.2)	(17.0)	–	(17.0)

The full fair value of a hedging derivative is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months and as a current asset or liability, if the maturity of the hedged item is less than 12 months.

The ineffective portion recognised in the income statement arising from cash flow hedges amounts to a gain of £0.4m (2008 £0.3m).

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50% of Group net borrowings are at fixed rate. At 31 March 2009 57% of Group net borrowings were at fixed rate (2008 58%).

At 31 March 2009 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £760.0m and a weighted average maturity of 2.4 years (2008 £634.0m, with 2.1 years). The weighted average interest rate of the swaps for their nominal amount was 4.5% (2008 4.8%).

At 31 March 2009 the Company had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £50m and a weighted average maturity of 1.0 years (2008 £50.0m, with 2.0 years). The weighted average interest rate of the swaps was 4.5% (2008 4.5%).

In 2009 derivatives held for trading relate to interest rate swaps which no longer qualify for hedge accounting. In 2008 derivatives deemed held for trading related to the Company's investment of £100.0m in the preference shares of a subsidiary undertaking to benefit from the efficient deposit of surplus funds up to September 2008.

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

23. CASH AND CASH DEPOSITS

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Cash at bank and in hand	10.2	14.7	77.0	49.1
Short-term bank deposits	144.6	141.1	80.8	–
Other deposits	198.5	201.6	10.9	0.6
	353.3	357.4	168.7	49.7

The effective interest rate on Group short-term deposits was 1.4% (2008 5.7%) and these deposits have an average maturity of one day.

The effective interest rate on Group other deposits was 2.3% (2008 7.4%) and these deposits have an average maturity of 222 days.

Group other deposits include £16.7m (2008 £10.1m) of restricted funds to settle long-term lease liabilities (note 26) and in 2008 £100.0m of surplus funds deposited up to September 2008.

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

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Cash and cash deposits as above	353.3	357.4	168.7	49.7
Bank overdrafts (note 26)	(12.9)	(18.6)	–	–
	340.4	338.8	168.7	49.7
Less: deposits with a maturity of three months or more (restricted funds)	(18.4)	(111.4)	(0.9)	(0.6)
	322.0	227.4	167.8	49.1

24. TRADE AND OTHER PAYABLES – CURRENT

	Group		Company	
	2009	2008 (Restated note 37)	2009	2008
	£m	£m	£m	£m
Trade payables	77.2	89.6	0.1	0.2
Amounts owed to subsidiary undertakings	–	–	2.4	11.0
Amounts owed to joint venture (note 42)	–	0.2	–	–
Other tax and social security	39.4	45.3	0.3	0.2
Other creditors	7.7	14.8	4.4	7.0
Accruals	42.5	54.1	0.4	0.5
	166.8	204.0	7.6	18.9

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

25. CURRENT TAX LIABILITIES/(RECOVERABLE)

	Group		Company	
	2009	2008	2009	2008
	£m	£m	£m	£m
UK corporation tax	43.2	43.1	(2.4)	(7.1)

26. BORROWINGS

	Group		Company	
	2009	2008 (Restated note 37)	2009	2008
	£m	£m	£m	£m
Current				
Bank overdrafts	12.9	18.6	–	–
Short-term loans	205.0	–	205.0	–
European Investment Bank	14.1	14.1	–	–
Unsecured loan stock notes	0.8	1.4	0.8	1.4
Amounts owed to subsidiary undertakings	–	–	280.2	295.9
	232.8	34.1	486.0	297.3
Obligations under finance leases (restated)	30.1	23.6	–	–
Total current borrowings	262.9	57.7	486.0	297.3
Non-current				
Bank and other loans	507.5	706.4	189.5	394.7
European Investment Bank	287.7	201.8	–	–
	795.2	908.2	189.5	394.7
Obligations under finance leases (restated)	1,187.2	1,154.6	–	–
Total non-current borrowings (note 36)	1,982.4	2,062.8	189.5	394.7
Total borrowings	2,245.3	2,120.5	675.5	692.0

Accrued finance charges arising on obligations under finance leases have been re-analysed between current and non-current amounts and comparatives have been restated accordingly.

26. BORROWINGS *continued*

The fair values of non-current borrowings were:

	2009		2008	
	Book value	Fair value	Book value (Restated note 37)	Fair value (Restated)
	£m	£m	£m	£m
Group				
Bank and other loans	507.5	445.0	706.4	673.1
European Investment Bank	287.7	245.6	201.8	197.3
	795.2	690.6	908.2	870.4
Obligations under finance leases (restated)	1,187.2	1,070.2	1,154.6	1,022.9
	1,982.4	1,760.8	2,062.8	1,893.3
Company				
Bank and other loans	189.5	194.7	394.7	392.4

Where market values are not available, fair values of borrowings have been calculated by discounting expected future cash flows at prevailing interest rates.

The maturity of non-current borrowings was:

	Group		Company	
	2009	2008 (Restated note 37)	2009	2008
	£m	£m	£m	£m
Between 1 and 2 years	233.5	263.4	80.0	205.0
Between 2 and 5 years	206.4	345.1	10.0	90.0
Over 5 years	1,542.5	1,454.3	99.5	99.7
	1,982.4	2,062.8	189.5	394.7

The weighted average maturity of non-current borrowings was 23 years (2008 24 years).

Finance lease liabilities – minimum lease payments:

	Group		Company	
	2009	2008 (Restated note 37)	2009	2008
	£m	£m	£m	£m
Within one year	62.0	76.8	–	–
In the second to fifth years inclusive	319.7	311.6	–	–
After five years	1,970.2	1,977.2	–	–
	2,351.9	2,365.6	–	–
Less: future finance charges	(1,134.6)	(1,187.4)	–	–
	1,217.3	1,178.2	–	–

Included above are accrued finance charges arising on obligations under finance leases totalling £135.9m (2008 £129.8m), of which £13.8m (2008 £8.0m, restated) is repayable within one year.

Within obligations under finance leases, South West Water Limited has utilised finance lease facilities of £180.0m for certain water and sewerage business property, plant and equipment which are secured by bank letters of credit issued by United Kingdom financial institutions. These letters of credit, covering the full period of the finance leases, are renewable between the financial institutions and South West Water Limited at five-yearly intervals, the next being March 2011.

During 2007 the period for repayment of these leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £16.7m at 31 March 2009 (2008 £10.1m), are being held to settle the lease liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

26. BORROWINGS *continued*

The effective interest rates at the balance sheet date and the exposure to interest rate changes and the repricing dates were:

	Effective rate	6 months or less	6–12 months	1–5years	Over 5 years	Total (Restated note 37)
	%	£m	£m	£m	£m	£m
Group						
31 March 2009						
Bank overdrafts	1.5	12.9	–	–	–	12.9
European Investment Bank	2.1	301.8	–	–	–	301.8
Unsecured loan stock notes	1.4	0.8	–	–	–	0.8
Bank and other loans	3.8	295.0	218.0	199.5	–	712.5
Finance leases	4.6	461.5	540.2	124.4	91.2	1,217.3
		1,072.0	758.2	323.9	91.2	2,245.3
Effect of swaps	4.5	(590.0)	90.0	325.0	175.0	–
		482.0	848.2	648.9	266.2	2,245.3
31 March 2008						
Bank overdrafts	6.3	18.6	–	–	–	18.6
European Investment Bank	6.0	215.9	–	–	–	215.9
Unsecured loan stock notes	5.2	1.4	–	–	–	1.4
Bank and other loans	5.7	295.0	211.7	199.7	–	706.4
Finance leases (restated)	4.6	576.8	358.2	153.0	90.2	1,178.2
		1,107.7	569.9	352.7	90.2	2,120.5
Effect of swaps	4.8	(594.0)	–	594.0	–	–
		513.7	569.9	946.7	90.2	2,120.5
Company						
31 March 2009						
Unsecured loan stock notes	1.4	0.8	–	–	–	0.8
Bank and other loans	3.4	295.0	–	99.5	–	394.5
		295.8	–	99.5	–	395.3
Effect of swaps	4.5	(50.0)	50.0	–	–	–
		245.8	50.0	99.5	–	395.3
31 March 2008						
Unsecured loan stock notes	5.2	1.4	–	–	–	1.4
Bank and other loans	6.3	295.0	–	99.7	–	394.7
		296.4	–	99.7	–	396.1
Effect of swaps	4.5	(50.0)	–	50.0	–	–
		246.4	–	149.7	–	396.1

Undrawn committed borrowing facilities:

	Group		Company	
	2009	2008	2009	2008
	£m	£m	£m	£m
Floating rate:				
Expiring within one year	94.0	50.0	80.0	25.0
Expiring after one year	110.0	135.0	–	55.0
	204.0	185.0	80.0	80.0

In addition the Group has short-term uncommitted bank facilities of £80.0m available to the Company or South West Water Limited.

27. OTHER NON-CURRENT LIABILITIES

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Amounts owed to subsidiary undertakings	–	–	8.7	8.7
Other creditors	3.7	4.0	–	–
	3.7	4.0	8.7	8.7

28. RETIREMENT BENEFIT OBLIGATIONS

The Group operates a number of defined benefit pension schemes including a defined contribution section within the main scheme.

The assets of the Group's pension schemes are held in separate trustee administered funds. The trustees of the funds are required to act in the best interest of the funds' beneficiaries. The appointment of schemes' trustees is determined by the schemes' trust documentation. The Group has a policy that one-half of all trustees, other than the Chairman, are nominated by members of the schemes, including pensioners.

Defined contribution schemes

Pension costs for defined contribution schemes were £1.9m (2008 £1.1m).

Defined benefit schemes

Assumptions

The principal actuarial assumptions at 31 March were:

	2009 %	2008 %
Expected return on scheme assets	7.0	7.0
Rate of increase in pensionable pay	3.75	4.4
Rate of increase for current and future pensions	2.75	3.4
Rate used to discount schemes' liabilities	6.5	6.9
Inflation	2.75	3.4

Mortality

Assumptions regarding future mortality experience are set based on actuarial advice in accordance with published statistics and experience. From 31 March 2008 the mortality assumption uses a scheme-specific 'medium cohort' basis.

The average life expectancy in years of a pensioner retiring at age 62 on the balance sheet date is projected at:

	2009	2008
Male	21.9	21.8
Female	25.4	25.3

The average life expectancy in years of a pensioner retiring at age 62, 20 years after the balance sheet date is projected at:

	2009	2008
Male	23.4	23.3
Female	26.5	26.4

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

The sensitivities regarding the principal assumptions used to measure the schemes' liabilities are:

	Change in assumption	Impact on schemes' liabilities
Rate of increase in pensionable pay	+/- 0.5%	+/- 2.0%
Rate of increase in present and future pensions	+/- 0.5%	+/- 5.6%
Rate used to discount schemes' liabilities	+/- 0.5%	+/- 8.6%
Inflation	+/- 0.5%	+/- 8.0%
Life expectancy	+/- 1 year	+/- 2.4%

The amounts recognised in the income statement were:

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Current service cost	(10.2)	(12.9)	(0.8)	(0.9)
Past service cost	(1.1)	(1.1)	-	-
Total included in employment costs	(11.3)	(14.0)	(0.8)	(0.9)
Expected return on pension schemes' assets	22.4	21.0	2.3	1.9
Interest cost on retirement benefit obligations	(24.0)	(18.5)	(2.6)	(1.6)
Total included within net finance costs	(1.6)	2.5	(0.3)	0.3
Total charge	(12.9)	(11.5)	(1.1)	(0.6)

The actual return on schemes' assets was a loss of £79.2m (2008 £23.7m).

The amounts recognised in the statement of recognised income and expense were:

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Actuarial (losses)/gains recognised in the year	(66.8)	5.1	(8.0)	(1.3)

The amounts recognised in the balance sheet were:

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Fair value of schemes' assets	276.4	331.5	29.6	33.9
Present value of defined benefit obligations	(342.4)	(357.8)	(36.9)	(36.8)
Net liability recognised in the balance sheet	(66.0)	(26.3)	(7.3)	(2.9)

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

The schemes' assets and the expected long-term rates of return at the year end were:

	Expected return %	2009 Value £m	Fund %	Expected return %	2008 Value (restated) £m	Fund %
Equities	8.75	128.2	46	8.5	161.7	49
Property/currency	7.9	21.2	8	7.8	30.2	9
Bonds	5.2	96.1	35	4.6	121.7	37
Other	8.75	30.9	11	8.5	17.9	5
		276.4	100		331.5	100

Asset values have been reanalysed to show other assets which principally represent cash contributions received from the Group towards the year-end which are invested during the subsequent financial year. Comparatives have been restated accordingly.

The Company's share of the schemes' assets at the balance sheet date were:

	2009 £m	2008 £m
Equities	13.6	16.7
Property/currency	2.3	3.2
Bonds	10.2	12.2
Other	3.5	1.8
	29.6	33.9

The expected return on schemes' assets is determined by considering the long-term returns and the balance between risk and reward on the various categories of investment assets held. Expected returns on equity and property investments reflect long-term rates of return experienced in the respective markets. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date.

In conjunction with its investment advisers, the trustees have structured the schemes' investments with the objective of balancing investment returns and levels of risk. The asset allocation has three main elements:

- holding of bonds which is expected to be less volatile than most other asset classes and reflects the schemes' liabilities
- a proportion of equities, with fund managers having freedom in making investment decisions to maximise returns
- investment of a relatively small proportion of the schemes' assets (circa 10%) in alternative asset classes which give the potential for gaining higher returns (property and currency).

Equities held by the scheme are spread between the UK and international markets circa 50% each.

The Group provides retirement benefits to some of its former and approximately 42% (2008 49%) of current employees through defined benefit schemes. The level of retirement benefit is principally based on final annual salary earned in employment.

The liabilities of the defined benefit schemes are measured by using the projected unit credit method which is an accrued benefits valuation method in which the scheme liabilities make allowance for projected earnings.

An alternative method of valuation to the projected unit credit method is a solvency basis, which is estimated using the cost of buying-out benefits with a suitable insurer. This amount represents the amount that would be required to settle the schemes liabilities at the balance sheet date rather than the Group continuing to fund the on-going liabilities. The Group estimates the amount required to settle the schemes' liabilities at the balance sheet date was £566m.

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

Movements in the net liability were:

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
At 1 April	(26.3)	(41.2)	(2.9)	(3.4)
Income statement	(12.9)	(11.5)	(1.1)	(0.6)
Statement of recognised income and expenditure	(66.8)	5.1	(8.0)	(1.3)
Regular contributions	1.3	2.3	–	0.5
Other employer contributions	38.7	19.0	4.7	1.9
At 31 March	(66.0)	(26.3)	(7.3)	(2.9)

Movements in the fair value of schemes' assets were:

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
At 1 April	331.5	347.6	33.9	27.0
Expected return on schemes' assets	22.4	21.0	2.3	1.9
Actuarial (losses)/gains	(101.6)	(44.7)	(9.6)	4.0
Members' contributions	0.4	0.3	0.1	–
Benefits paid	(16.3)	(14.0)	(1.8)	(1.4)
Group regular contributions	1.3	2.3	–	0.5
Other employer contributions	38.7	19.0	4.7	1.9
At 31 March	276.4	331.5	29.6	33.9

Movements in the present value of schemes' defined benefit obligations were:

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
At 1 April	(357.8)	(388.8)	(36.8)	(30.4)
Service cost	(11.3)	(14.0)	(0.8)	(0.9)
Interest cost	(24.0)	(18.5)	(2.6)	(1.6)
Actuarial gains/(losses)	34.8	49.8	1.6	(5.3)
Members' contributions	(0.4)	(0.3)	(0.1)	–
Benefits paid	16.3	14.0	1.8	1.4
At 31 March	(342.4)	(357.8)	(36.9)	(36.8)

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.

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

The five-year history of experience adjustments is:

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Group					
Fair value of schemes' assets	276.4	331.5	347.6	317.5	223.8
Present value of defined benefit obligations	(342.4)	(357.8)	(388.8)	(359.2)	(303.6)
Net liability recognised	(66.0)	(26.3)	(41.2)	(41.7)	(79.8)
Experience (losses)/gains on schemes' assets					
Amount (£m)	(101.6)	(44.7)	1.5	34.2	9.8
Percentage of schemes' assets	(36.7)%	(13.5)%	0.4%	10.8%	4.4%
Experience gains/(losses) on defined benefit obligations					
Amount (£m)	34.8	49.8	(2.7)	(37.0)	(7.9)
Percentage of defined benefit obligations	10.2%	13.9%	(0.7)%	(10.3)%	(2.6)%

The cumulative actuarial losses recognised in the Group statement of recognised income and expense at 31 March 2009 were £63.8m (2008 gains of £3.0m).

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Company					
Fair value of schemes' assets	29.6	33.9	27.0	25.4	17.9
Present value of defined benefit obligations	(36.9)	(36.8)	(30.4)	(28.7)	(24.3)
Net liability recognised	(7.3)	(2.9)	(3.4)	(3.3)	(6.4)
Experience (losses)/gains on schemes' assets					
Amount (£m)	(9.6)	4.0	0.1	3.9	0.9
Percentage of schemes' assets	(32.4)%	11.8%	–	15.3%	5.0%
Experience gains/(losses) on defined benefit obligations					
Amount (£m)	1.6	(5.3)	(0.4)	(0.3)	(1.1)
Percentage of defined benefit obligations	4.3%	(14.4)%	(0.1)%	(0.1)%	(4.5)%

The cumulative actuarial losses recognised in the Company statement of recognised income and expense at 31 March 2009 were £6.2m (2008 gains of £1.8m).

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

The Group's current service cost during the year was 17.5% of pensionable earnings (2008 21.7%). The Group's defined benefit schemes were closed to new entrants from 1 April 2008.

In 2008 the Group completed the triennial actuarial valuation of its defined benefit schemes as at 1 April 2007 which resulted in higher future service and deficit recovery contributions. The Group further updated this valuation to 30 September 2008 and has made contributions of £38.7m during the year (2008 £19.0m). The Group monitors funding levels on an annual basis and no further Group regular contributions are expected to be paid to the schemes during the year ending 31 March 2010.

29. DEFERRED TAX

Deferred tax is provided in full on temporary differences under the liability method using a tax rate of 28% (2008 28%).

Movements on deferred tax were:

	Group		Company	
	2009	2008 (Restated note 37)	2009	2008
	£m	£m	£m	£m
Liability/(asset) at 1 April	306.7	313.5	(1.6)	(1.8)
Charged/(credited) to the income statement	36.9	(9.0)	1.0	0.7
(Credited)/charged to equity	(17.9)	1.2	(2.0)	(0.5)
Arising on acquisitions	0.6	1.0	-	-
Liability/(asset) at 31 March	326.3	306.7	(2.6)	(1.6)

Deferred tax assets have been recognised in respect of all temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

All deferred tax assets and liabilities within the same jurisdiction are offset.

29. DEFERRED TAX *continued*

The movements in deferred tax assets and liabilities were:

Group
Deferred tax liabilities

	Accelerated tax depreciation		Other (Restated note 37) £m	Total (Restated note 37) £m
	Owned assets (Restated note 37) £m	Leased assets £m		
At 1 April 2007	310.0	10.0	24.5	344.5
(Credited)/charged to the income statement	(21.3)	5.5	(3.1)	(18.9)
Arising on acquisitions (restated)	0.9	–	0.1	1.0
At 31 March 2008	289.6	15.5	21.5	326.6
Charged/(credited) to the income statement	26.8	0.8	(2.0)	25.6
Arising on acquisitions	0.1	–	0.5	0.6
At 31 March 2009	316.5	16.3	20.0	352.8

Deferred tax assets

	Provisions £m	Retirement benefit obligations	Other £m	Total £m
		£m		
At 1 April 2007	(9.1)	(12.4)	(9.5)	(31.0)
Charged to the income statement	2.5	3.6	3.8	9.9
Charged/(credited) to equity	–	1.4	(0.2)	1.2
At 31 March 2008	(6.6)	(7.4)	(5.9)	(19.9)
Charged to the income statement	1.5	7.6	2.2	11.3
(Credited)/charged to equity	–	(18.7)	0.8	(17.9)
At 31 March 2009	(5.1)	(18.5)	(2.9)	(26.5)
Net deferred tax liability:				
At 31 March 2008				306.7
At 31 March 2009				326.3

Company
Deferred tax assets

	Retirement benefit obligations £m	Other £m	Total £m
Charged to the income statement	0.6	0.1	0.7
Credited to equity	(0.4)	(0.1)	(0.5)
At 31 March 2008	(0.8)	(0.8)	(1.6)
Charged to the income statement	1.0	–	1.0
(Credited)/charged to equity	(2.2)	0.2	(2.0)
At 31 March 2009	(2.0)	(0.6)	(2.6)

29. DEFERRED TAX *continued*

Deferred tax credited/(charged) to equity during the year was:

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Actuarial losses/(gains) on defined benefit schemes	18.7	(1.4)	2.2	0.4
Share-based payments (note 34)	(0.8)	0.2	(0.2)	0.1
	17.9	(1.2)	2.0	0.5

30. PROVISIONS

	Environmental and landfill restoration (Restated note 37) £m	Restructuring £m	Other provisions £m	Total (Restated note 37) £m
Group				
At 1 April 2008 (restated)	100.6	1.5	0.2	102.3
Charged to the income statement	5.7	5.0	–	10.7
Landfill restoration	1.4	–	–	1.4
Utilised during year	(10.2)	(6.2)	–	(16.4)
At 31 March 2009	97.5	0.3	0.2	98.0

The amount charged to the income statement includes £4.5m charged to finance costs as the unwinding of discounts in provisions.

The addition to landfill restoration provision of £1.4m recognised in the year has been matched with an addition to property, plant and equipment.

The analysis of provisions between current and non-current is:

	2009 £m	2008 (Restated note 37) £m
Current	18.8	18.1
Non-current	79.2	84.2
	98.0	102.3

Environmental and landfill restoration provisions are expected to be substantially utilised over the period from 2010 to beyond 2050. The provisions have been established assuming current waste management technology based upon estimated costs at future prices which have been discounted to present value. The restructuring provision related principally to severance costs and will be utilised within one year.

31. SHARE CAPITAL

	2009 £m	2008 £m
Authorised		
429,975,270 ordinary shares of 40.7p each	175.0	175.0

31. SHARE CAPITAL *continued*
Allotted, called up and fully paid

	Number of shares		£m
	Treasury shares	Ordinary shares	
At 1 April 2007			
Ordinary shares of 40.7p each	–	356,123,879	144.9
For consideration of £5.9m, shares purchased and subsequently cancelled		(960,000)	(0.4)
For consideration of £43.4m, shares purchased and held as treasury shares	7,285,008	(7,285,008)	–
For consideration of £1.6m, shares re-issued under the Company's Sharesave Scheme	(873,602)	873,997	–
At 31 March 2008 ordinary shares of 40.7p each	6,411,406	348,752,868	144.5
For consideration of £1.6m, shares re-issued under the Company's Sharesave Scheme	(687,275)	687,275	–
At 31 March 2009 ordinary shares of 40.7p each	5,724,131	349,440,143	144.5

Shares held as treasury shares may be sold or re-issued for any of the Company's share schemes, or cancelled.

Employee share schemes

The Group operates a number of equity-settled share plans for the benefit of employees. Details of each plan are:

i) Sharesave Scheme

An all-employee savings related plan is operated that enables employees, including executive directors, to invest up to a maximum of £250 per month for three or five years. These savings can then be used to buy ordinary shares at a price set at a 20% discount to the market value at the start of the savings period at the third, fifth or seventh year anniversary of the option being granted. Options expire six months following the exercise date and, except for certain specific circumstances such as redundancy, lapse if the employee leaves the Group before the option exercise period commences.

Outstanding options to subscribe for ordinary shares of 40.7p each under the Company's share option schemes are:

Date granted and subscription price fully paid	Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March	
		2009	2008
4 July 2001	2004 – 2008	–	31
9 July 2002	2005 – 2009	37	40
8 July 2003	2006 – 2010	63	339
6 July 2004	2007 – 2011	278	314
5 July 2005	2008 – 2012	270	633
4 July 2006	2009 – 2013	559	612
3 July 2007	2010 – 2014	472	550
8 July 2008	2011 – 2015	464	–
		2,143	2,519

At 31 March 2009 there were 1,299 participants in the Sharesave Scheme (2008 1,281).

31. SHARE CAPITAL *continued***Employee share schemes** *continued**i) Sharesave Scheme (continued)*

The number and weighted average exercise price of Sharesave options are:

	2009		2008	
	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	2,519	322	2,925	244
Granted	495	517	580	522
Exercised	(687)	228	(875)	189
Expired	(184)	423	(111)	337
At 31 March	2,143	389	2,519	322

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 594p (2008 606p). The options outstanding at 31 March 2009 had a weighted average exercise price of 389p (2008 322p) and a weighted average remaining contractual life of 1.9 years (2008 2.0 years).

The aggregate fair value of Sharesave options granted during the year was £0.8m (2008 £0.9m), determined using the Black-Scholes valuation model. The significant inputs into the valuation model at the date of issue of the options were:

	2009	2008
Weighted average share price	646p	652p
Weighted average exercise price	517p	522p
Expected volatility	21.3%	18.7%
Expected life	3.8 years	3.9 years
Risk-free rate	4.9%	5.3%
Expected dividend yield	3.3%	3.6%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

31. SHARE CAPITAL *continued*
Employee share schemes *continued*
ii) Restricted Share Plan

Under this plan executive directors and senior management receive a conditional award of ordinary shares in the Company. The eventual number of shares, if any, which vest is dependent upon the achievement of the performance condition of the plan over the restricted period, being not less than three years.

The number and weighted average price of shares in the Restricted Share Plan are:

	2009		2008	
	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	684	449	1,498	346
Vested	(233)	357	(666)	270
Lapsed	(119)	494	(148)	304
At 31 March	332	498	684	449

The plan was succeeded in 2007 by the Performance and Co-investment Plan and only the 2006 award remains at 31 March 2009. None of the 2006 award will vest in September 2009 as the performance criterion has not been met.

The awards outstanding at 31 March 2009 had an average price of 498p (2008 449p) and a remaining contractual life of 0.5 years (2008 1.1 years). The fair value of awards was determined using a Monte-Carlo simulation model.

iii) 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 dependant upon the achievement of conditions of the plan over the restricted period, being not less than three years.

The number and price of shares in the Performance and Co-investment Plan are:

	2009		2008	
	Number of ordinary shares (thousands)	Exercise price per share (p)	Number of ordinary shares (thousands)	exercise price per share (p)
At 1 April	436	557	–	–
Granted	450	638	436	557
At 31 March	886	598	436	557

The awards outstanding at 31 March 2009 had a weighted exercise price of 598p (2008 557p) and a weighted average remaining contractual life of 1.9 years (2008 2.5 years).

31. SHARE CAPITAL *continued***Employee share schemes** *continued**iii) Performance and Co-investment Plan (continued)*

The aggregate fair value of awards granted during the year was £1.8m (2008 £1.1m) determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2009	2008
Weighted average share price	638p	557p
Expected volatility	21.3%	18.7%
Risk-free rate	4.9%	5.3%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

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 Incentive Bonus Plan are:

	2009		2008	
	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	368	465	406	350
Granted	153	630	124	600
Vested	(163)	368	(162)	320
At 31 March	358	575	368	465

The awards outstanding at 31 March 2009 had a weighted average exercise price of 575p (2008 465p) and a weighted average remaining contractual life of 1.4 years (2008 1.3 years). The Company's share price at the date of the awards ranged from 484p to 620p.

The aggregate fair value of awards granted during the year was £0.9m (2008 £0.7m), determined from market value. No option pricing methodology is applied since dividends declared on the shares are receivable by the participants in the scheme.

Further details of the plans and options granted to Directors, included above, are shown in the Directors' remuneration report.

32. SHARE PREMIUM ACCOUNT

	£m
At 1 April 2007	11.7
At 31 March 2008	11.7
At 31 March 2009	11.7

33. CAPITAL REDEMPTION RESERVE

	£m
At 1 April 2007	143.8
Own shares purchased and subsequently cancelled	0.4
At 31 March 2008	144.2
At 31 March 2009	144.2

34. RETAINED EARNINGS AND OTHER RESERVES

	Own shares £m	Hedging reserve £m	Retained earnings £m	Total £m
Group				
At 1 April 2007	(7.2)	15.8	318.2	326.8
Profit for year	–	–	133.6	133.6
Other recognised income and expense for the year	–	(12.7)	3.7	(9.0)
Dividends paid relating to 2007	–	–	(65.6)	(65.6)
Credit to equity in respect of share-based payments	–	–	1.9	1.9
Charge in respect of share options vesting	3.0	–	(3.0)	–
Deferred tax in respect of share-based payments	–	–	0.2	0.2
Own shares purchased and subsequently cancelled	–	–	(5.9)	(5.9)
Own shares purchased and held as treasury shares	–	–	(43.4)	(43.4)
Proceeds from treasury shares re-issued	–	–	1.6	1.6
Own shares acquired by the Pennon Employee Share Trust	(0.3)	–	–	(0.3)
At 31 March 2008	(4.5)	3.1	341.3	339.9
Profit for year	–	–	91.5	91.5
Other recognised income and expense for the year	–	(21.0)	(48.1)	(69.1)
Dividends paid relating to 2008	–	–	(69.1)	(69.1)
Credit to equity in respect of share-based payments	–	–	2.7	2.7
Charge in respect of share options vesting	1.5	–	(1.5)	–
Deferred tax in respect of share-based payments	–	–	(0.8)	(0.8)
Proceeds from treasury shares re-issued	–	–	1.6	1.6
At 31 March 2009	(3.0)	(17.9)	317.6	296.7

The own shares reserve represents the cost of ordinary shares in Pennon Group Plc issued to or purchased in the market and held by the Pennon Employee Share Trust to satisfy awards under the Group's Restricted Share Plan and Incentive Bonus Plan.

During 2008 the trustees of the Pennon Employee Share Trust acquired 57,967 of the Company's ordinary shares, financed through non interest-bearing advances made by sponsoring group companies.

The market value of the 810,000 ordinary shares (2008 1,210,000 ordinary shares) held by the trust at 31 March 2009 was £3.3m (2008 £7.8m).

34. RETAINED EARNINGS AND OTHER RESERVES *continued*

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 2007	1.7	433.5	435.2
Profit for the year	–	74.2	74.2
Other recognised income and expense for the year	(1.2)	(0.9)	(2.1)
Dividends paid relating to 2007	–	(65.6)	(65.6)
Credit to equity in respect of share-based payments	–	0.6	0.6
Charge in respect of share options vesting	–	(0.7)	(0.7)
Deferred tax in respect of share-based payments	–	0.1	0.1
Own shares purchased and subsequently cancelled	–	(5.9)	(5.9)
Own shares purchased and held as treasury shares	–	(43.4)	(43.4)
Proceeds from treasury shares re-issued	–	1.6	1.6
At 31 March 2008	0.5	393.5	394.0
Profit for the year	–	140.1	140.1
Other recognised income and expense for the year	(1.9)	(5.8)	(7.7)
Dividends paid relating to 2008	–	(69.1)	(69.1)
Credit to equity in respect of share-based payments	–	0.6	0.6
Deferred tax in respect of share-based payments	–	(0.2)	(0.2)
Proceeds from treasury shares re-issued	–	1.6	1.6
At 31 March 2009	(1.4)	460.7	459.3

35. CASH FLOW FROM OPERATING ACTIVITIES

Reconciliation of profit for the year to cash generated from operations:

Cash generated from operations

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Continuing operations				
Profit for the year	91.5	133.6	140.1	74.2
Adjustments for:				
Employee share schemes	2.7	1.9	0.6	0.6
Profit on disposal of property, plant and equipment	(2.1)	–	–	–
Depreciation charge	132.0	127.9	–	–
Amortisation of intangible assets	1.2	1.3	–	–
Share of post-tax profit from joint venture	(0.8)	(0.2)	–	–
Finance income	(43.5)	(42.0)	(24.3)	(22.0)
Finance costs	138.0	129.4	31.8	36.5
Dividends receivable	–	–	(128.6)	(85.7)
Taxation	67.6	16.0	(0.3)	(3.9)
Changes in working capital (excluding the effect of acquisition of subsidiaries):				
Decrease/(increase) in inventories	0.8	(0.6)	–	–
Increase in trade and other receivables	(15.4)	(29.9)	(12.1)	(103.0)
(Decrease)/increase in trade and other payables	(24.5)	12.5	(9.1)	(3.8)
Decrease in retirement benefit obligations from contributions	(28.7)	(7.3)	(3.9)	(1.8)
Decrease in provisions	(10.2)	(5.5)	–	–
Cash generated/(outflow) from operations	308.6	337.1	(5.8)	(108.9)

36. NET BORROWINGS

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Cash and cash deposits	353.3	357.4	168.7	49.7
Borrowings – current				
Bank overdrafts	(12.9)	(18.6)	–	–
Other current borrowings	(219.9)	(15.5)	(205.8)	(1.4)
Finance lease obligations	(30.1)	(23.6)	–	–
Amounts owed to subsidiary undertakings	–	–	(280.2)	(295.9)
Total current borrowings	(262.9)	(57.7)	(486.0)	(297.3)
Borrowings – non-current				
Bank and other loans	(507.5)	(706.4)	(189.5)	(394.7)
Other non-current borrowings	(287.7)	(201.8)	–	–
Finance lease obligations	(1,187.2)	(1,154.6)	–	–
Total non-current borrowings	(1,982.4)	(2,062.8)	(189.5)	(394.7)
Total net borrowings	(1,892.0)	(1,763.1)	(506.8)	(642.3)

Accrued finance charges arising on obligations under finance leases have been re-analysed between current and non-current amounts. Comparatives have been restated accordingly.

37. ACQUISITIONS

On 4 April 2008 the entire issued share capital of Handside Limited was purchased by Viridor Waste Management Limited for a cash consideration of £4.7m, including costs of £0.3m. The acquisition has been accounted for using the acquisition method.

Handside Limited contributed revenues of £1.2m and broke-even for the period from 4 April 2008 to 31 March 2009. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the provisional fair value adjustments.

The residual excess over the net assets acquired has been recognised as goodwill.

	Book value £m	Fair value adjustment £m	Fair value £m
Property, plant and equipment	0.9	2.2	3.1
Receivables	0.5	0.6	1.1
Payables	(0.3)	(0.3)	(0.6)
Taxation – current	(0.2)	–	(0.2)
Taxation – deferred	(0.1)	(0.5)	(0.6)
Cash and cash deposits	1.3	–	1.3
Net assets acquired	2.1	2.0	4.1
Goodwill			0.6
Total consideration			4.7
Satisfied by:			
Cash			4.4
Directly attributable costs			0.3
			4.7
Net cash outflow arising on acquisition			
Cash consideration			4.7
Cash and cash deposits acquired			(1.3)
			3.4

37. ACQUISITIONS *continued***Restatements at 31 March 2008**

At 31 March 2008 the accounting for the acquisition of Grosvenor Waste Management Limited (renamed Viridor Resource Management Limited) was provisional. Completion of the accounting for the acquisition has resulted in an increase in goodwill of £2.2m, a decrease in intangible assets of £2.6m, a decrease in property, plant and equipment of £0.8m, a decrease in borrowings of £0.7m, an increase in provisions of £2.3m and a £1.8m decrease in trade and other payables with an additional creditor for current tax of £0.1m and a £1.1m reduction in deferred tax. Comparative figures at 31 March 2008 have been restated accordingly.

At 31 March 2008 the accounting for the acquisition of Ledge 806 Limited (renamed Viridor Electrical Recycling (Holdings) Limited), the holding company of Shore Recycling Limited, was provisional. Completion of the accounting for the acquisition has resulted in a decrease in goodwill of £0.9m, an increase in property, plant and equipment of £3.6m, an increase in provisions of £0.6m and a £1.6m increase in trade and other payables with a reduction in the creditor for current tax of £0.1m and a £0.6m increase in deferred tax. Comparative figures at 31 March 2008 have been restated accordingly.

These restatements have had no impact on profit for the year or retained earnings.

Acquisitions since 31 March 2009

On 8 April 2009 the entire issued share capital of Greater Manchester Waste Limited (now renamed Viridor Waste (Greater Manchester) Limited) was purchased by Viridor Waste Management Limited for a nominal consideration. The acquisition will be accounted for using the acquisition method. No goodwill arises on the acquisition. The majority of the cash balances on acquisition of £6.2m will be used to fund the retirement benefit obligations of the acquired business. This acquisition will be accounted for in the 2009/10 financial year.

On 5 June 2009 the entire issued share capital of London Recycling Limited (now renamed Viridor London Recycling Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £11.0m, excluding costs. The acquisition will be accounted for using the acquisition method. Provisional goodwill of £8.5m will be capitalised. This acquisition will be accounted for in the 2009/10 financial year.

38. PRINCIPAL SUBSIDIARY AND JOINT VENTURE UNDERTAKINGS AT 31 MARCH 2009**Country of incorporation, registration and principal operations****Water and sewerage**

South West Water Limited*	England
South West Water Finance Plc	England

Waste management

Viridor Limited*	England
Viridor Waste Limited	England
Viridor Waste Exeter Limited	England
Viridor Waste Management Limited	England
Viridor EnviroScot Limited	Scotland
Viridor Glass Recycling Limited	England
Viridor Parkwood Holdings Limited	British Virgin Islands †
Parkwood Group Limited	England
Viridor Waste (Sheffield) Limited	England
Viridor Resource Management Limited	England
Viridor Waste Kent Limited	England
Viridor Waste (Landfill Restoration) Limited	England
Viridor Waste (Somerset) Limited	England
Viridor Waste (Thames) Limited	England
Viridor Waste Suffolk Limited	England
Viridor Waste (West Sussex) Limited	England

Other

Peninsula Insurance Limited*	Guernsey
------------------------------	----------

* Indicates the shares are held directly by Pennon Group Plc, the Company.

† Operations are carried out in England.

The subsidiary undertakings are wholly-owned and all shares in issue are ordinary shares. All companies above are consolidated in the Group financial statements.

Joint ventures

All joint ventures and the subsidiary undertakings of Lakeside Energy from Waste Holdings Limited and Viridor Laing (Greater Manchester) Holdings Limited are incorporated and registered in England which is also their country of operation.

	Share capital in issue	Percentage held	Activity
Lakeside Energy from Waste Holdings Limited	1,000,000 A ordinary shares	–	
	1,000,000 B ordinary shares	100%	
Lakeside Energy from Waste Limited			Waste management
Shares in Lakeside Energy from Waste Holdings Limited are held by Viridor Waste Management Limited.			
Viridor Laing (Greater Manchester) Holdings Limited	2 ordinary shares	50%	
Viridor Laing (Greater Manchester) Limited			Waste management

Shares in Viridor Laing (Greater Manchester) Holdings Limited are held by Viridor Waste Management Limited.

39. OPERATING LEASE COMMITMENTS

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
The future aggregate minimum lease payments under non-cancellable operating leases are:				
Within one year	7.2	7.2	–	–
Later than one year and less than five years	19.1	18.8	–	–
After five years	81.2	91.7	–	–
	107.5	117.7	–	–

The Group leases various offices, depots and workshops under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. Property leases are negotiated for an average term of 25 years and rentals are reviewed on average at five yearly intervals.

The Group also leases plant and machinery under non-cancellable operating lease agreements.

40. CONTINGENT LIABILITIES

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	–	–	452.4	344.3
Contractors' claims on capital schemes	1.3	2.3	–	–
Performance bonds	96.6	87.4	96.6	87.4
Letters of credit	–	2.0	–	–
Other	6.9	6.9	6.9	6.9
	104.8	98.6	555.9	438.6

Guarantees in respect of performance bonds are entered into in the normal course of business. No liability is expected to arise in respect of the guarantees.

Viridor Waste Management Limited has given a commitment to supply 200,000 tonnes of waste per annum (or pay market price based compensation) to the energy from waste plant of the joint venture in Lakeside Energy from Waste Holdings Limited. The Directors consider that the committed waste volume will be available in the ordinary course of business.

Other contingent liabilities relate to a possible obligation to pay further consideration in respect of a previously acquired business when the outcome of planning applications is known.

41. CAPITAL COMMITMENTS

	Group		Company	
	2009 £m	2008 £m	2009 £m	2008 £m
Contracted but not provided	85.3	91.2	–	–
Share of commitment contracted but not provided by joint ventures	6.1	13.3	–	–
	91.4	104.5	–	–

42. RELATED PARTY TRANSACTIONS

During the year, Group companies entered into the following transactions with related parties who are not members of the Group:

	2009 £m	2008 £m
<i>Sales of goods and services</i>		
Echo South West Limited	–	2.7
<i>Purchase of goods and services</i>		
Echo South West Limited	–	10.3

Year end balances

	2009 £m	2008 £m
<i>Receivables due from related parties</i>		
Echo South West Limited	–	2.1
Lakeside Energy from Waste Limited	10.6	9.3
	10.6	11.4
<i>Payables due to related parties</i>		
Echo South West Limited	–	0.2

The £10.6m relates to loans included within receivables due for repayment in instalments between 2010 and 2030. Interest is charged at 15%.

Company

The following transactions with subsidiary undertakings occurred in the year.

	2009 £m	2008 £m
Sales of goods and services (management fees)	7.3	6.8
Purchase of goods and services (support services)	0.5	0.5
Interest receivable (loans)	17.6	15.8
Interest payable (short-term funding)	1.7	0.8
Dividends received	128.6	85.7

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 that would also be available to unrelated third parties.

Year end balances

	2009 £m	2008 £m
<i>Receivables due from subsidiary undertakings</i>		
Loans	339.1	326.9
Trading balances	0.9	0.8

Interest on £104.8m of the loans is charged at a fixed rate of 5.0% and on £76.2m at a fixed rate of 6.0% (2008 £66.2m, 6.0%). Interest on the balance of the loans is charged at Barclays Bank Plc base rate +1% (2008 Barclays Bank Plc base rate +1%). The loans are repayable in instalments over the period 2010 to 2013. During the year £0.1m (2008 £0.6m) was provided in respect of loans to subsidiaries not expected to be repaid.

42. RELATED PARTY TRANSACTIONS *continued*

	2009 £m	2008 £m
<i>Payables due to subsidiary undertakings</i>		
Loans	280.2	295.9
Trading balances	11.1	19.7

The loans from subsidiary undertakings are unsecured and interest-free without any terms for repayment.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Income statement					
Revenue	952.9	875.0	748.3	645.7	551.4
Underlying operating profit	259.0	242.1	202.1	176.7	152.3
Net finance costs	(94.5)	(87.4)	(69.2)	(64.3)	(62.0)
Share of profit in joint ventures	0.8	0.2	0.3	0.1	0.1
Underlying profit before tax and exceptional items	165.3	154.9	133.2	112.5	90.4
Non-underlying and exceptional items (before tax)	(6.2)	(5.3)	(2.1)	(58.4)	(1.3)
Taxation	(67.6)	(16.0)	(37.2)	(16.3)	(23.5)
Profit for the year	91.5	133.6	93.9	37.8	65.6
Dividends proposed	73.4	69.1	65.6	61.0	55.1
Underlying earnings per share (basic):					
<i>From continuing operations</i>					
Earnings per share	26.3p	38.2p	26.5p	9.9p	16.0p
Non-underlying and exceptional items (net of tax)	1.3p	1.3p	0.6p	10.4p	1.7p
Deferred tax	10.6p	(2.6p)	3.8p	5.3p	4.1p
Underlying earnings per share	38.2p	36.9p	30.9p	25.6p	21.8p
Declared dividends per share	21.0p	19.81p	18.55p	17.2p	14.3p
	2009 £m	2008 (Restated note 37) £m	2007 £m	2006 £m	2005 £m
Capital expenditure					
Acquisitions	3.4	89.0	37.0	45.8	30.8
Property, plant and equipment	239.8	228.8	245.1	249.7	181.0
Balance sheet					
Non-current assets	3,029.1	2,924.1	2,728.6	2,527.5	2,292.2
Net current assets/(liabilities)	42.1	200.7	(56.7)	(61.2)	193.1
Non-current liabilities	(2,474.1)	(2,484.5)	(2,044.7)	(1,885.1)	(1,776.4)
Net assets	597.1	640.3	627.2	581.2	708.9
Number of employees (average for year)					
Water and sewerage business	1,227	1,276	1,301	1,299	1,336
Waste management	2,154	2,059	1,686	1,388	1,169
Other businesses	41	42	38	35	39
	3,422	3,377	3,025	2,722	2,544

FINANCIAL CALENDAR

Financial year end	31 March
Twentieth Annual General Meeting	30 July 2009
Ex-dividend date for 2009 Final dividend	12 August 2009*
Record date for 2009 Final dividend	14 August 2009*
2009 Final dividend payable	7 October 2009*
2009 Half yearly financial report announcement	November 2009
2010 Interim dividend payable	April 2010
2010 Preliminary results announcement	May 2010
Twenty-first Annual General Meeting	July 2010
2010 Final dividend payable	October 2010

* these dates are subject to obtaining shareholder approval at the 2009 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2009.

SHAREHOLDERS' ANALYSIS AT 31 MARCH 2009

Range	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1 - 100	2,419	10.38	0.03
101 - 1,000	9,450	40.54	1.37
1,001 - 5,000	9,868	42.33	5.86
5,001-50,000	1,226	5.26	3.63
50,001 - 100,000	88	0.38	1.81
100,001 - HIGHEST	260	1.11	87.30
	22,311	100.00	100.00
Individuals	20,561	88.20	8.60
Companies	198	0.85	3.88
Trust companies (pension funds etc)	2	0.01	0.00
Banks and nominees	2,550	10.94	87.52
	23,311	100.00	100.00

SUBSTANTIAL SHAREHOLDINGS

At 15 June 2009, interests in the issued share capital had been notified pursuant to the Financial Service Authority's Disclosure and Transparency Rules:

Invesco Ltd	12.12%
Ameriprise Financial Inc	10.10%
Pictet Asset Management SA	7.32%
Legal & General Group Plc	6.23%
AXA SA and its Group Companies	6.21%

Further shareholder information may be found at: pennon-group.co.uk

SHAREHOLDER SERVICES

Share dealing service

The low-cost share dealing service offered by Stocktrade enables shareholders to buy and sell shares in the Company on a low-cost basis and to make regular investments in the Company. Telephone Stocktrade on 0845 601 0995 and quote: LOW C0107. Commission is 0.5% (subject to a minimum charge of £15) to £10,000, then 0.2% thereafter.

Share gift service

Through Sharegift, an independent charity share donation scheme, shareholders who only have a small number of shares with a value that makes it uneconomical to sell them, can donate such shares to charity. Donations can be made by completion of a simple share transfer form which is available from the Company's Registrars, Equiniti.

Individual Savings Accounts

By holding their shares in the Company in an Individual Savings Account (ISA), shareholders may gain tax advantages.

Scrip Dividend Alternative

Directors propose to introduce a Scrip Dividend Alternative to enable shareholders to elect to receive all, or part, of their dividends in the form of shares instead of cash. The Scrip Dividend Alternative is intended to replace the Dividend Re-investment Plan which shareholders were previously invited to participate in. By electing for the Scrip Dividend Alternatives, shareholders can increase their shareholding in the Company without incurring stamp duty or dealing expenses. Full details of the Scrip Dividend Alternative, including how to join, will be sent out to shareholders on 28 August 2009, subject to obtaining shareholder approval at the Annual General Meeting on 30 July 2009.

Online portfolio service

The online portfolio service provided by Equiniti gives shareholders access to more information on their investments. Details of the portfolio service are available from Equiniti online at shareview.co.uk

Electronic communications

A resolution was passed by the Company which allows it to communicate with its shareholders by means of its website. As a consequence, shareholders will only receive copies of the Annual Report and other shareholder communications by post if they have specifically requested to do so or if they became a shareholder after 3 January 2008.

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 via the shareview service provided by Equiniti, online at shareview.co.uk and selecting 'e-mail' as the preferred format for shareholder communications.

The Pennon website

The Pennon website at pennon-group.co.uk provides news and details of the Group's activities plus links to its business websites. The Investor Information section contains up-to-date information for shareholders including comprehensive share price information, financial results, dividend payment dates and amounts, and Stock Exchange announcements. There is also a comprehensive share services section on the website which includes information on buying, selling and transferring shares, and the action to be undertaken by shareholders in the event of a change in personal circumstances, for example, a change of address.

'Brokers' contacting shareholders

A number of companies, including the Company, have become aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters which imply a connection to the company concerned. These are typically from overseas based 'brokers' who target UK shareholders offering to sell them what can turn out to be worthless or high risk shares in US or UK investments. They can be very persistent and extremely persuasive and a 2006 survey by the Financial Services Authority (FSA) has reported that the average amount lost by investors

is around £20,000. It is not just the novice investor who has been duped in this way; many of the victims had been successfully investing for several years. Shareholders are advised to be wary of any unsolicited advice, offers to buy shares at a discount or offers of free reports into the Company. If you are contacted in this manner, please make sure you obtain the correct name of the person and organisation and where they are based. You should also check that they are properly authorised by the FSA before getting involved. You can check online at fsa.gov.uk/register/home.do. If you deal with an unauthorised firm, you would not be eligible to receive any payment under the Financial Services Compensation Scheme. The FSA also maintains on its website a list of unauthorised overseas firms who are targeting, or have targeted, UK investors and any approach from such organisations should be reported to the FSA so that this list can be kept up-to-date and any other appropriate action can be considered. The FSA can be contacted by completing an online form at fsa.gov.uk/pages/Doing/Regulated/Law/Alerts/overseas.shtml. It would be helpful if you could also inform our Registrars on 0871 384 2047* who will record the details and pass them on to the Company and liaise with the FSA. Details of any share dealing facilities that the Company endorses will be included in Company mailings only. More detailed information on this or similar activity can be found on the FSA website moneymadeclear.fsa.gov.uk

**Calls to this number are currently charged at 8p per minute from a BT landline. Other telephony providers' costs may vary.*

