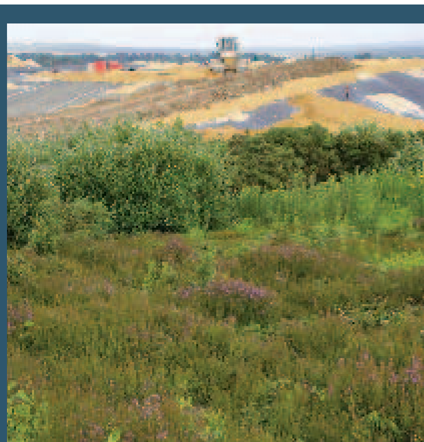
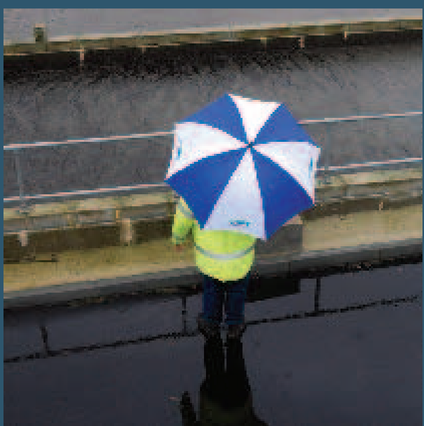
PENNON GROUP PLC

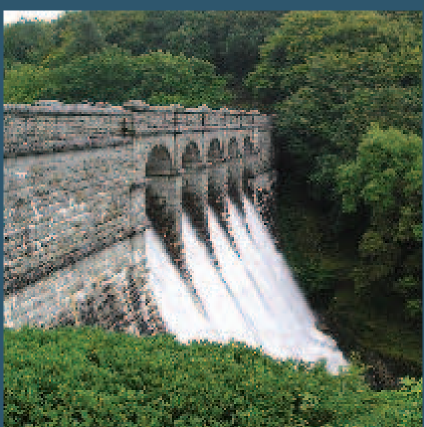
ANNUAL REPORT & ACCOUNTS 2010

CONTENTS

The Group's key performance indicators are shown throughout the Business Review by: KPI



Revenue up

11.6% to £1,069 million

Underlying earnings per share up

9.2% to 41.6p

Underlying profit before tax up

14.2% to £189 million

Dividend per share up

7.4% to 22.55p

PENNON GROUP OPERATES AND INVESTS IN WATER AND SEWERAGE SERVICES, WASTE MANAGEMENT, RECYCLING AND RENEWABLE ENERGY. IT HAS ASSETS OF AROUND £3.9 BILLION AND A WORKFORCE OF OVER 4,100 PEOPLE.

Statutory results are:

- **Profit before tax £184 million (2008/09 £159 million)**
- **Earnings per share 39.9p (2008/09 25.8p)**

A reconciliation to underlying measures of performance is given on page 5.

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, recycling 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:

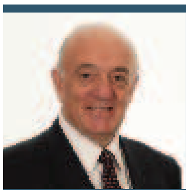
- **the impact of its operations and activities on the community and the environment**
- **the maintenance of high standards of business conduct**
- **the need to foster business relationships with suppliers, customers and other key persons important to the success of the Group**
- **the likely long-term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

Pennon Group's business is operated through two subsidiaries:

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

CHAIRMAN'S STATEMENT

Another excellent year with significant achievements despite difficult economic conditions



KEN HARVEY
CHAIRMAN
PENNON GROUP PLC

BUSINESS OVERVIEW

I am pleased to say that it has been another excellent year for Pennon Group with significant achievements by both businesses, despite difficult economic conditions.

South West Water has delivered strong operational results and has outperformed the operating cost efficiency and financing targets set by Ofwat for the K4 period (2005-2010).

Viridor has once again delivered a very strong financial performance. The Greater Manchester Waste PFI contract, the Lakeside Energy from Waste (EfW) project and the latest acquisitions are further major steps forward in the successful evolution of Viridor.

The continuing prudent approach to financing in the Group, combined with a dedicated Board, management and staff, has also significantly contributed to our success.

FINANCIAL OVERVIEW

Group revenue increased by 11.6% to £1,068.9 million, exceeding £1 billion for the first time. Underlying* profit before tax increased by 14.2% to £189.1 million and underlying* earnings per share increased by 9.2% to 41.6p. The Group also has a strong liquidity and funding position.

South West Water's Regulatory Capital Value (RCV) grew by 31% over the K4 (2005-2010) period to £2.6 billion by March 2010, the highest percentage increase for any quoted UK water company. Viridor's underlying* profit before tax was up by 34.8%, building on the growth achieved by the company over the last eight years.

* Underlying measures are defined in the Pennon Group financial performance section on page 5

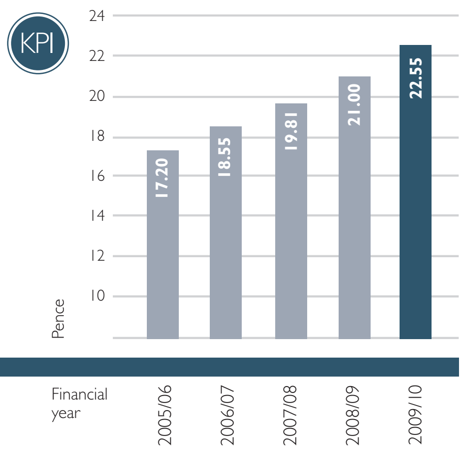
DIVIDEND

The Board is recommending to shareholders a final dividend per share of 15.60p, a 9.5% increase on last year's final dividend. This represents a full year dividend of 22.55p which is an increase of 7.4% compared with 2008/09 reflecting RPI of 4.4% to March 2010. We have therefore delivered the policy to increase dividends from 2005/06 by 3% per annum above inflation.

Following the setting of price limits for South West Water by Ofwat for delivery of the K5 (2010-2015) regulatory contract and the expectation that Viridor will continue to deliver strong long-term growth, the Board has reviewed its dividend policy and is pleased to announce that it intends to enhance its progressive dividend policy to 4% per annum real increases from 2010/11 to at least until the end of 2014/15.

Dividends have increased over the last five years as follows:

DIVIDENDS PER ORDINARY SHARE



BUSINESS PERFORMANCE

South West Water increased its revenue in the year by 2.9% and profit before tax was up by 8.7%. The operating cost efficiency target set by Ofwat for K4 was achieved in 2008/09, ahead of schedule. The company has accepted Ofwat's Final Determination for the setting of price limits for the K5 period. Notwithstanding the lower returns envisaged by Ofwat's Final Determination and the impact of current economic conditions which represent a very tough challenge for South West Water, the company is determined to achieve additional efficiencies despite having already delivered substantial efficiencies over the last two decades.

Viridor has yet again delivered a strong financial performance in difficult market conditions with revenue up by 18.7% and profit before tax up by 34.8%. The company expects to continue to deliver long-term growth through successfully leading the way in exploiting opportunities arising from the Government's targets for recycling, landfill diversion and renewable energy.

Plastics, waste electrical and electronic equipment (WEEE) and paper processing in particular are a growing part of Viridor's recycling business. These recycling activities were enhanced in the year with two acquisitions: Intercontinental Recycling Limited which processes plastics into pellet or flake form and London Recycling Limited with WEEE and paper processing facilities.

I am also pleased to say that the Greater Manchester PFI waste and renewables contract and another major scheme, the Lakeside EfW plant joint venture at Colnbrook, near Heathrow, are now operational and trading profitably.

HEALTH & SAFETY

Ensuring the health and safety of all our employees continues to be central to our ethos as a responsible Group. The Corporate Responsibility Committee and the Board pay particular attention to ensuring that we continually strive to improve occupational health and safety performance. We are therefore very disappointed to report that last year our recorded number of incidents in Viridor increased. Where incidents do occur they are fully investigated and every effort is made to ensure that they cannot be repeated through, in particular, raising the level of training and support available to staff and reinforcing strong positive attitudes to health and safety at all levels in the Group.

GOVERNANCE

We operate businesses which can and do have a material impact on the environment. We believe that a responsible approach to environmental, social and governance (ESG) matters and our sustainable practices not only benefit the communities in which we operate, but also enable our businesses to be more successful. This year we have set out in full in this Annual Report our Corporate Responsibility Report which demonstrates our commitment to ESG and the improvements we have made in protecting the environment, carbon capture, energy savings and resource recovery which all contribute to a more sustainable future for everyone. We also take into account the views of our shareholders and major institutional groups on what they regard to be the key governance issues in reviewing annually our practices, policies and procedures. This ensures that we continue to have a strong and appropriately experienced Board with governance structures in place which can successfully respond to the challenges we face in the best interests of our shareholders and other stakeholders.

OUR PEOPLE

We fully recognise that the Group's success is due to the quality of the staff and their support and commitment.

I once again express my personal thanks to all members of staff for their continuing dedication and commitment particularly as we continue to implement further efficiences and develop new systems and processes to strengthen further governance across the Group.

In addition I am extremely grateful to my Board colleagues for their support and significant contributions to another successful year.

OUTLOOK

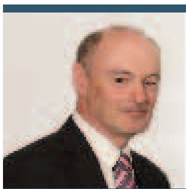
Notwithstanding the lower returns envisaged by Ofwat's Final Determination and the impact of current economic conditions, the Group remains well positioned to continue to deliver shareholder value and meet future challenges. South West Water is well placed to achieve Ofwat's efficiency targets and outperform its financing cost assumptions for K5. Viridor expects to continue to deliver strong long-term growth through successfully leading the way in exploiting opportunities arising from the Government's landfill diversion, recycling and renewable energy targets. This anticipated success has enabled the Board to announce an enhanced dividend policy for the next five years.

I am confident that we have the right strategy in place for the Group to succeed 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, 24 June 2010

PENNON GROUP

The Group's 2009/10 financial results showed continued growth in revenue and profit from the main businesses



DAVID DUPONT
GROUP DIRECTOR
OF FINANCE
PENNON GROUP PLC

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, recycling and renewable energy.

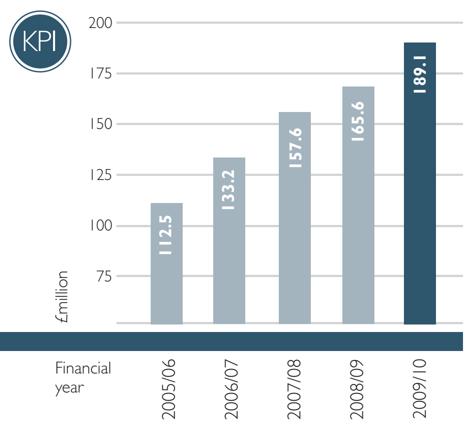
The Group's 2009/10 financial results showed continued growth in revenue and profit from both main businesses.

All profit and earnings per share figures in this Business Review on pages 2 to 37 relate to underlying business performance unless otherwise stated.

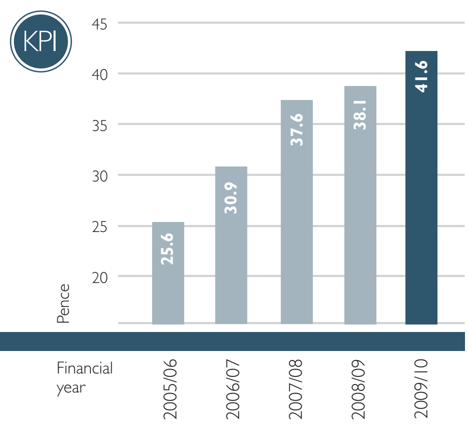
The Directors believe that underlying measures provide a more useful comparison on business trends and performance. Underlying results exclude restructuring costs, intangibles amortisation and deferred tax. The term underlying is not a defined term under International Financial Reporting Standards (IFRS) and may not be comparable with similarly titled measures used by other companies.

The key measures used by the Directors to assess the financial performance of the Group are profit before tax and earnings per share, shown below:

PROFIT BEFORE TAX (PBT)



EARNINGS PER SHARE (EPS)



Revenue above £1 billion for the first time

Effective management of interest rates – Group average 4.1%

REVENUE
Group revenue increased by 11.6% (£110.7 million) to £1,068.9 million. South West Water's revenue rose 2.9% (£12.5 million) to £444.2 million as a result of tariff increases and new connections. Approved tariff increases, including the 1.4% K factor, amounted to £20.9 million. Customers switching from unmeasured to metered charging reduced turnover by £7.0 million but around 5,000 new customer connections contributed £0.6 million of additional turnover. Customer demand remained constant, reversing the trend of consumption decline seen in recent years. Viridor's revenue rose by 18.7% (£98.5 million) to £626.5 million of which the acquisitions of London Recycling and Intercontinental Recycling plus the Greater Manchester Waste sub-contract accounted for £89.7 million. Existing business increased by £8.8 million (including an increase in landfill tax of £6.3 million).

OPERATING PROFIT
Group operating profit increased by 4.9% (£12.6 million) to £269.6 million with South West Water up 2.6% (£4.9 million) to £196.5 million and Viridor up 15.1% (£9.6 million) to £73.1 million.

Details of the financial performance of South West Water and Viridor are set out in this Business Review on pages 11 and 12 respectively.

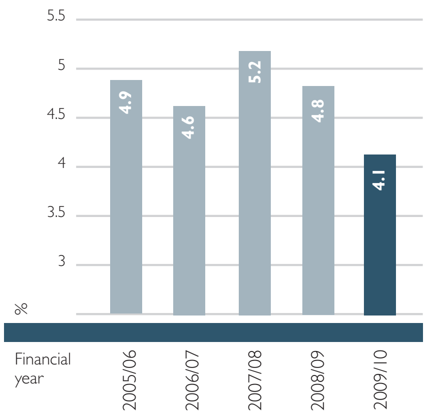
FINANCE COSTS
Excluding pensions net interest, discount unwind on provisions and IFRIC12 contract interest receivable, net finance costs were £78.2 million (2008/09 £88.4 million) and were 3.4 times covered by Group operating profits (2008/09 2.9 times). On this measure, net interest payable equated to a rate of 4.1% on average net debt (2008/09 4.8%) and demonstrates the Group's effective management of interest rates.

South West Water's interest rate on average net debt for the year was 4.0% (2008/09 4.6%).

Over the last five years the average interest rate on Group net debt has been:

INTEREST RATE ON AVERAGE NET DEBT

KPI



Interest rate management is analysed further on page 31.

RECONCILIATION OF UNDERLYING AND STATUTORY RESULTS

	2009/10 £m	2008/09 (restated) £m	Growth
OPERATING PROFIT			
Statutory operating profit	**264.3**	250.8	5.4%
Non-underlying costs :			
- Restructuring – South West Water	**5.0**	5.0	
- Intangibles amortisation – Viridor	**0.3**	1.2	
Underlying operating profit	**269.6**	257.0	4.9%
PROFIT BEFORE TAX			
Statutory profit before tax	**183.8**	159.4	15.3%
Non-underlying costs :			
- Restructuring – South West Water	**5.0**	5.0	
- Intangibles amortisation – Viridor	**0.3**	1.2	
Underlying profit before tax	**189.1**	165.6	14.2%
EARNINGS PER SHARE - pence			
Statutory earnings per share	**39.9**	25.8	54.7%
Non-underlying costs :			
- Restructuring (after tax) – South West Water	**1.2**	0.9	
- Intangibles amortisation – Viridor	**0.1**	0.3	
Deferred tax	**0.4**	11.1	
Underlying earnings per share	**41.6**	38.1	9.2%

The 2008/09 results have been restated for the application of IFRIC 12 "Service concession arrangements" as described in note 5 to the financial statements on page 71.

PROFIT BEFORE TAX

Profit before tax was £189.1 million, an increase of 14.2% (£23.5 million).

TAXATION

The UK corporation tax charge for the year was £43.0 million, including £0.6 million tax relief on restructuring costs (2008/09 £31.3 million including £1.7 million of relief on restructuring costs). Employer pension contributions to defined benefit schemes resulted in corporation tax relief of £5.2 million in 2009/10 (2008/09 £10.7 million).

The deferred tax charge for the year was £1.3 million (2008/09 £38.3 million). 2008/09 included a non-recurring charge of £24.9 million relating to the abolition of industrial buildings allowances as contained in the Finance Act 2008.

EARNINGS PER SHARE

Earnings per share increased by 9.2% to 41.6p.

The weighted average number of shares in issue during the year was 350.0 million (2008/09 348.1 million). Net assets per share at book value at 31 March 2010 were 189p.

DIVIDENDS AND RETAINED EARNINGS

The statutory net profit of £139.5 million has been transferred to reserves.

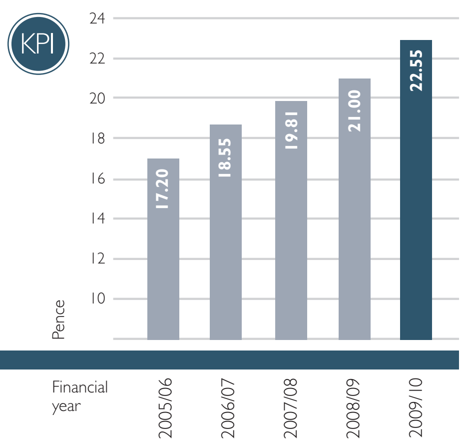
The Directors recommend the payment of a final dividend of 15.60p per share for the year ended 31 March 2010. Together with the interim dividend of 6.95p per share paid on 1 April 2010, this gives a total dividend for the year of 22.55p per share, an increase of 7.4% compared with 2008/09, reflecting RPI of 4.4% at March 2010.

Proposed dividends of £79.6 million (2008/09 £73.4 million) are covered 1.8 times (2008/09 1.8 times) by net profit. Dividends are charged against retained earnings in the year in which they are paid.

DIVIDEND POLICY

Notwithstanding the lower returns envisaged by Ofwat's Final Determination and the impact of current economic conditions, the Group remains well positioned to continue to deliver shareholder value and meet future challenges. As a result the Board has announced its intention to increase the dividend by 4% per annum above inflation from 2010/11 at least until 2014/15.

DIVIDENDS PER ORDINARY SHARE



Adding value for shareholders with a progressive dividend policy

Diversified funding sources

FUNDING POSITION

The Group had a strong liquidity and funding position as at 31 March 2010 and is well placed in current financial market conditions:

- cash and deposits of £494 million (including circa £92 million of restricted cash from deposits with lenders)
- committed undrawn facilities of £200 million
- South West Water has committed funding in place to at least mid-2011/12 and its funding requirements for the remainder of the K5 period thereafter are modest.

Efficient long-term funding

Average debt maturity 23 years

During the year the following finance initiatives were implemented:

- £125 million convertible bond
- £215 million term loans and Revolving Credit Facilities (RCFs) renewed
- £89 million of new term loans
- circa £200 million finance lease extended to 2052 and converted to 'bullet' repayment
- £25 million finance lease for South West Water
- £25 million 5-10 year finance lease for Viridor
- new provider for £35 million of Environment Agency bonds sourced.

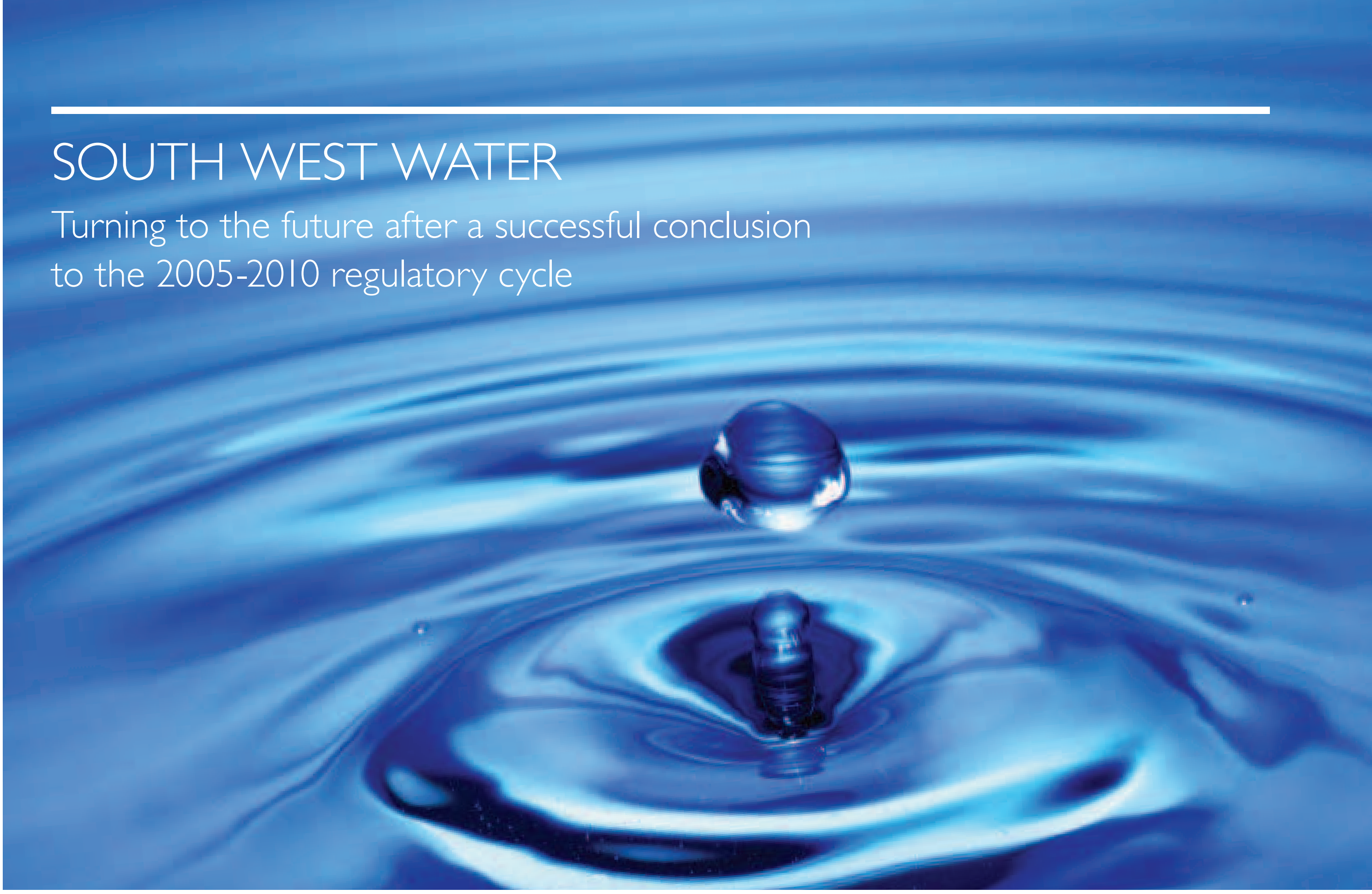
£216 million of loan repayments are required during 2010/11. Refinancing of existing facilities is being progressed and £100 million of debt facilities have been established or renewed in April 2010.

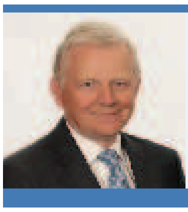
The fair value benefit (i.e. the difference between the book value and fair value) of Group debt has increased over the year by £75 million to £296 million at 31 March 2010 as a result of the rise in medium and long-term gilt rates.

The Group's average debt maturity is now 23 years.

SOUTH WEST WATER

Turning to the future after a successful conclusion to the 2005-2010 regulatory cycle





CHRIS LOUGHLIN
CHIEF EXECUTIVE
SOUTH WEST WATER LIMITED

CHIEF EXECUTIVE'S OVERVIEW

South West Water performed strongly this year, improving its customer service, delivering further operational efficiencies and achieving sound financial results. It has now successfully completed the 2005 – 2010 regulatory contract and has a solid platform in place for continued success during the next regulatory period (2010 – 2015).

The company continues to be led by its vision of 'Pure Water, Pure Service and Pure Environment'. Underpinning this vision is the strategy of striking the right balance between investing to improve our services, customer affordability and financeability.

In November 2009 Ofwat announced its Final Determination of the company's business plans and set price limits for the period 2010-2015. This confirmed average real price increases of 1.9% over the next five years.

Throughout the Periodic Review process, our focus was on safeguarding our many achievements of the last 20 years through investment where needed whilst delivering stable bills for our customers. Our future plans continue to reflect customer priorities but we have also challenged ourselves to deliver further cost efficiencies beyond those set by Ofwat.

Many of our key operational results and achievements over the last 12 months demonstrate the benefits of our 'Pure Water, Pure Service and Pure Environment' vision.

During 2009/10, the company delivered significant improvements in both operational and customer service performance across a range of key measures, which will provide a springboard to meet the challenges to come.

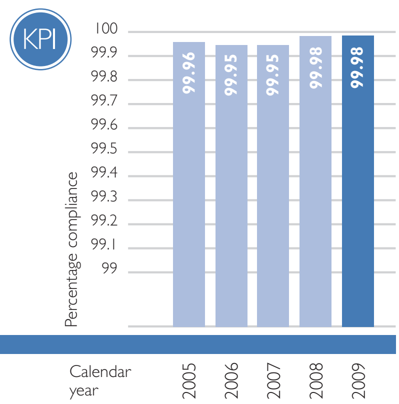
PURE WATER

Tap water quality is measured by Mean Zonal Compliance (MZC) which is the Drinking Water Inspectorate's preferred method for water quality assessment. It was maintained for a second year at its highest ever level of 99.98% in 2009.

Maintaining high water quality levels was the target of our recently completed £220 million water mains renewal programme undertaken between 2005 and 2010. During the final year of the project, 104 kilometres of mains pipes were relined or replaced and all five DWI-approved programme milestones were successfully completed. The final milestone was achieved ahead of schedule.

Carrying out repairs on the network can cause the interruption of water supplies to customers. However during 2009/10 there was a welcome improvement in this area with the number of properties experiencing unplanned interruptions reducing to 514 properties from 1,407 in 2008/09.

DRINKING WATER QUALITY (MZC)



This has been our 13th consecutive year without water restrictions

Despite the coldest winter for nearly 30 years causing a surge in burst pipe incidents for both our customers and network, we still beat our leakage control target of 84 Megalitres per day (Ml/d), and achieved a best ever performance of 82 Ml/d.

We have now achieved or beaten our leakage targets every year since they were first introduced by Ofwat in 1999/2000. Our leakage rate remains amongst the lowest in the industry at 5.5 cubic metres per kilometre of mains per day.

This has been our 13th consecutive year without water restrictions. The company has put in place a comprehensive strategy to ensure a continued secure supply of water for the region.

During the year work on two major new trunk mains serving South Devon and East Cornwall was completed, strengthening water supplies in each area for decades to come.

Park Lake on Bodmin Moor is now operational while work has started on converting nearby Stannon Lake into the company's fourth biggest reservoir. These former china clay pits were purchased in 2006 as a cost-effective alternative to building new reservoirs.

PURE SERVICE

Renewing its emphasis on excellent service has helped the company improve its performance for customers.

We are achieving year-on-year reductions in operational service contacts, with a 24% reduction in the last year, and reductions in repeat service contacts. Improvements to the handling of service contacts have helped reduce the number of complaints received.

Customer satisfaction with the way their contact with the company has been handled and the ease of contacting us has improved resulting in a best ever performance of 4.53 out of a possible 5.0 maximum.

However there is always room for improvement to ensure that we have systems in place which will provide continuous advances in our customer service.

This will include extending a range of measures to assist those customers in genuine financial difficulty as a result of the recession whilst still actively pursuing those who can pay their bills but do not.

In particular, we will be continuing to support our innovative 'WaterCare' programme, which has assisted over 7,000 households since its introduction in 2007.

Through WaterCare, customers are advised on how to better manage their water use and household budgets including claiming all the benefits to which they are entitled. The free installation of water-saving devices has proved popular with customers and both they and the company have benefited from moving them on to affordable and regular payment plans.

A number of the customers on this programme are now paying more than double the level of payments they did before, thereby reducing the company's outstanding debt.

Between 2010 and 2015 we will also be expanding our involvement with consumer organisations such as Citizens Advice and will be implementing a personalised debt advice initiative.

PURE ENVIRONMENT

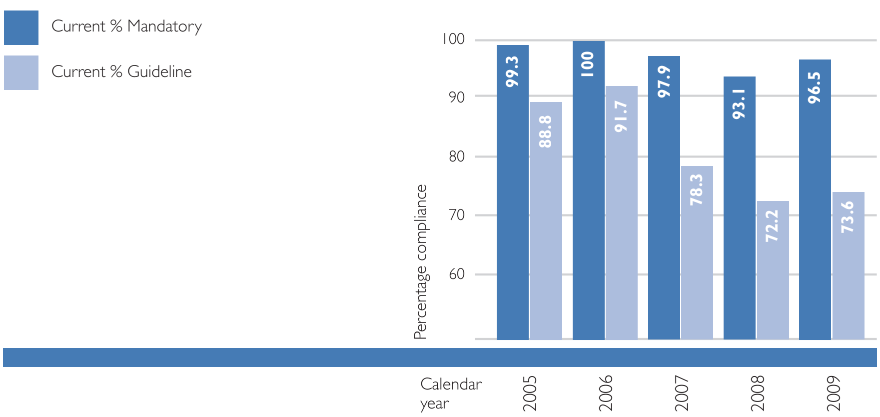
South West Water's record of environmental achievements was further strengthened during 2009/10.

The company's focus on proactive maintenance of its waste water network resulted in an 11th consecutive year without a major Category 1 pollution incident and the number of more minor Category 2 and 3 incidents remained at a low level.

The long-term transformation of bathing water quality in the South West, due to the £2 billion Clean Sweep programme, was also safeguarded with 96.5% of bathing waters complying with the EU mandatory standard. A decade ago this figure was only 42.6%. This major improvement in quality has also helped the South West gain the most Blue Flag beaches of any region in the UK.

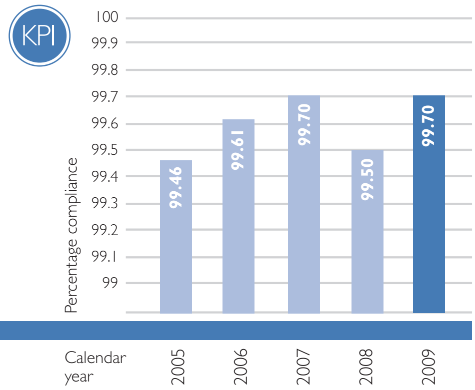
The region's bathing water quality has been affected by significant rainfall for the last three summers. This has carried agricultural and other surface water pollutants into the sea.

BATHING WATER COMPLIANCE WITH CURRENT MANDATORY STANDARD / CURRENT GUIDELINE STANDARD



The percentage population equivalent served by sanitary-compliant waste water treatment works in the calendar year 2009 was 99.7%. This consistently high performance contributes to the region having the highest percentage of high quality rivers in England.

POPULATION EQUIVALENT SANITARY COMPLIANCE



A pilot moorland restoration project 'Mires', undertaken on Exmoor between 2003 and 2010, beat strong competition to win a Water Industry Achievement Award for 'Sustainable Drainage and Flood Management Initiative of the Year'. The success of Mires and other environmental initiatives has led to a more extensive programme of catchment management which is being implemented called 'Upstream Thinking'. Restoring wetlands will allow slower and steadier flows and cleaner water from the moors to rivers and reservoirs. This in turn will help minimise long-term treatment costs.

Mires will be expanded across the region with moorland and farmland projects between 2010 and 2015 in partnership with Exmoor National Park Authority, Dartmoor National Park Authority, Natural England, the Environment Agency, English Heritage, local farmers and landowners.

Focussing on our 'Pure' vision has assisted the company in delivering a strong set of results both financially and operationally. This has also ensured there is a solid platform in place for further progress to be made. Ofwat's Final Determination represents a tough challenge for the company but it is one we have accepted and are determined to deliver.

To meet this challenge, we have:

- renegotiated our key operational contracts with service partners to create more innovative ways of working and further cost efficiencies through establishing the new incentivised 'H_5O' Delivery Alliance to deliver the capital programme
- invested in a more centralised operating structure employing increased levels of automation
- continued our organisational restructuring drive to sustain our services through flexible working while securing efficiencies. It is expected that a further £4 million will be provided for restructuring costs in 2010/11
- successfully reduced our energy consumption through our 'Megawatt Challenge' company-wide initiative. Staff led energy saving projects resulted in overall energy savings of 6.5 GWh, a reduction of around 3,500 tonnes of CO_2 and a cost saving of around £600,000 per annum. Further energy savings will be delivered by our 'PowerDown' programme which is in place to achieve more efficiencies and cost reductions between 2010 and 2015.

This has been another successful year for South West Water. Further significant improvements have been made in achieving service excellence and new operational efficiencies.

I would like to thank all our staff and our suppliers for their dedicated and innovative work. Their achievements this year have ensured we are in the strongest position possible to deliver in the years ahead.

FINANCIAL REVIEW

Against the background of an uncertain economic recovery, South West Water has had another strong year, with sound financial performance being supplemented by improved customer service and delivery of further operational efficiencies.

Operating profit up by £4.9 million (2.6%) to £196.5 million (2009 £191.6 million). For the five-year period 2005/06 to 2009/10 operating profit is shown in the graph below.

The company's revenue increased by £12.5 million to £444.2 million:

- Increases: tariff increases approved by Ofwat (£20.9 million) and around 5,000 new customer connections (£0.6 million).
- Decreases: customers switching to metered tariffs (£7.0 million) with income from other sales decreasing by £2.0 million.

68% of our domestic customers now receive a metered supply.

Operating costs, excluding depreciation, increased by £3.8 million to £154.1 million:

- Efficiency savings were £4.4 million in the year.
- Additional costs from new capital schemes, £1.8 million.
- Price increases, including inflation, £6.5 million.
- Lower income from assets, including property sales, £1.1 million.
- Other cost increases £0.4 million, offset by a reduction in costs of other sales £1.6 million.

Restructuring costs were £5.0 million in 2009/10 and a further £4.0 million is expected to be provided in 2010/11.

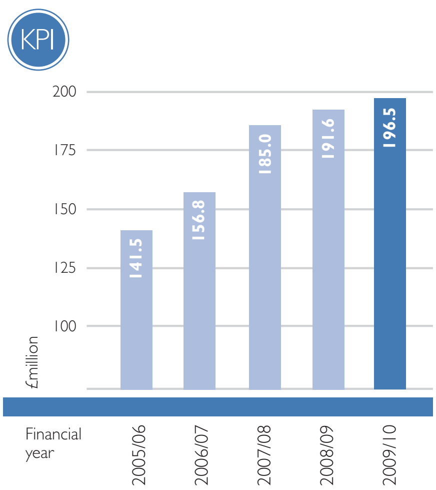
Despite the downturn in the property market, property disposals in the year contributed £1.0 million to profit (2009 £1.7 million).

The bad debt charge increased by £0.9 million from £6.4 million to £7.3 million. Collections performance on older debt marginally improved over the year.

Capital expenditure was £143.3 million, including £9.7 million on advanced spend for K5. £37.6 million was spent on quality schemes, principally on concluding the water mains rehabilitation programme and making progress on waste water programmes, including the new sewage treatment works for Bossiney, Boscastle and Tintagel.

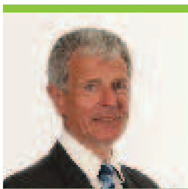
Further contributions totalling £9.9 million were made to the defined benefit pension schemes.

OPERATING PROFIT



VIRIDOR

Viridor profits grew strongly in 2009/10 as it continued to expand its resource management activities



COLIN DRUMMOND
CHIEF EXECUTIVE
VIRIDOR LIMITED

CHIEF EXECUTIVE'S OVERVIEW

Viridor is one of the UK's leading waste management, recycling and renewable energy companies. Over the past 10 years we have evolved from waste collection and disposal into a more broadly based resource recovery business with major activities in recycling and waste-based renewable energy generation. At the same time we have increased our profits at an average rate of over 20% (PBITA plus joint ventures) per annum since 2001. Over 40% of our profit contribution now comes from recovering value from waste.

We have core competencies in landfill disposal, recycling and waste-based renewable energy generation. The company operates materials recycling facilities (MRFs), waste transfer stations, treatment plants, household waste recycling sites (HWRS), composting facilities, landfills and renewable energy generation facilities in most regions of the UK and has a collection fleet focussed on the industrial and commercial market.

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 2009/10 Viridor delivered another year of very strong profit growth despite the difficult economic conditions in the UK and worldwide. 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) and the Lakeside Energy from Waste (EfW) plant, both of which commenced profitable operations. We also completed the acquisition of two further recycling companies. These and other initiatives are expected to enhance our business significantly in future years.

This reflects our focussed strategy of:

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

Further detail on the climate change and environmental drivers behind governments' policies and Viridor's strategy is given in the sections on main trends and business and strategy on pages 14 and 15.

FINANCIAL HIGHLIGHTS

Viridor traded very strongly in 2009/10, building further on the growth achieved over the past eight years. Revenue was up 18.7% (£98.5 million) to £626.5 million, of which acquisitions accounted for £89.7 million and existing business £8.8 million (including landfill tax of £6.3 million).

Viridor's earnings before interest, tax, depreciation and amortisation of intangibles (EBITDA) rose 9.1% from £105.2 million to £114.8 million. Profit before interest, tax and amortisation of intangibles (PBITA) for the year increased by 15.1% (£9.6 million) to £73.1 million, compared with £63.5 million in 2008/09.

With the commencement of the Greater Manchester and Lakeside projects, joint ventures now account for a significant part of Viridor's profits (£4.2 million in 2009/10) and we now focus on PBITA plus joint ventures as a key performance indicator. We profit from our joint ventures both via interest on shareholder loans and via share of the joint ventures' profit after tax (PAT). PBITA plus joint ventures grew by 19% in 2009/10 and has grown by a compound rate of 22% since 2001.

Profit before tax (PBT) at £55.4 million was up 34.8% on the previous year and has grown at a compound rate of 19% since 2001. Capital expenditure for the year was £46.6 million (2008/09 £84.0 million) and we invested £30.8 million in our Greater Manchester, Runcorn Combined Heat and Power (CHP) and Lakeside joint ventures.

PBITA PLUS JOINT VENTURES, PBT AND RETURN ON EQUITY

PBITA plus joint ventures (which contributed from 2008) and PBT are key overall measures of Viridor's performance and are set out in the table below for the ten-year period 2001 to 2010. The table also sets out the Compound Annual Growth Rate (CAGR) for these measures, being the rate of growth between 2001 and 2010 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 (£252 million at 31 March 2010).

KPI

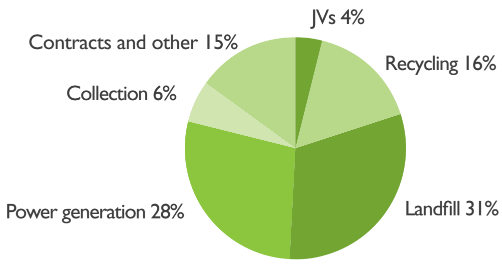
Year ended 31 March	2001* £m	2002* £m	2003* £m	2004* £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	CAGR 2001-10
PBITA plus joint ventures	13.1	15.2	19.1	22.7	30.0	35.9	46.8	58.1	64.9	77.3	22%
PBT	11.7	13.8	15.7	17.2	21.5	23.5	29.4	35.5	40.8	55.4	19%
Return on equity investment	6.1%	7.2%	8.2%	8.8%	11.0%	11.3%	14.2%	17.1%	19.7%	22.0%	–

*UK GAAP

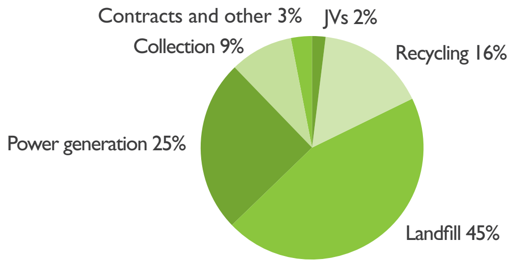
VIRIDOR PROFIT CONTRIBUTION BY SEGMENT

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 2009/10 landfill accounted for 31% and landfill gas power generation 28% of Viridor's profit contribution, compared with the previous year's 45% and 25% respectively. Recycling accounted for 16% (last year 16%) and contracts grew to 15% from 3% in the previous year whilst joint ventures accounted for 4% (last year 2%). In total 44% of Viridor's profits come from recovering value in waste either by power generation or recycling.

FINANCIAL YEAR 2009/10



FINANCIAL YEAR 2008/09



LANDFILL

Total landfill disposal volumes decreased by 0.7 million tonnes (15%) to 3.9 million tonnes in the year. Approximately 0.2 million tonnes of this was due to landfill closures, as reported last year. The bulk of the remaining reduction was in third party industrial and commercial volumes which were heavily impacted by the general weakness in the UK economy. Average revenue per tonne increased by 1.1% to approaching £22 per tonne (3.1% like for like excluding site closures). Consented landfill void reduced from 81 million cubic metres at 31 March 2009 to 77 million cubic metres at 31 March 2010, reflecting 1.2 million cubic metres planning gains and usage during the period of 4.8 million cubic metres.

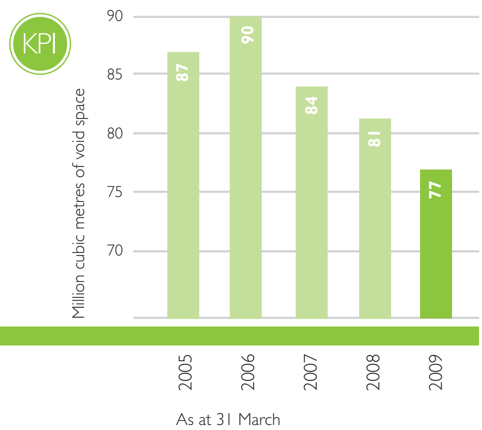
LANDFILL GAS

Viridor's landfill gas power generation output increased by a further 10% to 555 Gigawatt hours (GWh) during the year particularly reflecting capacity brought on in late 2008/09. All of the output increase was accredited for full ROCs in advance of the banding change. Viridor's average revenues per Megawatt hour (MWh) grew by 21% to approaching £90 reflecting the growth in the proportion of output eligible for Renewables 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 May 2008 prices. Current power generation prices are significantly (circa £30 per MWh) lower. This will materially affect power generation segment performance for 2010/11.

At 31 March 2010 Viridor's landfill gas power generation capacity was 100 Megawatts (MW) including a small amount of sub-contract capacity. At 31 March 2010 63% of Viridor's power generating capacity was eligible for ROCs and 37% for the Non Fossil Fuel Obligation (NFFO).

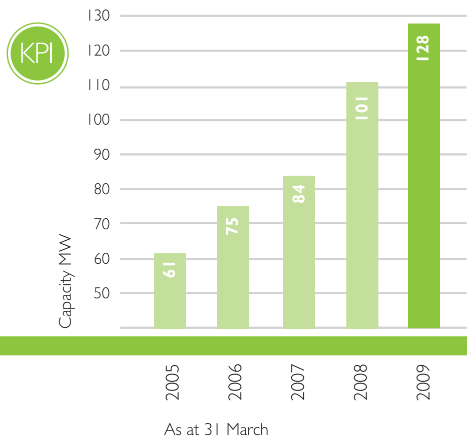
CONSENTED LANDFILL VOID

As at 31 March 2010 Viridor had a consented void capacity of 77 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 2010 Viridor had 100 MW of operational landfill gas generating capacity which is virtually the same as the previous year. These figures exclude 3 MW of sub-contract capacity in Suffolk. In addition there is 27.5 MW of energy from waste combustion capacity (Bolton and 50% of Lakeside).



RECYCLING

The UK is required under the EU Landfill Directive to reduce the amount of biodegradable municipal waste going to landfill sites. To meet the requirements of the Landfill Directive the UK Government uses landfill tax as a price mechanism. At the same time the Government has set clear targets for the recycling of household waste, and local authorities must also implement strategies for the diversion of biodegradable municipal waste away from landfill. The former Chancellor's Budget announcement on 24 March 2010, continuing the increase in landfill tax of £8 a year from £48 per tonne currently to £80 per tonne in 2014/15, will further enhance the long-term economics of recycling. In general, recyclate costs are typically significantly lower than the cost of using virgin materials for manufacturers.

As reported last year recyclate prices were high in the first half of 2008/09 and low in the second half, reflecting the prevailing general world economic conditions. Since then recyclate prices have recovered, ending the year at around the peak levels seen in early 2008/09. Viridor's recycling traded volumes grew 3.5% to a little over 1.4 million tonnes, with an improved recyclate mix. Recyclate prices have continued to strengthen since the year-end but are expected to ease back later in the year.

In June 2009 Viridor acquired London Recycling Limited for a cash consideration of £10.6 million, plus debt acquired of £1.5 million. With its headquarters in East London, the business comprises a full range of recycling operations including a fleet of collection vehicles, a 'WEEE' facility, paper processing, confidential material destruction, a MRF and a waste auditing facility. It handles approximately 50,000 tonnes of material per annum. London Recycling has had a good track record over recent years in providing essential recycling services to businesses in the capital and has an excellent geographic and business fit with Viridor's operations in the South East of England.

Plastics in particular are a significant and growing part of Viridor's recycling business and in July 2009 Viridor acquired Intercontinental Recycling Limited for a cash consideration of £4.2 million, plus debt acquired of £3.9 million. Based in Skelmersdale, Lancashire, the company processes High Density Polyethylene (HDPE) and Polyethylene Terephthalate (PET) plastic bottles, such as are recovered by Viridor's MRFs. It converts the bottles to pellet or flake for sale to plastic product manufacturers, mostly within the UK. The plant has the capacity to treat 40,000 tonnes of plastics waste per annum. Intercontinental Recycling also has a good geographic and business fit with Viridor's existing operations and is particularly well-placed to receive volumes from the Greater Manchester Waste PFI.

CONTRACTS

Contracts profits were well ahead with continued good performance from the West Sussex PFI and 10 other municipal contracts. The sludge contracts business which performed poorly in the second half of 2008/09 was back in profit. There was also a significant contribution from the Greater Manchester Waste PFI sub-contract.

PUBLIC PRIVATE PARTNERSHIPS AND PRIVATE FINANCE INITIATIVES

Public Private Partnership (PPP) and Private Finance Initiative (PFI) contracts are a key part of Viridor's strategy.

Financial close on the Greater Manchester Waste PFI 25-year contract was achieved 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 140 MW from Phases I and II of the Runcorn plant, the four anaerobic digesters (ADs) and the existing Bolton Energy from Waste (EfW) plant.

The PFI is a joint venture between Viridor and John Laing Infrastructure. Operation of the associated facilities is being carried out on a sub-contract basis by Viridor. In October 2009 it was confirmed that all required facilities planned for development had received planning permission. At 31 March 2010 of these 42 facilities 22 had been completed and handed over to Viridor to operate.

Associated with the Greater Manchester PFI is an EfW CHP facility (Runcorn Phase I) which is a three-way joint venture between Ineos Chlor, Viridor and John Laing Infrastructure. Planning permission was achieved by Ineos Chlor for both phases of the EfW CHP plant at Runcorn in September 2008 and construction of the first phase has commenced. Total capital expenditure for the Greater Manchester PFI is projected to be £405 million with an additional £235 million for the associated EfW CHP plant (Runcorn Phase I). Viridor's funding contribution will be £85 million. In addition we have secured all of the rights to 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 upside to the initial project given rising landfill tax and the shortage of competing capacity in the North West.

In addition to the above contracts we continue to bid selectively for other projects. We are the preferred bidder for the Oxfordshire PPP and one of the last two for the Cheshire PFI and the South West Devon Waste Partnership. We are one of the last three for the Peterborough EfW and MRF contracts and one of four still in the bidding for the Gloucestershire PFI and South London Waste Partnership contracts. Most of these projects include renewable energy.

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 influenced 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 a response in part to methane emissions from landfills, although in fact the bulk of this in the UK is now captured for renewable energy generation.

Government targets of diverting municipal waste away from landfill up to 2020 are 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 77 million cubic metres is regarded as a very valuable resource, with 15 years' average capacity available at current rates of fill.

At the same time it is increasingly recognised that waste is a major renewable energy source, accounting for approximately 25% of the current UK's renewable energy or roughly 1.5% of the total UK's electricity production. 1.2% of this comes from landfill gas utilisation, which has grown by 600% over the past 10 years, and 0.3% from energy from waste combustion. As the energy produced from waste is a product of waste treatment, it is effectively low cost. Unlike certain other renewables it provides baseload power which is distributed around the grid typically close to where energy is required.

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 Anaerobic Digestion (AD). Viridor estimates that waste could account for 6% of UK electricity production by 2015 if planning barriers could be addressed, and has called upon the UK Government to set this as a target.

The need for councils to avoid steeply increasing landfill tax and to achieve their landfill diversion targets creates attractive opportunities for PFI/PPP and other 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, recycling operations such as those of Viridor Resource Management and our electrical goods and glass recycling services.

Whilst the long-term trends in favour of Viridor's business are very positive, the weakness of the UK economy is having a significant effect on waste volumes and power generation prices. It is certain that public expenditure will be reduced in the face of the UK's massive budget deficit.

This is likely to put particular pressure on local councils' budgets and may result in their delaying new major waste PPPs/PFIs or in seeking other ways to reduce their waste management costs.

BUSINESS AND STRATEGY

Our strategy is to deliver strong growth and add value by:

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

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 77 million cubic metres as at 31 March 2010. Viridor is at present filling this at a rate of around five million cubic metres per annum, which results in an average remaining life of 15 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 1.2% of the UK's total electricity generation. EfW represents a further 0.3% according to Defra. The Government's stated strategy is to increase the percentage of electricity generated from all renewable sources from the current figure of around 5% to a target of 10% in 2010 and 15% in 2015. Viridor has called on the Government to set a target of 6% of electricity to be generated from waste sources by 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 Renewables Obligation (RO) regime. Under the RO, eligible generators receive the brown energy price plus the value of the associated Renewables 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 100 MW at 31 March 2010, compared with 27 MW in March 2002. Of this power generation capacity, 63% is under the RO regime and 37% is under NFFO. Viridor's existing NFFO contracts end in tranches over the next six years 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 detailed below (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.

Viridor is pursuing possible long-term EfW opportunities, including proposals in Cardiff (which received planning permission in June 2010), Avonmouth, Dunbar and Oxfordshire (which have had planning permission turned down locally and are being appealed), and near Plymouth. Construction of the consented Exeter EFW plant is expected to start during 2010/11.

In pursuing its strategy, Viridor seeks to grow its recycling, renewable energy and 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 2010, has made 17 acquisitions in the waste sector for an aggregate consideration of over £310 million. These businesses have now been integrated into the Viridor group.

Greater Manchester 25-year PFI contract operating successfully

Lakeside Energy from Waste plant commenced operations

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 over 1.65 million residents. In addition over 39 million visitor nights as recorded by South West Tourism were spent in the region in 2009. On average each day it distributes over 420 Megalitres (Ml) of treated water and disposes of around 235 Ml of waste water through an asset base comprising:

Water distribution mains	15,058km
Sewers	9,288km
Impounding reservoirs	15
Water treatment works	39
Waste water treatment works, including 55 works with ultra-violet treatment and three with membrane filtration	634
Intermittent discharge points, including 1,029 combined sewer overflows	1,668

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 19 years from the company's marine investment programme. Following completion of an entire overhaul of water resources, water treatment and distribution over the same period we are able to demonstrate major improvements in water supply quality and reliability for our customers.

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.

For the new regulatory period which started in April 2010 Ofwat assumed that the equity cost of capital for all companies will be 7.1% real after tax with an overall weighted average cost of capital of 4.5% real after tax.

Customers using more than 50 Ml of water per year can contract with alternative suppliers for water supply. South West Water has 36 customers in this category whose aggregate water charges account for approximately 1.5% of its total water and sewerage revenue or 3.2% of its water revenue. No single customer accounts for more than 1% of revenue.

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. Legislation will be required for any further significant extension of competition in the water and sewerage markets. During the year Ofwat consulted on extending the current 50 Ml criteria for competition under water supply licensing arrangements to cover customers using more than 5 Ml. This extension to the existing competition regime is expected to apply during 2010/11. Ofwat has published a number of consultation papers concerning the potential for future retail and upstream market reform.

The review into fairer water charges commissioned by Defra, known as the Walker Review, was concluded in 2009. The review noted that, while the regulatory regime in the water industry has served customers well over the last 20 years, improvements can be made to address the twin aspects of affordability and fairness for water customers. The Government has asked Ofwat to advise it on one or more of a number of options to address the issue of water bills in the South West:

- a one-off or other financial adjustment by Government
- contributions by other water customers across the country
- a package of tariff proposals for South West Water customers.

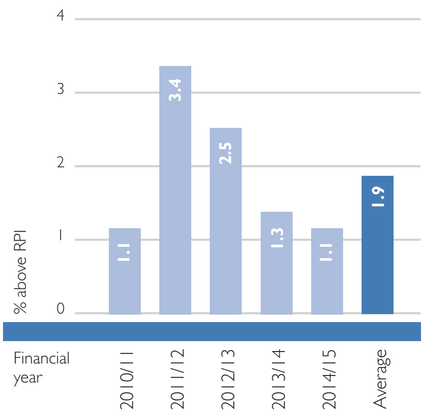
Ofwat and South West Water have established a joint working group to develop and examine the options which could address the recommendations in the Walker Review.

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 2010 to 2015 for South West Water were determined by Ofwat in its Final Determination in November 2009 and are shown in the table below:

'K' FACTORS FOR THE PERIOD 2010-15



The 2004 Final Determination provided for total capital expenditure of £762 million (2002/03 prices) over the five-year period 2005-2010. All major projects required in the period 2005-2010 were delivered in line with Ofwat's, the Drinking Water Inspectorate's and the Environment Agency's expectations. The required customer service and infrastructure outputs at 31 March 2010 included:

Activity	2005-2010 Target	Status at 31 March 2010
Adequacy of water resources	Security of Supply Index to be maintained at 100	Security of Supply Index was 100. No water restrictions for the 13th consecutive year
Leakage control based on three-year rolling average	Maintain at 84Ml/d	82Ml/d achieved in 2009/10
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	Completed
Improvements to continuous discharges	Complete 95 schemes by 31 March 2010	Completed
Improvements to intermittent sewage overflows	Complete 113 schemes by 31 March 2010	Completed

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 2010 amounted to £2.621 billion. After adjustment for PR09 log up/down and other Final Determination adjustments the figure is £2.555 billion which represents an increase of 3.8% in the year. From 31 March 2005 to 31 March 2010 the company achieved a 31% growth in RCV, the highest percentage increase of any quoted UK water company.

The gearing ratio in relation to adjusted year-end Regulatory Capital Value improved to 60.6% from 63.8% in 2008/09.

The growth in RCV adds directly to shareholder value as the allowed return is attributed to South West Water's asset base by Ofwat.

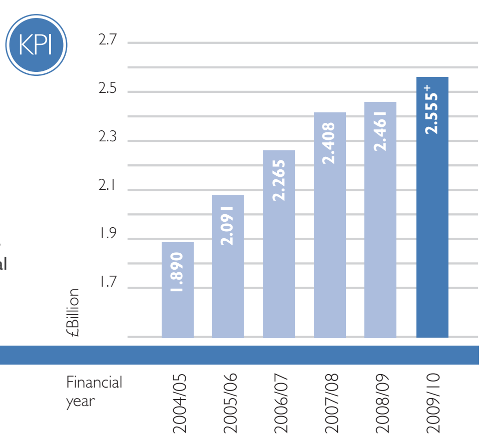
PERIODIC REVIEW 2009

Following submission of South West Water's Final Business Plan in April 2009, the company's Final Determination was made by Ofwat on 26 November 2009. Key elements of the Final Determination for the company included:

- a cost of capital of 4.5% (real, post tax basis), applicable to the whole industry
- 'K' price increases (above RPI inflation) averaging 1.9% per annum over the five years
- a capital programme of around £705 million at 2007/08 prices
- a Capital Incentive Scheme (CIS) score of 105 (water) and 110 (sewerage), in line with the industry average
- operating efficiency improvements of 2.8% per annum, comparable with K4 delivery
- over the period 2010-2015 average bills decreasing by 1% before inflation
- capital investment priorities, including protection and maintenance of the improvements made over the last 20 years, further improvements to meet EU Directives and their corresponding UK legislation, achievement of operating cost savings and delivery of projects to increase levels of renewable energy generation and to improve sustainability of the company's activities.

Further information on the Final Determination is available on the company's website **southwestwater.co.uk**

REGULATORY CAPITAL VALUE



Notes
+ Source: Ofwat, adjusted for logging up/down of capital expenditure, K5 to K4 capital advancement, land sales and COPI adjustments from Ofwat's Final Determination

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 of 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 Final River Basin Management Plan, published by the Environment Agency in December 2009, confirmed that the Plan's implications are unlikely to require changes to South West Water's assets at least until 2015, due to the successful delivery of a wide range of river, estuarine and coastal water environmental improvements by the company since 1989.

Further legislative regulations are expected for the water industry following introduction of the Flood and Water Management Act in April 2010. Many of the changes are expected to implement the recommendations of the Pitt Report which was commissioned after the severe flooding in other parts of the country 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 was published in the summer of 2009 and was approved by Defra. It includes information relating to rainfall and temperature variations. The plan includes 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. Increasingly 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 11th year in succession. Two Category 2 (significant pollution) events and 69 Category 3 events were recorded by the Environment Agency in 2009 which were deemed non-compliant with discharge consents. This compares with three Category 2 incidents and 64 Category 3 incidents in 2008. The total number of waste water pollution incidents in 2009 was 106 (2008 92). 41% of the Category 2 and 3 incidents in 2009 were identified by the company and self-reported.

PROSECUTIONS

During the year the company was convicted on four occasions for environmental offences and fined a total of £11,500 (2008/09 four convictions and fines of £28,100).

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, the company takes such steps as are necessary to ensure as far as possible 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

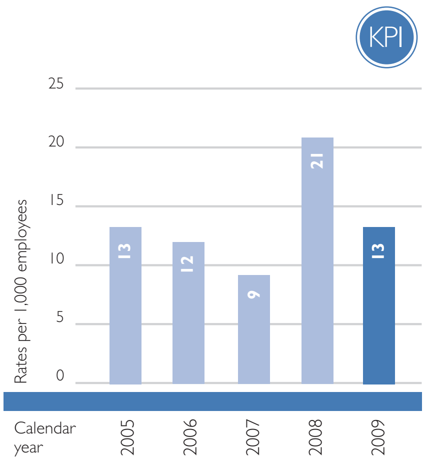
HEALTH AND SAFETY PERFORMANCE

The health, safety and welfare of South West Water's employees remain paramount in all its activities. The company has 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 including a cross-section of the company's 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 welfare of the company's employees through the provision of training on, and promotion of, good health and safety practices.

RIDDOR accidents and incidents per 1,000 employees totalled 13 in 2009 compared with 21 in 2008 and we welcome this improvement.

RATES PER 1,000 EMPLOYEES



CUSTOMERS

South West Water has consulted with customers about its priorities for 2010-2015 and this feedback has been central to the development of customer service improvement plans to deliver its Pure Water, Pure Service and Pure Environment strategy.

Providing help and support to customers in need is at the heart of the company's Pure Service strategy and accordingly the company remains an industry leader in the provision of priority services to vulnerable customers. In 2009/10 the company helped thousands of such customers with reading their meters 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 third successful year. Since the start of the programme over 7,000 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** Consultation with customers and stakeholders has an influence on the improvements made to our literature and website as we seek to provide information of interest in increasingly accessible ways.

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

CUSTOMER SATISFACTION OVERALL

South West Water's 'Customer Plus' programme is transforming the customer experience with the aim of making it amongst the best in the industry. In 2009/10 customer contact performance improved significantly. The number of complaints about billing, charges and water and sewerage services has fallen.

CUSTOMER SATISFACTION CALL HANDLING

Ofwat measures the overall manner in which a customer call is handled. The measure is obtained by quarterly tracking surveys undertaken by an independent company engaged and managed by Ofwat. The data is averaged for the year to assess a performance trend. For 2009/10 the satisfaction score was 4.53 (2008/09 4.5). The maximum score is 5.0.

The company continues to promote the efficient use of water with advice and practical support for householders and non-domestic customers. An education programme for schools has also been developed this year to extend the spread and reach of this work. As part of the WaterCare programme and to investigate customers' high water consumption queries, 2,831 audits were completed in 2009/10 (2008/09 3,088).

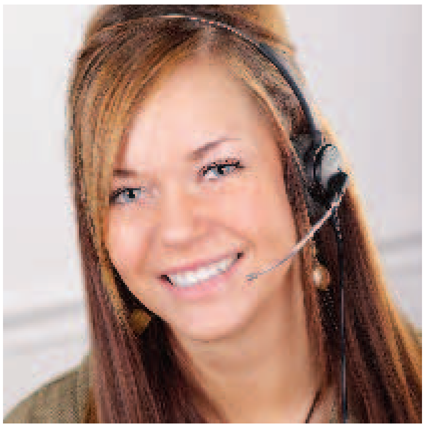
South West Water continues to support business customers through water efficiency reviews, waste minimisation projects, providing advice for water management plans and by highlighting opportunities for reduction, re-use or alternative sources of supply.

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 211 businesses with over 7,250 water service accounts have registered to use the water efficiency element of this service.

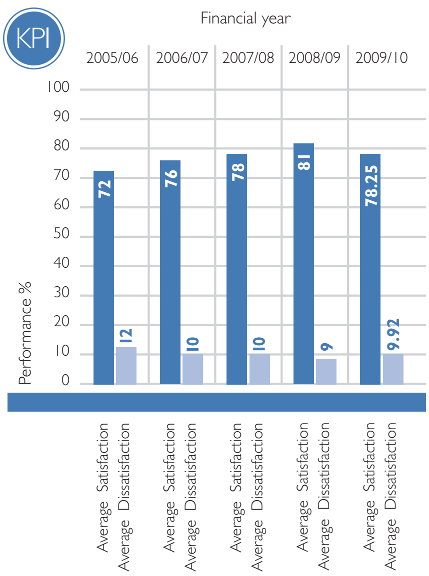
OVERALL PERFORMANCE ASSESSMENT

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, complaint handling, billing, debt collection, asset serviceability, environmental compliance and quality of drinking water delivered. In 2008/09 South West Water's performance moved to eighth place amongst the ten water and sewerage companies (seventh in 2007/08).

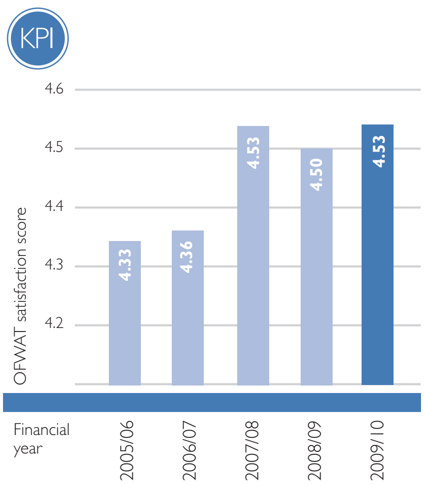
Ofwat has announced that OPA will be replaced with a new measure of water industry customer performance, called the Service Incentive Mechanism. 2010/11 data will be reported on this new basis.



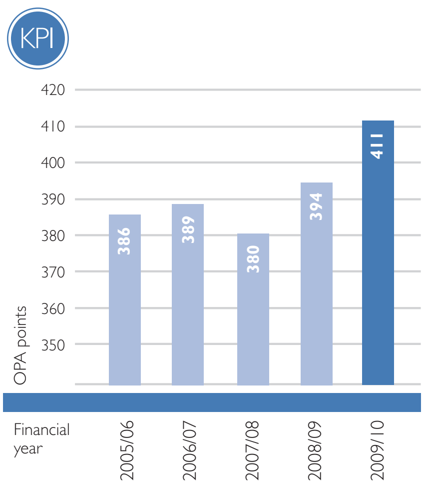
CUSTOMER SATISFACTION OVERALL



CUSTOMER SATISFACTION CALL HANDLING



OVERALL PERFORMANCE ASSESSMENT



COMMUNITY, CORPORATE RESPONSIBILITY AND SPONSORSHIP

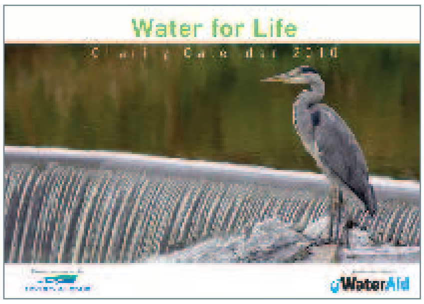
South West Water concentrates its sponsorship on community projects and organisations within its service area which are linked to water, benefit the environment or promote youth participation.

Highlights in 2009/10 included the staging of a series of environmental walks with Cornwall Wildlife Trust around the coastline to mark the completion of a pipe replacement scheme at Looe and sponsoring the 'Nipper' youth championships of the Surf Life Saving Association of Great Britain at Falmouth.

Other supported events ranged from the TRAIL environmental art sculpture festival on the South West Coast Path between Dawlish and Shaldon and the opening of Pynes water treatment works, Brokenbury waste water treatment works and Mary Tavy hydro power station for guided public tours during the national Heritage Open Days.

For the third year the company also co-sponsored South West Tourism's annual awards and funded the sustainable tourism prize. This demonstrates how its 'Clean Sweep' project has helped underpin the renaissance of tourism, the region's number one industry.

The company is proud to support the water industry charity, WaterAid, through sponsorship and many other fund-raising activities such as the publication of a calendar featuring water-themed photographs taken by Group employees.



South West Water achieved a 'Green Apple' award for transforming a disused sludge lagoon into a pond for wildlife with a number of other habitat improvements around its water treatment works site at Tottiford, near Bovey Tracey. This project was shortlisted as a finalist in the Community Campaign of the Year category of the Water Industry Achievement Awards. This recognises the way South West Water engaged with adults with learning difficulties for the supply of bat, bird and dormouse boxes now fitted across the site.

EMPLOYEES

South West Water's people strategy continues to focus on recruiting and developing individuals who can support the delivery of the company's 'Pure' vision, enabling the provision of a high quality service to customers and the achievement of operational efficiencies.

Technical and managerial skills training have underpinned the company's Puros project. A range of other learning programmes to support the development of customer facing and operational skills continue to form a fundamental part of our strategy.

Employee involvement and participation in all aspects of business and organisational change is encouraged and supported through the company's 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 focussed 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 has successfully completed a programme of tendering strategic contracts in preparation for the K5 period and has established a new 'H_5O' Delivery 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 supplier (revenue) accounts for more than 5% of revenue and South West Water sources all its purchases from competitive markets. South West Water's electricity supplies have been secured to 2014 through recently negotiated fixed price contracts.

SOUTH WEST WATER'S PRINCIPAL RISKS AND UNCERTAINTIES

Risk	Mitigation
Tighter price controls over the revenue of the company's regulated business	The current periodic review was completed in November 2009 when Ofwat set water company charges for the years 2010-2015. South West Water has met Ofwat's efficiency targets in the last three Periodic Review periods.
Failure to deliver the capital investment programme	The company has a track record of delivering its capital programme in accordance with regulatory requirements and progress is regularly monitored and reviewed. The K4 capital programme has been delivered and the company has developed plans to deliver the K5 programme.
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 29 to 31.
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 to contribute towards the additional efficiencies required for the K5 period.
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 which 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, which are kept under review, South West Water continues to implement 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 has been made in the K5 Final Determination for companies to make an application for an Interim Determination in the event of household bad debts being significantly above the amount allowed by the water regulator due to worsening economic circumstances in the company's operating area.
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 Water Resources Plan indicates that no new reservoirs are required before the planning horizon of 2035. However, investment is needed to develop the overall trunk main infrastructure, to expand treatment capacity and to enhance certain pumped storage facilities.
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 K4 regulatory period has been taken into account by the regulator in setting a baseline turnover level for the K5 period. A revenue correction mechanism is in place from the start of the K5 period, which allows water companies to recover a shortfall in income for a five-year regulatory period in the next period.
Financial loss arising from the insolvency of a major supplier or contractor	The company uses a third party credit monitoring service to track changes to major 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 continues to consider and evaluate developments and proposals in relation to the development of competition as part of its risk management and business strategic planning processes. Legislation will be required for any further extension of competition in the water and sewerage 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 to:

– 75% of 1995 level by 2010
– 50% of 1995 level by 2013
– 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 Government has set targets in England 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% by 2020. Higher targets are in place for some of the devolved administrations. 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.

The Government introduced landfill tax as an 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 has been frozen to 2010/11. A standard rate of £48 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 £80 per tonne in 2014/15.

In order to meet the requirements of the Landfill Directive, individual local authorities have also 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 is currently consulting on possible long-term bans on the disposal of certain types of waste to landfill.

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 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 50 MW must receive consent from the relevant Secretary of State.

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 which have 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 authorities to fund a proportion of the capital and operating expenditures needed for projects.

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.

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. In early April 2009 the Viridor/Laing consortium reached financial close for the 25-year Greater Manchester 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, remedial action.

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) ORDER 2009 (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 6% 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 for the Renewables Obligation Certificate (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 (such as the planned Runcorn EfW CHP plant) are eligible.

A recent change in RO in 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.

37% of Viridor's landfill gas power generation output is under NFFO schemes. These contracts are due to end in tranches over the next six years 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 that currently received under the RO.

CUSTOMERS, COMMUNITY AND EMPLOYEES

The company employs a comprehensive range of technical and professional managerial and operational and support personnel. Many are vocationally trained and have extensive operational experience. Membership of relevant trade unions and 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 is 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 workplace.

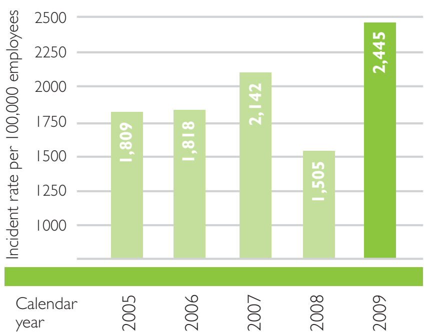
Viridor is pursuing a number of occupational health and safety initiatives, particularly focusing on reducing slip, trip and fall type accidents, continuing improvements in transport management, reducing vehicle/ personnel interfaces and improving manual handling performance. Accreditation to the OHSAS 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 period 2005 to 2009. The company is very disappointed that the rate rose from 1,505 in 2008 to 2,445 per 100,000 employees in 2009.

This increase in reportable accidents (to 67 in total) was due primarily to manual handling type injuries and slips, trips and falls which are the company's largest cause of accidents. Despite comparing favourably with industry averages in previous years, Viridor's focus on health and safety improvement and performance has been further strengthened. The company has recruited additional health and safety professionals and continues to raise the level of training and support available to its staff. Particular efforts are being made to reinforce strong positive attitudes to health and safety at all levels in the company and health and safety is a key aspect of management incentive schemes.

RIDDOR ACCIDENT AND INCIDENT RATES

KPI



ENVIRONMENT

Viridor's operations create significant positive environmental impacts including: 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 (CO_2)); 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; energy use in materials processing; 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 Business Management System (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.

Accreditation to the BMS across all sites and operations has been retained during 2009/10, accredited shortly. 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 and traded by the company grew by 3.5% to a little over 1.4 million tonnes.

Viridor promotes positive working relationships with regulators and communities

SOCIAL AND COMMUNITY ISSUES

A 'good neighbour' policy is implemented at all facilities managed by Viridor. This includes local liaison groups meeting regularly at major sites, enabling local community stakeholders to be consulted and to be 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 amounts 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 £9.4 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 respectively. Viridor maintains a positive working relationship with the regulators via proactive liaison and issues management, at both a site-specific and strategic level.

Local authorities are the largest single customer group accounting in total for 31% of the company's revenue. No individual authority accounts for more than 11%. Viridor's ROC contracts account for 7% of revenue primarily with one customer. No supplier accounts for more than 6% of Viridor's revenue. The company sources from competitive markets.

VIRIDOR'S PRINCIPAL RISKS AND UNCERTAINTIES

Risk	Mitigation
RISKS ASSOCIATED WITH CURRENT UK AND WORLD ECONOMIC CONDITIONS	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. A full assessment of the key risks to Viridor's business arising from current economic uncertainties has been conducted, including the following:
Landfill volumes may decline due to contraction in economy	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 from these inputs. Local authority and Viridor volumes have been less affected to date.
Landfill prices	To date, landfill prices in general have proved robust. In a prolonged recession such prices may be impacted by increased price competition.
Recyclate prices	Recyclate prices are, like any commodity, volatile and are directly impacted by world economic conditions. The effect is most significant on the 40% of Viridor's recycling volumes of internationally traded commodities such as paper, card, plastics and metals. However recyclate is typically cheaper than virgin materials which limits the impact on prices for good quality recyclate. Recyclate prices have recovered to the levels pertaining before the global financial crisis.
Collection volumes (particularly industrial customers) are subject to economic conditions	Currently margins are holding up. However volumes have fallen significantly.
Bad debt collection more challenging in an economic downturn	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.
Government funding cutbacks may lead to the delay or abandonment of major waste projects.	Viridor's existing business with local authorities is covered by contracts on a variety of terms up to 25 years.
INCREASES IN LANDFILL COSTS MAY NOT BE RECOVERED THROUGH PRICE INCREASES	The raising of environmental standards is leading to a gradual increase in landfill costs in general, including engineering (resulting 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.
Recovery of costs of legislative change	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.
Aftercare costs levels	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.
Residual contamination	Viridor's landfill aftercare management includes restoration, maintenance, supervision, monitoring and management of gas and leachate levels after the landfilling activities have ceased. Provision is also made for estimated costs of remediation if required. The EA or SEPA will only grant a full or partial surrender of the permit once it is satisfied that the landfill no longer poses any environmental risk.
Estimated compaction rates (tonnes per cubic metre)	These are best estimates, based on current information, which are reviewed every year based on actual compaction rates assessed by external consultants.

Risk	Mitigation
THE UK GOVERNMENT'S WASTE STRATEGY, STEMMING FROM THE LANDFILL DIRECTIVE, WILL LEAD TO A REDUCTION IN VOLUMES OF WASTE BEING DISPOSED TO LANDFILL.	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 in 2020 will be five to 10 million tonnes. The Government is now seeking to reduce the amount of industrial and commercial waste to be landfilled. However it is believed there will still be a significant total landfill market in 2020 and beyond. Scarcity of landfill will ensure available voidspace remains a valuable asset. With the exception of the most recent year, Viridor has seen its underlying landfill volumes holding steady probably reflecting a greater share of the landfill market.
PRICING AND OTHER RISKS RELATING TO RENEWABLE ENERGY:	
Fluctuating 'brown energy' prices	Viridor's 'brown energy' prices were fixed at high levels 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. Current prices are around £30 per MWh lower than achieved in 2009/10 which will affect the company's 2010/11 power generation comparative performance in 2010/11.
Changes in ROC pricing mechanism	The Government has made a strong commitment to renewables which are key to meeting the UK's long-term carbon reduction strategy. To date the major political parties have stressed their 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.
UK renewable energy generating capacity & licensed electricity suppliers	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.
Volume of gas generated	Current and future waste composition (including Biodegradable Municipal Waste (BMW) diversion due to Landfill Directive and calorific value) is assessed against costs on each landfill gas project.
THE CURRENT PLANNING REGIME MAY RESTRICT THE AVAILABILITY OF FUTURE WASTE TREATMENT FACILITIES	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.
RISKS ASSOCIATED WITH LONG-TERM INTEGRATED CONTRACTS (RISK TRANSFER IS A KEY PART OF GOVERNMENT PFI PROCUREMENT GUIDELINES)	Risks include waste volumes and mix, planning, technology, input costs and recyclate 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. Extensive due diligence is conducted so that risks are correctly identified. Viridor then seeks to protect itself through contractual documentation with its client, sub-contractors and sub-suppliers. Viridor takes a robust approach to 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.

ABOUT OUR BUSINESSES – PENNON GROUP

OTHER FINANCIAL INFORMATION

OPERATING COSTS

Group operating costs for the year totalled £799.3 million and included the following major categories of expenditure:

	£m
Landfill tax	150
Depreciation	135
Manpower	132
Transport	51
Raw materials and consumables	27
Property	26
Power	24
Abstraction and discharge consents	8
Lease rentals – plant and machinery	8
Statutory operating licences and royalties	8

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.

GROUP INVESTMENT

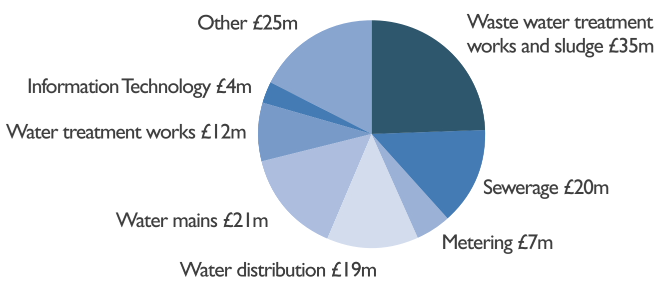
Capital expenditure by the Group on property, plant and equipment was £190.2 million (2008/09 £231.8 million). The major categories of expenditure were:

CASH FLOW

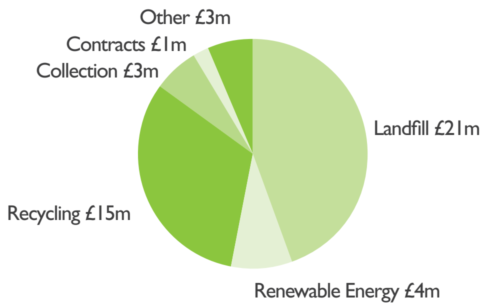
In 2009/10 the Group once again had a strong operating cash flow, with net borrowing increasing by only £3 million. The operating cash flow was offset by capital expenditure and investment in acquisitions and joint ventures.

Summarised cash flow	2009/10 £m	2008/09 £m
Cash inflow from operations	380	341
Pension contributions	(16)	(40)
Net cash inflow from operations	364	301
Net interest paid	(70)	(80)
Dividends and tax paid	(68)	(100)
Capital expenditure payments	(192)	(236)
Acquisitions/joint ventures	(40)	(3)
Net cash outflow	(6)	(118)
Shares issued	2	2
Equity component of convertible bond issued	10	–
Debt acquired with acquisitions	(5)	–
Debt indexation/interest accruals	(4)	(13)
Increase in net borrowings	(3)	(129)

SOUTH WEST WATER CAPITAL EXPENDITURE



VIRIDOR CAPITAL EXPENDITURE

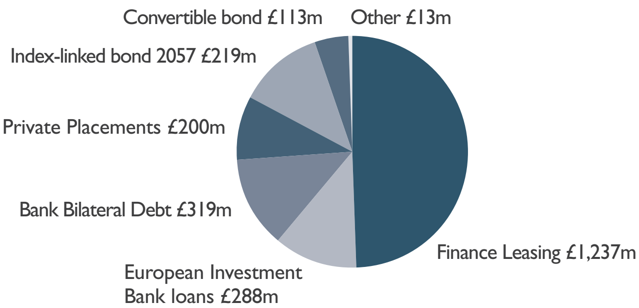


LIQUIDITY AND DEBT PROFILE

At 31 March 2010 the Group held cash and deposits of £494 million, and also had committed undrawn facilities of £200 million. During the year new borrowings and finance lease drawdowns, less debt repayments, amounted to £145 million. In April 2010 a further £100 million of debt facilities have been established or renewed.

At 31 March 2010 loans and finance lease obligations were £2,389 million, giving net debt (after the £494 million cash) of £1,895 million, an increase of £3 million during the year.

The major components of debt finance at 31 March 2010 were:



During the year the following finance initiatives were implemented:

- £125 million convertible bond
- £215 million term loans and RCFs renewed
- £89 million of new term loans
- circa £200 million finance lease extended to 2052 and converted to 'bullet' repayment
- £25 million finance lease for South West Water
- £25 million 5-10 year finance lease for Viridor
- new provider for £35 million of Environment Agency bonds sourced.

Pennon Group debt has a maturity of 0-47 years with an average maturity of 23 years.

The Group has fixed or put in place swaps to fix the interest rate on 50% of South West Water's net debt for the entire K5 period. The average rate achieved on the £803 million fixed rate debt is circa 3.65%.

In addition, South West Water has approximately 23% of its debt index-linked to 2041-2057, at an overall real rate of 1.66%.

South West Water held cash and deposits of £265 million at 31 March 2010 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 27 to the financial statements and amounted to a £296 million funding benefit compared with book value as at 31 March 2010 (2009 £221 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.

CAPITAL STRUCTURE – OVERALL POSITION

With year-end net debt of £1,895 million, the Group year-end ratio of net debt to (equity plus net debt) was 74% (31 March 2009 76%).

South West Water's debt to Regulatory Capital Value (RCV) was 60.6% at 31 March 2010 (2009 63.8%), 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 £420 million (2009 £443 million), equivalent to 3.7 times EBITDA (2008/09 4.2 times).

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 at least 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.

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

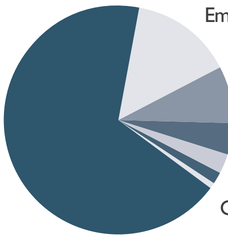
Pennon Group's tax strategy is to enhance shareholder value by legally minimising taxes whilst having regard to the longer-term relationships with the taxing authorities. The Group will consider bona fide business arrangements which qualify for tax exemption or tax relief.

The Group made a net payment of £4 million for UK corporation tax in the year (2009 £31 million). The significant reduction in the net payment, compared to the prior year, is due to refunds received from HMRC arising on the reassessment of payments made in previous years.

The UK corporation tax charge of £43 million was less than the charge which would have arisen from the accounting profit of £184 million taxed at the statutory corporation tax rate of 28%. A reconciliation is provided in note 9 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:

TAX CONTRIBUTION 2009/10



Total taxes amounted to £250 million, of which £43 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 £146 million was accounted for by the Group on behalf of HMRC. Landfill tax is an operating cost which is chargeable to customers in turnover. In addition the Group incurred landfill tax of £24 million on the disposal of waste to third parties. This element is an operating cost for the Group and reduces profit before tax
- Value Added Tax (VAT) of £7 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 £36 million included 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% capitalised to property, plant and equipment
- Fuel Excise Duty of £11 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. The main schemes were closed to new entrants on or before 1 April 2008.

The Group pension schemes had net liabilities (before deferred tax) at 31 March 2010 of £108 million (2009 £66 million). The deficit increase was due to increased liabilities from a reduced discount rate and higher expected long-term inflation partially offset by employer contributions of £16m and increases in asset values from market movements.

The increase in fund assets from £276 million to £402 million includes £55 million from the acquisition of Greater Manchester Waste Limited.

The net liabilities (after deferred tax) of £78 million represented less than 5% of the Group's total market capitalisation at 31 March 2010.

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.

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 sourced from:

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

Contract terms include financial and legal covenants as outlined in the covenant compliance risk section on page 31.

PENNON'S PRINCIPAL RISKS AND UNCERTAINTIES

Risk	Commentary and mitigation
EARNINGS GROWTH/ SHAREHOLDER VALUE	
It may not be possible to continue to sustain the same level of earnings and growth of the Group as in the past	This is dependent upon the correct strategies being pursued by strong and able management within the Group as well as on external factors.
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	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.

Risk	Commentary and mitigation
TREASURY	
The Company may be unable to raise sufficient funds to finance its activities	Pennon Group has robust treasury policies in place, as listed below:
Liquidity risk	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.
Refinancing risk	Ensuring that no more than 20% of Group net debt is permitted to mature in any one financial year. At 31 March 2010 the Group had cash and deposits of £494 million, and undrawn committed bank facilities of £200 million, giving access to total cash resources of £694 million. Loan repayments falling due by 31 March 2011 amount to £216 million.
Covenant compliance risk	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. Redemption penalties included in the facility documentation can be invoked if debt facilities are redeemed early. The redemption penalties vary in each facility. 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 UK 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.
Counterparty risk	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. 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 (Aa2 Moody's/ AA Standard & Poor's).
Interest rate risk	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 50% of South West Water's existing net debt up to 31 March 2015. At 31 March 2010 the Group had interest rate swaps to convert floating rate liabilities to fixed rate, and hedge financial liabilities, with a notional value of £775 million and a weighted average maturity of 3.0 years (2009 £760 million, with 2.4 years). The weighted average interest rate of the swaps for their nominal amount was 4.0% (2009 4.5%). 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 23 to the financial statements. In addition South West Water has index-linked approximately 23% 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.
TAXATION	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. Professional tax consultants are employed with experience of analysing the types of specialist assets involved.
PENSIONS	
The future costs of defined benefit schemes are subject to a number of risks	New employees are generally offered defined contribution arrangements.
The returns achieved on pension fund investments	Pension trustees keep investment policy under review and use professional investment advisers.
Movements in interest rates and inflation	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 £16 million were made in the year.
Pensioner longevity	Independent actuaries have identified scheme-specific mortality experience which is reflected in liabilities.

PENNON GROUP'S CORPORATE RESPONSIBILITY

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

OUR APPROACH TO SUSTAINABILITY

Sustainability in all its three aspects – environmental, social and economic – is fundamental to the Group's business models and is reflected in our corporate responsibility objectives listed above. We believe that green business is good business.

1. Environmental Sustainability

The key linked environmental issues facing the world are climate change, excessive resource use, environmental degradation and loss of biodiversity. The Pennon Group has a role to play in all these areas and is concerned that the high profile rightly given to climate change may lead to the other equally pressing and related challenges being overlooked.

a. Environmental Improvement

South West Water's £2 billion Clean Sweep programme has transformed the coastal and estuarial environment of the South West, which has over 30% of the bathing waters of England and Wales. With other improvements carried out by South West Water under the Urban Waste Water Treatment Regulations to protect river quality, the company's operating area now has the best river quality in England. The investment made since 1989 has also largely met the Water Framework Directive's first cycle of requirements for 2010-2016.

Similarly Viridor has invested heavily to control and mitigate the two most serious potential adverse environmental effects of its operations, landfill generated leachate and gas. Since 2002 Viridor has invested £13 million in leachate control systems and £80 million in landfill gas control and power generation.

b. Climate Change/Greenhouse Gases

Both our two main subsidiaries generate significant amounts of CO_2 and are striving to reduce this. Viridor's strategy is based upon helping the UK to meet its landfill diversion, recycling and renewable energy targets which are in turn driven, in significant part, by climate change considerations. Methane emissions from landfill are the most important greenhouse gas pollutant source for Viridor and for the waste industry as a whole, methane being 21 times as harmful as CO_2. Huge achievements have been made in the waste industry in reducing methane emissions from landfill and putting it to beneficial use in the generation of renewable electricity. This is the key factor behind the waste industry's 57% reduction in CO_2 emissions since 1990, the best of any sector in the UK. At the same time the waste industry has increased renewable energy generation from landfill gas by 600% which now provides nearly 25% of the total renewable energy in the UK. Viridor has increased its landfill gas renewable energy generation capacity from 27 MW in 2002 to 100 MW in 2009/10 and it captures 90% of the methane from its landfills for power generation. This provides major environmental benefits and produces a return for shareholders.

South West Water recognises that the water industry is a major user of energy, requiring 2% of the UK's total consumption. Following a successful submission in South West Water's price setting to Ofwat, moorland restoration through the company's 'Mires' programme is being undertaken. One of the most valuable outputs is the ability of wetted peat to capture significant quantities of CO_2. South West Water secured in Ofwat's Final Determination £5 million of funding to increase its renewable energy output from 15 GWh in 2010 to 30 GWh by 2015. This investment will help South West Water to meet its CO_2 emissions reduction target by 18% over the five-year period. The company's longer term targets are to produce 50 GWh from renewable energy by 2030 and to reduce energy consumption by 10% by 2015 and by 30% by 2030.

c. Resource Productivity

It is generally believed that the world has used as much resource since 1950 as in all previous history. There are developing shortages in a number of key areas including hydrocarbons, water, topsoil and in a number of key metals.

Minimising resource use has become a major priority for society. Viridor has invested heavily in maximising recycling and composting, at a value approaching £200 million in the past three years. We are convinced that such investment makes long-term economic and environmental sense. Our total recycling traded volumes and composting have grown from about 100,000 tonnes in 2001 to 1.4 million tonnes in 2010. The supply of good quality recyclate is a profitable business yielding twice as much profit per tonne for Viridor as does landfill. This is an example of where the interests of shareholders and the needs of the environment are aligned.

The best use for low quality residual waste, after recycling has been optimised, is to generate renewable energy either by anaerobic digestion of organic wastes or through controlled energy from waste combustion. These are the main current alternatives to landfill with methane capture and utilisation. Including its Bolton EfW plant and its 50% share in the recently opened Lakeside EfW plant, as well as landfill gas utilisation, Viridor now has a total renewable energy capacity of close to 130 MW and plans to increase this to 300 MW in the next five years. Pennon is pleased that the Government now recognises the significant contribution that energy from waste in all its forms can make to UK renewables and energy production. Energy from waste currently accounts for 1.5% of the UK's total electricity production. As the energy generated is a by-product of required waste treatment it is cheaper than other forms of renewable energy. It also provides base load energy distributed round the electricity grid, which is a significant advantage over wind power. Our estimate is that energy from waste could provide 6% of the UK's electricity by 2015 and we have called upon the Government to set this as a specific target.

South West Water is ensuring, as part of its environmental and quality management systems, that all wastes are minimised and segregated for recycling so that wastes taken off site for disposal are kept to the absolute minimum. We work with contractors and our partners to minimise the quantities of waste produced. Site waste management plans are in place for all capital schemes.

2. Social Sustainability

Both our businesses strive to be good neighbours and to show exemplary concern for our employees. It is acknowledged that required waste water or waste management installations may be opposed in certain locations. Our policy is to consult and engage fully with communities and stakeholders on planning applications.

Where new infrastructure is built we work closely with the communities in which we operate to be as good neighbours as possible.

Viridor continues to benefit from the high levels of skill and expertise amongst its workforce and acknowledges their valuable contribution. The company employs around 3,000 people at all levels and across all socio-economic groups. During this recessionary period we have striven to maintain morale and motivation despite having to implement a modest programme of downsizing and restructuring. We have maintained our training programmes and are confident that as the recession lifts we will still have first class, well qualified teams of capable people ready to meet future challenges.

South West Water's focus is on achieving an appropriate balance for customers, investors and other stakeholders. Costs are being rigorously controlled to outperform the Regulatory Contract. Capital is being invested in assets to secure operating cost savings and to protect the improvements made over the last 20 years through increased capital maintenance expenditure. The combined effects of these approaches are to ensure long-term improvements in quality of service for our customers, supported by enhanced employee training and development programmes for our managers and staff.

3. Economic Sustainability

This involves having business strategies and policies which are geared towards long-term shareholder value creation. The Company's strategy is to aim for long-term shareholder value creation while being fully aware of our environmental impacts. Both businesses are planning and investing on a 25-year basis. Our financial policies are designed to avoid short-term gains which might damage long-term shareholder value creation. Debt funding is an important component of South West Water's capital structure and its debt/RCV ratio and other financial ratios remain well within Ofwat's guidelines.

Our Corporate Responsibility objectives link with our sustainability aims. Progress is monitored by measuring performance against a number of associated KPIs listed below.

Both South West Water and Viridor publish detailed verified corporate responsibility reports which support and amplify the Group's overall objectives. The 2010 Corporate Responsibility Reports, which will be available at the end of August, will include an audited assessment of the businesses' performance against published targets for 2009/10 and will set out their new targets for 2010/11.

OUR KPIs

The target for 2009/10 of 'maintain corporate standing of Pennon Group Plc on sustainability credentials' was measured by:

- the Carbon Disclosure Project awarded Pennon Group of 55th place out of the FTSE350 in the 2009 Carbon Disclosure Leadership Index for the Group's ability to log its carbon footprint and assess how climate change will affect its business
- membership of the FTSE Environmental Opportunities All-Share Index
- continued participation in the FTSE4Good Index which measures corporate responsibility.

For 2010/11 the Board has agreed the following six KPIs for the Pennon Group. Performance will be measured and reported against them:

- capital investment
- community support and donations
- RIDDOR statistics
- renewable energy generation
- CO_2 emissions data
- recycling volumes achieved.

OUR SOCIAL AND ENVIRONMENTAL POLICY

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. Particular attention is given to:

- operating through best practice to ensure the sustainability of our activities by maximising the efficiency of 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 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, recycling and renewable energy generation
- 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 for, 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 the treatment of everyone with respect and dignity
- not make any promises and commitments which our businesses 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 harm 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 business policy, our social and environmental policy and our health and safety policy and related targets. Further details of the work of the Committee are set out on page 51.

CORPORATE RESPONSIBILITY HIGHLIGHTS

Both South West Water and Viridor have continued to advance their environmental performance, and their engagement with the community, as detailed in their respective Corporate Responsibility Reports which will be available online in August on the Company's website **pennon-group.co.uk**

ENVIRONMENT AND CLIMATE CHANGE

The Group's strategy to combat climate change is to maximise its opportunities for renewable energy generation, to promote energy efficiency and to reduce its emissions of greenhouse gases wherever possible. In planning for the future it strives to ensure that it can adapt to the impacts of a changing climate while maintaining high standards of customer service.

Green energy generation

Renewable energy is generated by both subsidiaries. Viridor's renewable power generation capacity from landfill gas at 31 March 2010 was 100 MW. In addition during the year the Lakeside joint venture EfW plant commenced operation with a total power generation capacity of 37 MW (50% Viridor) and Viridor also took over the 9 MW Bolton EfW plant bringing Viridor's total renewable energy capacity to 127.5 MW. Its Greater Manchester combined waste and renewable energy project has the potential to provide a further 130 MW of power generation capacity (making a total of around 140 MW including the Bolton EfW). Viridor captures nearly 90% of the methane arising from its landfills and uses 70% of this for energy generation.

South West Water generates renewable energy from hydropower facilities in dams and other structures. Combined heat and power is available at nine waste water treatment works. South West Water has a total installed capacity of 7.4 MW.

Net electricity export

Since 1999/2000, the Group has exported more electrical energy each year than it has consumed. Recent renewable energy projects commissioned by the Group's operating companies have surpassed the milestone of 200% generation to consumption for the first time. In 2009/10 Viridor and South West Water generated 652.0 GWh of renewable energy through their operations. This is 223% (2009: 188%) of the Group's on-site electricity consumption of 291.7 GWh.

Greenhouse gas emissions

Pennon has registered for the Carbon Reduction Commitment Energy Efficiency Scheme which puts the Government's carbon reduction scheme in place for 5,000 UK companies in the mid-range of CO_2 producers. Pennon will be purchasing its first allowances in April 2011. The price of carbon will be fixed at £12 per tonne for the first three years of the scheme; active trading is expected to follow.

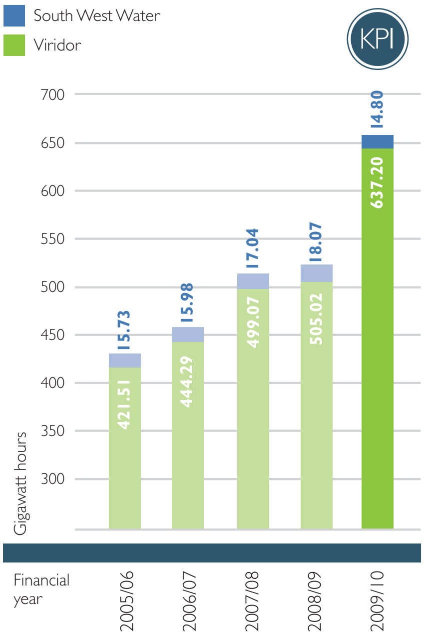
Pennon Group made its third submission to the Carbon Disclosure Project in 2009 and was placed 55th in the report. The reporting criteria differ from one year to the next making annual score comparisons unreliable. However, year by year scores within a sector are made and the Pennon Group's perfomance in relation to its peers in 2009 was good – it achieved third place amongst the six water companies who responded.

Greenhouse gas emissions reporting requirements have changed since last year. The Group is reporting against the Greenhouse Gas Protocol, with different methodologies used for South West Water and Viridor to match each company's operating characteristics.

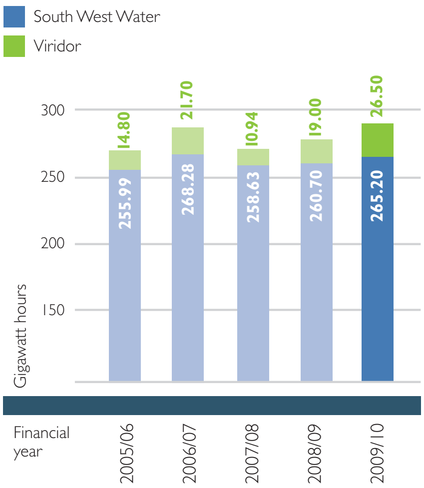
Group transport

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



ELECTRICITY CONSUMPTION AND GENERATION

On-site electricity consumed			**GWh**
South West Water (1) (3)			265.2
Viridor			26.5
Total consumed			**291.7**
Electricity generation			
	No of sites	Capacity MW	GWh
South West Water			
– Hydro	7	5.7	11.3
– Biogas from combined heat and power	9	1.7	3.5
Viridor			
– Landfill – biogas (2)	27	100.0	555.0
– Energy from waste combustion	2	27.5	82.2
Total generated			**652.0**
Generated/consumed ratio			**223%**

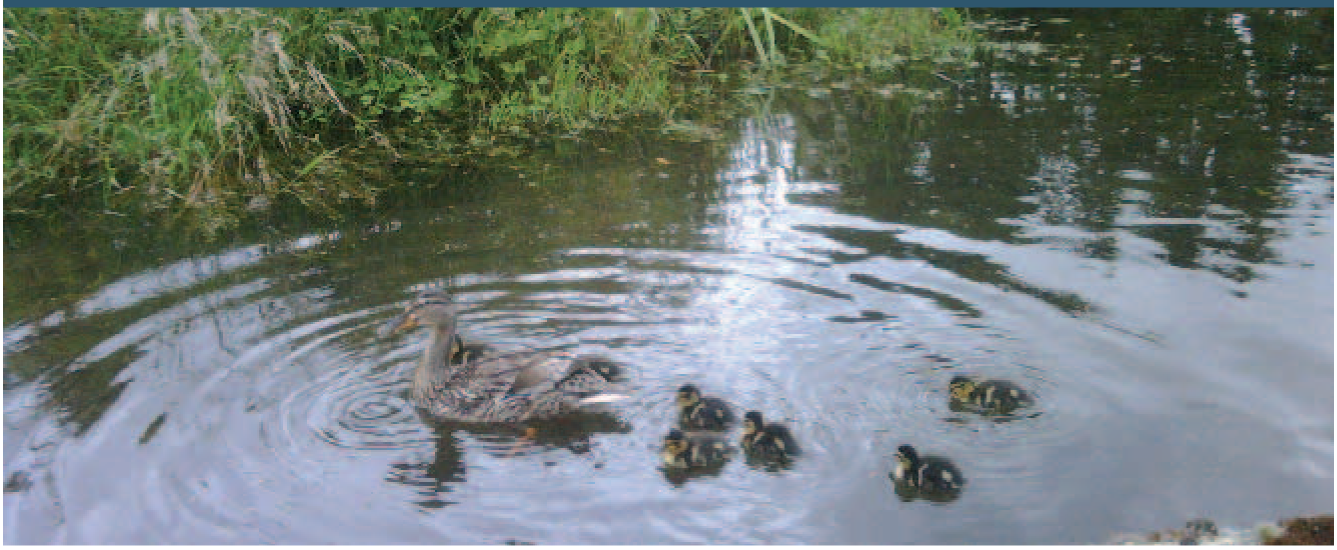
(1) Includes activity of Pennon Group Plc and partners working from Pennon's locations
(2) Excludes sub-contracted sites in Suffolk
(3) South West Water on-site electricity consumed includes electricity generated and used from on-site renewable plants and stand-by diesel generators and excludes non-electrical sources of energy such as the consumption of natural gas and LPG used for heating

Pennon Environmental Awards

In 2009 the winning prize was awarded to the operating team at Tottiford Water Treatment Works for enhancing wildlife and amenity on site. The project subequently won a Green Apple Award and was chosen as a finalist in the Water Industry Achievement Awards' Community Campaign of the Year category, as a number of the site features had been provided by a local business which employs adults with learning difficulties.

PEF Award Photo: the Tottiford team receives the award from Ken Harvey, Pennon Group Chairman.

PEF Award Photo: former process tank converted for wildlife and amenity use.



EMPLOYEES

Health and Safety Policy

Pennon Group Board and the Boards of each subsidiary company have established health and safety policies which are reviewed annually to ensure the health, safety and welfare at work of all their employees. These focus in particular on 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.

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 business and consults employees on measures for promoting health and safety at work
- requires its contractors and consultants working for each company within the Group to comply with each company's health and safety policy. 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 pages 18, 20 and 24.

COMMUNITY ENGAGEMENT

Pennon Group and its subsidiary companies aim to be good neighbours in all the communities in which they operate. An important element of this is to provide support to projects which bring lasting benefit to local communities and which are aligned with the Group's business.

South West Water's support focuses on water, the environment and youth education in the South West. A small proportion of its support also goes to Water Aid, which assists water projects in developing countries.

Viridor's business is UK wide. Its community support focuses on environmental and science education, and on engagement with the communities in which it operates.

Pennon Charitable Donations

The Pennon Charitable Donations Committee made 199 donations including pledges to individuals, local charities, volunteer groups and small community organisations in the South West Water and Viridor service areas. £63,784 was awarded in 2009/10 (2008/09 £65,624).

Pennon Environmental Fund

The Pennon Environmental Fund allocates awards derived from the Landfill Community Fund to qualifying projects developed by local community bodies based in South West Water's operating area. In 2009/10 it awarded £68,443 to 15 projects, including to church repairs, community amenities, and a number of habitat creation schemes in Devon and Cornwall to benefit biodiversity (2008/09 £47,404 to 11 projects).

Viridor Credits Environmental Company

During the year Viridor donated £9.4 million (£9.7 million in the previous year) via the Landfill Communities Fund to Viridor Credits Environmental Company, an independent charity established to distribute LCF funding in areas close to landfill sites. Decisions on funding use criteria of sustainability, value for money and proven need 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, sports and playgrounds, vital support for local museums and similar community assets. For further details see Viridor Credits' website **viridor-credits.co.uk**

'Back from the Brink', Slimbridge Wetlands Centre, Gloucester. Viridor Credits granted £106,500 for new wetland homes for once abundant mammals.

'Cricket for Change', Wallington, Sutton. Viridor Credits granted £60,000 towards a new indoor school for young cricketers from mixed backgrounds.

STAKEHOLDER ENGAGEMENT

Pennon Group maintains a regular dialogue with institutional investors, City analysts, retail shareholders, local stockbrokers and the financial press through its proactive investor relations programme. Other key stakeholders are our customers and our regulators, including the Environment Agency, local authorities, the Drinking Water Inspectorate, Natural England, the Consumer Consumer Council for Water and English Heritage. Viridor has on-going stakeholder and community relations programmes with local liaison groups in place for all major operational sites. South West Water proactively worked with customers to identify their priorities for investment from 2010 to 2015 as part of the recent Periodic Review process, and surveys 130 customers' opinions every month to assess their perceptions of overall service, value for money, quality and reliability of drinking water supplied.

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 also represents the regulated industries on the Environment Agency's Regional Environmental Protection Advisory Committee.

Viridor's Chief Executive chairs the Government's Living with Environmental Change Business Advisory Board and its Environmental Sector Advisory Group, which provides strategic advice to the Government on the promotion of exports and inward investment in the UK environmental sector. He is also chairman of the UK's Environmental Sustainability Knowledge Transfer Network, which improves the competitiveness of UK environmental industries, a Director of Sustainability South West, past 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.

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 Group's corporate responsibility performance for 2009/10 will be audited by Acona Limited, an independent risk and compliance management company. The verification statements for South West Water and Viridor will be 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 'Principal Risks and Uncertainties' within this Business Review.

GLOSSARY

The following are descriptions of some of the terms used in this Business Review:

AD	Anaerobic digestion
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
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
MZC	Mean Zonal Compliance or 'Overall Water Quality' as assessed by the Drinking Water Inspectorate
NFFO	Non Fossil Fuel Obligation
Ofwat or water regulator	Water Services Regulation 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, recycling 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 37 of this Directors' report.

In addition the Business Review contains a fair and balanced review of the business of the Group, including its position and prospects, Key Performance Indicators and a description of the principal risks and uncertainties facing the Group in accordance with the requirements of the Combined Code and Section 417 of the Companies Act 2006. In addition in accordance with the ABI Corporate Social Responsibility Guidelines, statements are included on any significant environmental, social and governance (ESG) risks and the actions taken in mitigating these risks within the Business Review on pages 21, 26, 27, 30 and 31. Further information on ESG aspects of the Group's business are included in the Corporate Responsibility Report on pages 32 to 36. The principal subsidiaries of the Company are listed in Note 39 to the financial statements on page 106.

CORPORATE GOVERNANCE STATEMENTS

The following disclosures are made pursuant to Part 6 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts & Reports) Regulations 2008 and Rule 7.2.3.R of the UK Listing Authority's Disclosure and Transparency Rules (DTR). The further information required by DTR 7.2 is set out in the Company's Corporate Governance and Internal Control Report set out on pages 49 to 52 of this Annual Report which is hereby included within this Directors' Report by reference.

As at 31 March 2010:

a) details of the Company's issued share capital, which consists of ordinary shares of nominal value 40.7 pence each, are set out in Note 32 to the financial statements on pages 97 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 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 39 '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 2009 Annual General Meeting (AGM). In addition, shareholders approved a resolution giving the Directors a limited authority to allot shares for cash other than pro rata to existing shareholders. These resolutions remain valid until the conclusion of this year's AGM. Similar resolutions will be proposed at this year's AGM. The Directors have no present intention to issue ordinary shares other than persuant to the Company's Scrip Dividend Alternative; and

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

FINANCIAL RESULTS AND DIVIDEND

Statutory Group profit on ordinary activities after taxation was £139.5 million. The Directors recommend a final dividend of 15.60p per ordinary share to be paid to shareholders on the register on 13 August 2010, making a total dividend for the year of 22.55p, the cost of which will be £79.6 million, leaving a credit to reserves of £59.9 million. The Business Review on pages 4 and 5 and 28 to 30 analyses the Group's financial results in more detail and sets out other financial information, including the Directors' opinion on asset values on page 28.

DIRECTORS

Gerard Connell and Chris Loughlin are due to retire at the AGM on 29 July 2010 and offer themselves up for re-election. In addition, in accordance with best practice as set out in the Combined Code, Ken Harvey continues to offer himself up for re-election annually as he has been a Director for over nine years. The Board continues to believe that Gerard Connell, as a Non-executive Director standing for re-election is independent, and that he makes an effective and valuable contribution to the Board, demonstrating continued commitment to the role. Ken Harvey and Gerard Connell do not have service contracts. Ken Harvey does have a contract for services which is terminable upon 12 months' notice. Chris Loughlin has a service contract which is due to expire in three years' time, being upon his normal retirement date. Resolutions for the above Directors' re-election will be proposed at the AGM. The Directors' biographies are set out on page 40.

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 44. Further details relating to the Directors and their service agreements or contracts for services are set out on pages 43 and 44 and details of the Directors' interests in shares of the Company are given on pages 45 to 48.

DIRECTORS' INSURANCE AND INDEMNITIES

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

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

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

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

RESPONSIBILITY STATEMENTS

Each of the Directors, whose names and functions are listed on page 40, confirms 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 adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and of the Company; and

b) 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.

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

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 page 31.

EMPLOYMENT POLICIES AND EMPLOYEE INVOLVEMENT

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

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

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

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

Further information about employment matters relating to the Group are set out on pages 18-20, 24 and 35 of the Business Review.

The Group encourages share ownership amongst its employees by operating an HM Revenue & Customs (HMRC) approved Sharesave Scheme and Share Incentive Plan. At 31 March 2010 around 36% 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 (2008/09 £0.2 million).

PENNON GROUP DONATIONS

During the year donations amounting to £63,609 (2008/09 £74,781) were made. Further details are included on page 36 of the Business Review. No political donations were made (2008/09 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 2011 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 2009/10 and the amount owed to its trade creditors at 31 March 2010, was 34 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 2009) which was valid as at 31 March 2010 and remains currently valid. Of the 5,724,131 shares held in Treasury at 31 March 2009, 631,557 were subsequently re-issued under the Company's Sharesave Scheme for proceeds of £1.9 million.

AUDITORS

PricewaterhouseCoopers LLP were appointed auditors until the conclusion of the twenty-first 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 2010 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 twenty-first Annual General Meeting of the Company will be held at the Sandy Park Conference Centre, Sandy Park Way, Exeter, Devon EX2 7NN on 29 July 2010 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 (with updating to accord with the latest institutional guidelines and the Companies Act 2006) 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 G D Connell and Mr C Loughlin as Directors of the Company
- adopt new Articles of Association. This is proposed principally to bring the Articles up to date in accordance with the provisions of the Companies Act 2006 which are all now in force and include changes to the limits set out in the existing Articles relating to Directors' fees
- increase the Company's borrowing power from $2\frac{1}{2}$ to 3 times capital and reserves (and amend the definition of capital and reserves to exclude therefrom the impact of market price movements on the accounting treatment of financial derivatives to which the Company is a party) as set out in the Company's Articles
- 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).

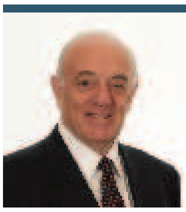
Details of the resolutions are set out in the separate Notice of Annual General Meeting which is circulated to shareholders with this Annual Report or provided by electronic communication via the Company's website **pennon-group.co.uk** Information required by Section 311A of the Companies Act 2006 is also on the Company's website.

By Order of the Board

KEN WOODIER,
Group General Counsel & Company Secretary

24 June 2010

BOARD OF DIRECTORS



KENNETH GEORGE HARVEY BSC, 69 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, CCMI, 59 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 Living with Environmental Change Business Advisory Board; of UKTI's Environmental Sector Advisory Group; and of the Environmental Sustainability Knowledge Transfer Network. He is a senior visiting research fellow in Earth Sciences at Oxford University; an adviser to Beehive Water and Waste Holdings LP; and a Past Master of the Worshipful Company of Water Conservators.

DAVID JEREMY DUPONT MA, MBA, 56 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, 57 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.

MARTIN DAVID ANGLE BSC HONS, FCA, 60 NON-EXECUTIVE DIRECTOR

Appointed on 1 December 2008. Martin currently holds non-executive directorships with Savills plc, JSC Severstal, Shuaa Capital and The National Exhibition Centre where he is Chairman. Until November 2009, he was also on the Board of Dubai International Capital. In addition he sits on the Advisory 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.

GERARD DOMINIC CONNELL MA, 52 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 having trained originally at Price Waterhouse 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.

DINAH ALISON NICHOLS CB, BA HONS, 66 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 charitable Trusts.

GROUP GENERAL COUNSEL & COMPANY SECRETARY

Ken Woodier, Solicitor

REGISTERED OFFICE

Peninsula House,
Rydon Lane,
Exeter
EX2 7HR

Registered in England No 2366640

COMMITTEES OF THE BOARD

AUDIT

Gerard Connell (Chairman)
Martin Angle
Dinah Nichols

NOMINATION

Ken Harvey (Chairman)
Martin Angle
Gerard Connell
Dinah Nichols

CORPORATE RESPONSIBILITY

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

REMUNERATION

Martin Angle (Chairman)
Gerard Connell
Dinah Nichols

DIRECTORS' REMUNERATION REPORT

PURPOSE

The Directors' Remuneration Report is designed to provide for the benefit of shareholders details of:

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

The Company understands investors' concerns relating to executive director remuneration and, whilst focus has been on the financial sector primarily, it is fully recognised that there is a need for other sectors to reflect this concern in their remuneration policies and overall remuneration practice. This is why last year, despite the Group's businesses being well positioned in the economic slowdown, the Remuneration Committee decided not to increase salaries for Executive Directors beyond those set in 2008.

REMUNERATION COMMITTEE

The Remuneration Committee of the Board comprises three Non-executive Directors who are all regarded by the Company as independent. Martin Angle is the Chairman of the Committee and the other two members are Gerard Connell and Dinah Nichols.

The Committee's Terms of Reference is available from the Group Company Secretary and can be found on the Company's website **pennon-group.co.uk** It includes:

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

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

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

- Ken Woodier, Group General Counsel & Company Secretary on remuneration and share scheme matters. He also provides legal advice and company secretarial services to the Company
- Hewitt Associates Limited, pensions and remuneration consultants, on calculating total shareholder return for the Company's Restricted Share Plan (now replaced by the Company's Performance & Co-investment Plan). Hewitt also provide actuarial and investment pensions advice to the Trustees of the Group's Pension Schemes
- Towers Perrin Limited (now Towers Watson Limited), remuneration consultants, who undertook a review of the Group's remuneration policy and practice for the Committee during the year.

REMUNERATION POLICY

Last year the Remuneration Committee reported that it would undertake a review of Remuneration Policy in September 2009. Having undertaken this review with advice from Towers Perrin the Committee concluded that the current policy remained appropriate. This policy which will be applied in 2010/11, and is also currently intended to be applied in each subsequent year, is 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 key guiding principles of this policy are to:

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

The policy in respect of Non-executive Directors' fees is set out on page 44 in the Non-executive Directors remuneration section.

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

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

REMUNERATION OF EXECUTIVE DIRECTORS

Below is an outline of the total remuneration package for Executive Directors.

Fixed	Variable (Performance-related)	
Base Salary	Short-term – Annual	Long-term – 3 years
Pension – Final Salary (Defined Benefit) or cash alternative	Annual Incentive Bonus Plan - Maximum 100% of basic salary with 50% paid in cash and 50% in shares deferred for 3 years	Performance and Co-investment Plan (PCP) – future performance over 3 years
Other – car benefit and health cover	Assessed against corporate financial performance and individual personal achievements relating to a range of operational and compliance targets.	50% linked to water and waste comparator group and 50% linked to relative FTSE 250 with an underpin relating to operational and economic performance.

The following is a detailed summary of the elements of remuneration:

(i) Basic salary and benefits – these are set out on page 44 for each Executive Director and are not related to performance. The Committee reviews salaries annually taking account of market data available from independent remuneration consultants. A pay freeze was applied in 2009/10. When reviewing base salaries the Committee takes account of the performance of the individual Executive Directors which the Committee assesses with the advice of Ken Harvey, Chairman of the Company. Other benefits, not mentioned below, include 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 the Group's Annual Incentive Bonus Plan (the Bonus Plan) and are based on the achievement by the Executive Directors of overall corporate and individual objectives set by the Committee. The maximum bonus achievable under the Bonus Plan for Executive Directors for 2009/10 was 100% of basic salary. To achieve the maximum percentage bonus allocated in respect of the corporate targets of earnings per share and profit before tax it is necessary for the Company to achieve a specified level of superior outperformance. Half of any bonus awarded is in the form of ordinary shares in the Company which must usually be held for a period of three years before release (Deferred Bonus Shares). During this period the Directors, in respect of the Deferred Bonus Shares, are entitled to receive any dividends declared by the Company. No additional performance conditions applicable to the release of the Deferred Bonus Shares apart from maintaining continuous service with the Company, are considered appropriate by the Committee in view of the stretching performance conditions applicable to achieve the initial award of the Deferred Bonus Shares. The Committee, in setting the performance objectives for Executive Directors, takes account of corporate performance on environmental, social and governance (ESG) matters. Objectives set embrace appropriate ESG parameters which are important to the success of the Group and which seek to ensure that the Group meets a number of its ESG targets as set out in the Group's Corporate Responsibility Report on pages 32 to 36 of the Business Review. The Committee in setting such objectives and in determining its remuneration policy overall ensures that the relevant incentives to Directors and Senior Management raise no ESG risks by inadvertently motivating irresponsible behaviour. In addition the Committee will take into account ESG matters in determining the vesting of any awards under the Company's Performance & Co-investment Plan referred to below.

In 2009/10 the Committee structured and operated the Bonus Plan on a different basis. The Bonus Plan was amended by the Committee to permit its operation in conjunction with the Company's Executive Share Option Scheme (ESOS) which received shareholder approval in 2001 on the basis that the aggregate pre-tax value of the awards made under both the Bonus Plan and the ESOS would be the same as they would have been if the Bonus Plan had been operated alone, as in previous years. This has been achieved by providing for Deferred Bonus Shares awarded to be forfeited by the Directors up to the same value as that of any gain made in respect of options exercised by the Directors pursuant to the ESOS at the end of the three-year restricted period. Only the HMRC approved part of the ESOS was operated in 2009/10 which enabled options over ordinary shares in the Company to be granted to Directors to the value of £30,000 at the then prevailing price. Details of the options granted are set out in the table in paragraph (d) on page 47.

Set out below is a summary of the performance targets determined by the Committee for each Executive Director for 2009/10 and for 2010/11.

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

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

Chris Loughlin – A bonus of up to 40% for outperformance of Group earnings per share against budget; up to 20% for personal objectives relating to implementing South West Water's new strategies and projects and meeting compliance targets; and up to 40% calculated by reference to the average bonus earned by the other executive directors of South West Water (which relate to outperformance against the operating costs, profit before tax, capital expenditure and net debt budgets of the company; the position the company achieves in the '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 the parameters set are known. This enables the Committee to apply largely objective criteria in determining the level of bonus (if any) which should be awarded, with the advice of the Chairman of the Company, Ken Harvey.

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

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

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

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

These are the Company's key listed sector comparators.

WATER/WASTE GROUP	Vesting % of total award
Above the index	
+15%	50%
Equal to the index	15%
Straight-line vesting in between the above points	
Below the index	0%

- Up to 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.

FTSE 250 GROUP	Vesting % of total award
At or above the 75th percentile	50%
Above 50th percentile	15%
Straight-line vesting in between the above points	
At or below the 50th percentile	0%

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.

Between 1997 and 2006 the Company operated a Restricted Share Plan (RSP). The final award made in September 2006 reached 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 RSP and the TSR performance condition applied are set out in the notes to table (b) 'Restricted Share Plan and Performance Co-investment Plan' on page 46). Over this period the Company achieved the position equivalent to the 50th percentile of the comparator group which resulted in no shares vesting from the award. For at least part of the award to have vested the Company would have 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 did not vest at the end of the relevant Restricted Period lapsed and therefore 15% and 30% of the awards which vested in 2007 and 2008 respectively lapsed and 100% of the 2006 award lapsed 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 contracts – In accordance with Company policy, all Executive Directors have service contracts subject to one year's notice. They are due to expire when Executive Directors reach their normal retirement age of 60 unless extended by agreement between the Director and the Company. No provision is made for termination payments under the service contracts. In the event of termination by the Company of any Executive Director's service contract, the Board would determine what payments (if any) should be made to the Director depending on the circumstances of the termination. The dates of the contracts are:

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

(vi) Provision for pensions – Colin Drummond and David Dupont 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, with the exception of service to 5 April 2006 where an Earnings Cap applied in these Schemes to these two Directors.

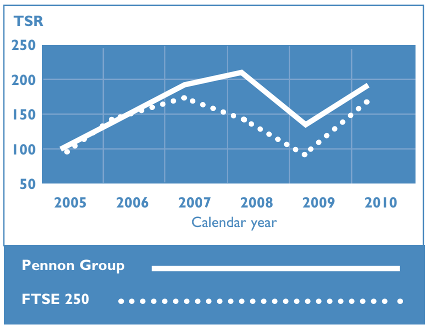
Both were provided with additional pension benefits under an unapproved funded Supplementary Pension Scheme of the Company in order to bring their pension benefits up to a level which would have been provided under the other schemes as if the Earnings Cap had not applied. With effect from 6 April 2006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

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

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.

TOTAL SHAREHOLDER RETURN (TSR)



The graph above shows the value, over the five-year period ending on 31 March 2010, of £100 invested in Pennon Group on 31 March 2005 compared with the value of £100 invested in the FTSE 250 Index. The other points plotted are the values at intervening financial year-ends. This Index is considered appropriate as it is a broad equity market index of which the Company has been a constituent over most of the period covered.

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

NON-EXECUTIVE DIRECTORS AND THE CHAIRMAN

Non-executive Directors' remuneration (excluding that of the Chairman, Ken Harvey) consisting of fees only as set out below, is determined by the Board of Directors, including the Chairman, but in the absence of the other Non-executive Directors. It is usually reviewed each year to take account of market changes in non-executive directors' fees. The Non-executive Directors' fees were not increased for 2009/10 in line with the Executive Directors. In reviewing the fees, the Board takes into account market information on non-executive directors' fees. For 2009/10 the Non-executive Directors received a base fee of £35,000 per annum. The Audit, Remuneration and Corporate Responsibility Committee chairs were paid fees of £10,000, £7,000 and £7,000 per annum respectively and the Committee members received £4,000 each. For this and subsequent years the policy expected to be applied in respect of Non-executive Director fees will be to set fees around the median level compared with the market, which the Board believes is appropriate to attract and retain suitably experienced non-executive directors.

The Chairman's remuneration is set by the Remuneration Committee. The Chairman's fee was not increased for 2009/10 in line with the Executive Directors.

The policy of the Committee to be applied for this and 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
Martin Angle	28 November 2008	30 November 2011
Gerard Connell	30 September 2003	30 September 2012
Dinah Nichols	10 June 2003	11 June 2012

The above contracts do not contain any notice periods.

The information set out below and on the remaining pages of this Remuneration Report (pages 44 to 48) has been audited by the Group's independent auditors, PricewaterhouseCoopers LLP.

EMOLUMENTS OF DIRECTORS

The emoluments of individual Directors holding office during 2009/10 were:

Director	Salary/fees £000	Performance related cash bonus paid or payable[2] £000	Other emoluments[1] £000	Payment in lieu of pension[3] £000	**Total 2010 - Year to 31 March £000**	Total 2009 - Year to 31 March £000
Chairman:						
Ken Harvey	220	–	26	–	**246**	246
Executive Directors:						
Colin Drummond	330	155	22	–	**507**	432
David Dupont	330	152[4]	21	–	**503**	435
Chris Loughlin	315	151[4]	22	95	**583**	527
Non-executive Directors:						
Martin Angle	50	–	–	–	**50**	17
Gerard Connell	53	–	–	–	**53**	50
Dinah Nichols	50	–	–	–	**50**	48
Total	1,348	458	91	95	**1,992**	1,755

1 Other emoluments are car benefit and health cover.

2 In addition to the performance-related cash bonus, Executive Directors are due to receive a conditional award of shares as referred to in a note to (c) 'Annual Incentive Bonus Plan – Deferred Bonus Shares (long-term incentive element)' on page 47.

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

4 The performance-related cash bonus payable to David Dupont includes £4,000 and to Chris Loughlin includes £6,600 which were paid in February 2010. This was an additional bonus paid to the two Directors for the year 2008/09 due to a reassessment of performance against budgeted parameters.

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

EXECUTIVE DIRECTORS' PENSIONS

Defined benefit pensions accrued and payable on retirement for Executive Directors holding office during 2009/10 were:

Director	Increase in accrued pension during 2009/10 (net of inflation) £000 a	Increase in accrued pension during 2009/10 £000 b	Accrued pension at 31 March 2010 £000 c	**Transfer value at 31 March 2010 £000 d**	Transfer value at 31 March 2009 £000 e	Increase in transfer value (net of Directors' contributions) £000 f	Transfer value of Column a (net of Directors' contributions) £000 g
Colin Drummond	5	8	146	**3,424**	2,930	464	79
David Dupont	6	9	131	**2,798**	2,319	450	91

Column a above is the increase in accrued pension during 2009/10 (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 2009/10.
Column c is the accrued pension at 31 March 2010 payable at normal retirement age.
Column d is the transfer value of the accrued pension set out in column c as at 31 March 2010.
Column e is the transfer value of the accrued pension at the end of the previous financial year on 31 March 2009.
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.

The above 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 2010 and 31 March 2009 were:

Director	2010 Ordinary shares (40.7p each)	2009 Ordinary shares (40.7p each)	Director	2010 Ordinary shares (40.7p each)	2009 Ordinary shares (40.7p each)
Martin Angle	**–**	–	Ken Harvey	**18,209**	13,209
Gerard Connell	**4,000**	–	Chris Loughlin	**38,876**	29,442
Colin Drummond	**239,218**	216,363	Dinah Nichols	**4,549**	4,549
David Dupont	**213,510**	193,819			

Since 31 March 2010 389 additional ordinary shares (40.7p each) have been acquired by Chris Loughlin as a result of participation in the Company's Scrip Dividend Alternative and the Company's Share Incentive Plan and 92 additional ordinary shares (40.7p each) have been acquired by David Dupont as a result of dividend reinvestment in an ISA.

There have been no other changes in the beneficial interests or the non-beneficial interests of the Directors in the ordinary shares of the Company between 1 April 2010 and 4 June 2010.

(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 2009	Conditional awards made in year	Market price of each share upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	**Conditional Awards held at 31 March 2010**	Date of end of period for qualifying condition to be fulfilled
Colin Drummond							
18/9/06 [1]	41,363	–	498.62p	Lapsed	Nil Value	**–**	17/9/09
29/8/07 [2]	53,859	–	557.00p	–	–	**53,859**	28/8/10
10/7/08 [2]	51,764	–	637.50p	–	–	**51,764**	9/7/11
1/7/09 [2]	–	67,831	486.50p	–	–	**67,831**	30/6/12
David Dupont							
18/9/06 [1]	41,363	–	498.62p	Lapsed	Nil Value	**–**	17/9/09
29/8/07 [2]	53,859	–	557.00p	–	–	**53,859**	28/8/10
10/7/08 [2]	51,764	–	637.50p	–	–	**51,764**	9/7/11
1/7/09 [2]	–	67,831	486.50p	–	–	**67,831**	30/6/12
Chris Loughlin							
18/9/06 [1]	36,099	–	498.62p	Lapsed	Nil Value	**–**	17/9/09
29/8/07 [2]	49,371	–	557.00p	–	–	**49,371**	28/8/10
10/7/08 [2]	49,411	–	637.50p	–	–	**49,411**	9/7/11
1/7/09 [2]	–	64,748	486.50p	–	–	**64,748**	30/6/12

[1] These awards relate to the Company's Restricted Share Plan (RSP).

[2] These awards 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 42 of this report.

None of the 2006 RSP Award vested in September 2009 because the performance criterion had not been met. The Award therefore lapsed in its entirety. The performance criterion applicable to this Award 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 had been met then 50% of an award would have vested with 100% vesting if the Company had achieved 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 would have resulted in vesting in steps reflecting the number of companies within that third quartile of the comparator group. The comparator group consisted 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 was measured by Hewitt Associates Limited assuming that all dividends were reinvested and was 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 was considered to be fair and transparent to participants in the Plan 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.

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

Colin Drummond £8,686; David Dupont £8,686; Chris Loughlin £7,580.

As the 2006 RSP Award was the final award made pursuant to that Plan (having been replaced in 2007 with the Performance and Co-investment Plan) no further dividends pursuant to the RSP will be payable to the Directors.

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

The following Directors 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 Bonus Plan) at the end of the relevant qualifying period:

Director and date of award	Conditional awards held at 1 April 2009	Conditional awards made in year	Market price of each share upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	**Conditional awards held at 31 March 2010**	Normal date of end of period for qualifying condition to be fulfilled
Colin Drummond							
26/7/06 [1]	16,527	–	486.00p	16,527	75	**–**	25/7/09
26/7/07 [2]	17,798	–	599.50p	17,798	94	**–**	25/7/10
27/6/08	22,838	–	620.00p	–	–	**22,838**	26/6/11
30/9/09 [3]	–	16,730	473.40p	–	–	**16,730**	29/9/12
David Dupont							
26/7/06 [1]	16,095	–	486.00p	16,095	73	**–**	25/7/09
26/7/07 [2]	17,018	–	599.50p	17,018	90	**–**	25/7/10
27/6/08	21,145	–	620.00p	–	–	**21,145**	26/6/11
30/9/09 [3]	–	17,880	473.40p	–	–	**17,880**	29/9/12
27/2/10	–	755	524.50p	–	–	**755**	26/2/13
Chris Loughlin							
26/7/07 [2]	8,767	–	599.50p	8,767	46	**–**	25/7/10
27/6/08	18,806	–	620.00p	–	–	**18,806**	26/6/11
30/9/09 [3]	–	19,562	473.40p	–	–	**19,562**	29/9/12
27/2/10	–	1,261	524.50p	–	–	**1,261**	26/2/13

[1] The amount of the awards made on 26 July 2006 were adjusted in the ratio three-for-one consequent upon the Company's share capital split on 31 July 2006 and the awards vested on 25 July 2009 at a market price of 454.36p per ordinary share as the performance condition had been met.

[2] The 26 July 2007 awards vested on 12 March 2010 at a market price of 527.60p per ordinary share. The Remuneration Committee varied the terms of the Bonus Plan to bring forward the vesting of these awards from 25 July 2010 subject to possible clawback in the event that the Bonus Plan performance condition (relating to service) would not be met at the end of the original qualifying period on 25 July 2010.

[3] In addition to the awards made on 30 September 2009 the Directors also received options pursuant to the Company's Executive Share Option Scheme (the ESOS), details of which are set out in the table of paragraph (d) below. These awards were made in conjunction with the operation of the Bonus Plan, the provisions of which have been varied by the Remuneration Committee to provide for forfeiture of equivalent shares from the Bonus Plan in the event that the ESOS options are exercised by the Directors. Further details of this variation to the Bonus Plan and to the operation of the ESOS are set out in paragraph (ii) 'Performance-related bonus' on page 42.

During the year the Directors received dividends on the above shares in accordance with the conditions of the Bonus Plan as follows: Colin Drummond £9,649; David Dupont £9,100; Chris Loughlin £5,790.

A further conditional award of shares will be made in 2010/11 to the value of the amount of the performance-related cash bonus shown in the Emoluments of Directors table on page 44. (Paragraph (ii) 'Performance-related bonus' on page 42 sets out the provisions relating to the conditional award of shares pursuant to the Plan), save to the extent already awarded on 27 February 2010 as set out in the table above.

(d) Executive Share Option Scheme

The following Directors have a contingent interest in the number of share options pursuant to the Company's Executive Share Option Scheme shown below. Further details relating to the operation of the Scheme are set out in paragraph (ii) 'Performance-related bonus' on page 42.

Director and date of grant	**Options held at 1 April 2009**	**Granted in year**	**Exercised in year**	**Exercise price per share**	**Market price of each share on exercising**	**Market value of each share at 31 March 2010**	**Options held at 31 March 2010**	**Maturity date**
Colin Drummond								
30/9/09	–	6,337	–	473.40p	–	522.50p	**6,337**	29/9/12
David Dupont								
30/9/09	–	6,337	–	473.40p	–	522.50p	**6,337**	29/9/12
Chris Loughlin								
30/9/09	–	6,337	–	473.40p	–	522.50p	**6,337**	29/9/12

(e) 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 2009	Granted in year	Exercised in year	Exercise price per share	Market price of each share on exercising	Value of each share at 31 March 2010	**Options held at 31 March 2010**	Exercise period/ maturity date
Colin Drummond								
4/7/06 †	2,613	–	2,613	357.66p	461.00p	–	**–**	1/9/09 – 28/2/10
6/7/09	–	2,351	–	386.00p	–	522.50p	**2,351**	1/9/12 – 28/2/13
David Dupont								
3/7/07	3,136	–	–	522.00p	–	522.50p	**3,136**	1/9/12 – 28/2/13
Chris Loughlin								
3/7/07	3,136	–	–	522.00p	–	522.50p	**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 2010 was 522.50p (2009 405.00p) and the range during the year was 404.00p to 549.50p (2008/09 380.75p to 663.00p).

By Order of the Board

KEN WOODIER, Group General Counsel & Company Secretary

24 June 2010

CORPORATE GOVERNANCE AND INTERNAL CONTROL

INTRODUCTION AND 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 2008 version) which apply to the Company, have been applied in practice. The Code is publicly available on the Financial Reporting Council website **frcpublications.com** or by telephoning 020 8247 1264.

The Company considers that it has complied with the provisions of the Code throughout the year.

The information required to be published by Rule 7.2.6R of the UK Listing Authority's Disclosure and Transparency Rules is set out in the Directors' Report on page 38.

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 three 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 them. They are also considered to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations. Gerard Connell is the Senior Independent Non-executive Director. The biographies on page 40 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 44 (Directors' Remuneration Report). The Board met in accordance with its schedule of meetings on twelve occasions. All Directors were present at each meeting with the exception of Martin Angle who was absent on one occasion. 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 internal procedures to evaluate the performance of the whole Board, each Committee, the Chairman, each individual Director and the Group General Counsel & Company Secretary. The evaluation procedure relating to the Board and its Committees was administered for the year by the Group General Counsel & Company Secretary. All participants' views were sought on a range of questions which were specifically designed to ensure objective evaluation of performance for the year 2009/10. The participants' responses were then summarised and evaluated by the Group General Counsel & Company Secretary for the Board and each Committee to consider and determine whether any changes should be made to be more effective. Overall performance was considered to be satisfactory but a number of views expressed by Directors on the operation of the Board and certain Committees were considered with a view to improving performance and overall governance. Arising from the evaluation the Board agreed that it would be appropriate to review the Matters Reserved to the Board and the financial limits on delegations to Directors.

The Board also considered whether there was a need in the forthcoming year for an independent and externally facilitated performance review to be carried out and noted that the new UK Corporate Governance Code of the Financial Reporting Council which applies to financial years commencing on or after 29 June 2010 stated that evaluation of the Board should be externally facilitated at least every three years. The Board agreed to consider the options available for an externally facilitated evaluation later in the year.

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.

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

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 overleaf.

AUDIT COMMITTEE

The Audit Committee was chaired by Gerard Connell, who has current and relevant financial experience. The other members of the Committee were Martin Angle and Dinah Nichols. During the year the Committee met on five occasions and all members were present at each meeting with the exception of Martin Angle who was absent on one occasion. 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 annually 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
– 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 33 of the Business Review).

The Committee pays particular attention to the independence and objectivity of the auditors having regard to the Auditing Practices Board's Ethical Standards. 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 also 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. Such appointment will only be granted if the Committee 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. 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. The Auditing Practices Board Ethical Standards recognise that fee arrangements (both their nature and size) may give rise to a self interest threat regarding auditor independence. Where such circumstances arise there is a need to put in place appropriate safeguards. The auditors have confirmed to the Committee that they have complied with all relevant guidance and have implemented appropriate safeguards including:

- all non-audit related services, where necessary, being performed by personnel independent of the audit engagement team;
- no work being undertaken that would require the auditors to act in a capacity as an advocate; and
- no aspect of the audit engagement partner's performance being assessed on the level of non-audit fees charged to the Company.

Taking account of the above the Committee acknowledges that on occasion it is necessary to appoint the auditors to perform non-audit work in view of their specialist knowledge of such matters as the financial modelling of Private Finance Initiative (PFI) projects. There is a limited number of other professional services 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. This has been a particular issue for the Committee and the Company over the last year because it has been considered appropriate to engage the auditors on a number of waste PFIs for the reasons stated above. In addition as reported last year, the auditors provided non-audit financial advice in connection with the Greater Manchester waste PFI which reached financial close in April 2009. The fees due for successful completion of circa £1.2 million are included in Note 7 to the financial statements on page 74. The auditors are also being considered for other non-audit work during 2010/11.

The Committee has been keeping the balance between audit and non-audit work under close review and continues to ensure that it is satisfied the auditors' independence and objectivity are safeguarded before granting permission for non-audit work to be undertaken.

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. Provision is made for both the external and internal auditors to have the right of direct access to the Committee, and in particular the Committee Chairman, without the presence of any Executive Director or other Senior Management.

REMUNERATION COMMITTEE

The Remuneration Committee was chaired by Martin Angle during the year and also comprised Gerard Connell and Dinah Nichols. The Committee met on seven occasions during the year. All members were present at each meeting. 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' Remuneration Report, which also provides more information on the activities of the Remuneration Committee, appears on pages 41 to 48.

NOMINATION COMMITTEE

The Nomination Committee was chaired by Ken Harvey and also comprised Martin Angle, 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. It is the practice of the Committee, led by the Chairman, to appoint an external search consultancy to assist in any Board appointments. During the year it met on three occasions to consider the annual performance evaluation results for the Committee, to review succession planning for the Group and to consider an Executive Director's appointment in an advisory role to an external body. All members were present at each meeting.

CORPORATE RESPONSIBILITY COMMITTEE

The Corporate Responsibility Committee was chaired by Dinah Nichols and also comprised Martin Angle, Gerard Connell and the Chief Executives of South West Water and Viridor. It met on five occasions during the year at which all members were present. 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 2 to 37 contains the Group's 2010 Annual Corporate Responsibility Report which includes ESG matters.

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 **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 2009/10 and up to the date of the approval of this Annual Report and Accounts.

The Board confirms that it continues to apply procedures in accordance with the Combined Code and the 'Guidance on Internal Control' (The Turnbull Guidance) which suggests means of applying the internal control part of the Code. As part of these procedures the Board has a 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 focussed assessment of key risks against corporate objectives. The Board at each meeting receives from the Executive Directors details of any new high-level risks identified and how they are to be managed, together with details of any changes to existing risks and their management. The subsidiary Boards of South West Water and Viridor also receive at each meeting similar reports in respect of their own areas of responsibility. All Executive Directors and senior managers are required to certify on an annual basis that they have effective controls in place to manage risks and to operate in compliance with legislation and Group procedures. All of these processes serve to ensure that a culture of effective control and risk management is embedded within the organisation and that the Group is in a position to react appropriately to new risks as they arise. Details of key risks affecting the Group are set out in the Business Review.

INTERNAL CONTROL FRAMEWORK

As well as the risk management policy and procedures of the Group there is an established internal control framework which is operated and which applies in relation to the process for preparing the Group's consolidated accounts. This framework comprises:

(a) 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 the financial reporting process, 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;

(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; and

(e) a post-investment evaluation process for major capital expenditure and acquisitions to assess the success of the project and learn any lessons to be applied to future projects.

INTERNAL CONTROL REVIEW

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

In addition the Audit Committee regularly reviews the operation and effectiveness of the internal control framework and annually reviews the scope of work, authority and resources of the Company's internal audit function. The Committee reports and makes recommendations to the Board on such reviews. For 2009/10 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 2006 and, as regards the Group financial statements, article 4 of the International Accounting Standards (IAS) Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

RELATIONS WITH SHAREHOLDERS

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.

A regular dialogue with the Company's institutional shareholders is maintained through 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 Group Director of Finance reports to the Board regularly on major shareholders' views about the Company.

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

24 June 2010

INDEPENDENT AUDITORS' REPORT

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PENNON GROUP PLC

We have audited the financial statements of Pennon Group Plc for the year ended 31 March 2010 which comprise the Consolidated income statement, the Group and Company Statements of comprehensive income, the Group and Company Balance sheets, the Group and Company Statements of changes in equity, the Group and Company Cash flow statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the Directors' Responsibilities Statement set out on page 52, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

OPINION ON FINANCIAL STATEMENTS

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Company's affairs as at 31 March 2010 and of the Group's profit and Group's and Company's cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the Corporate Governance Statement set out on pages 49 to 52 with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 29, in relation to going concern; and
- the parts of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

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

24 June 2010

	Notes	2010 £m	2009 (Restated note 5) £m
Revenue	6	**1,068.9**	958.2
Operating costs	7		
Manpower costs (excluding restructuring costs)		**(132.3)**	(108.6)
Raw materials and consumables used		**(76.3)**	(59.1)
Other operating expenses		**(455.6)**	(402.2)
Depreciation		**(135.1)**	(131.3)
Restructuring costs		**(5.0)**	(5.0)
Amortisation of intangibles		**(0.3)**	(1.2)
Operating profit	6	**264.3**	250.8
Finance income	8	**34.4**	45.8
Finance costs	8	**(116.0)**	(138.0)
Share of post-tax profit from joint ventures		**1.1**	0.8
Profit before tax	6	**183.8**	159.4
Taxation	9	**(44.3)**	(69.6)
Profit for the year		**139.5**	89.8
Profit attributable to equity shareholders		**139.5**	89.8
Earnings per share (pence per share)	11		
– Basic		**39.9**	25.8
– Diluted		**39.7**	25.7

The notes on pages 59 to 108 form part of these financial statements.

		Group		Company	
		2010	2009 (Restated note 5)	2010	2009
	Notes	£m	£m	£m	£m
Profit for the year		**139.5**	89.8	**81.6**	140.1
Other comprehensive income					
Actuarial losses on defined benefit pension schemes	29	**(44.4)**	(66.8)	**(4.3)**	(8.0)
Cash flow hedges					
Net fair value (losses)/gains		**–**	(21.0)	**1.1**	(1.9)
Share of other comprehensive loss from joint ventures		**(3.2)**	–	**–**	–
Tax on items taken directly to or transferred from equity	9,30	**17.4**	18.7	**0.9**	2.2
Other comprehensive loss for the period net of tax	35	**(30.2)**	(69.1)	**(2.3)**	(7.7)
Total comprehensive income for the year		**109.3**	20.7	**79.3**	132.4
Total comprehensive income attributable to equity shareholders		**109.3**	20.7	**79.3**	132.4

The notes on pages 59 to 108 form part of these financial statements.

	Notes	Group 2010 £m	2009 (Restated note 5) £m	2008 (Restated note 5) £m	Company 2010 £m	2009 £m
Assets						
Non-current assets						
Goodwill	15	**254.4**	236.5	235.9	**–**	–
Other intangible assets	16	**5.1**	5.4	6.6	**–**	–
Property, plant and equipment	17	**2,822.7**	2,745.8	2,644.7	**0.2**	0.2
Other non-current assets	19	**101.0**	46.2	38.4	**338.5**	271.3
Derivative financial instruments	23	**–**	0.2	4.0	**–**	–
Deferred tax assets	30	**–**	–	–	**5.0**	2.6
Investments in subsidiary undertakings	20	**–**	–	–	**1,032.0**	944.8
Investments in joint ventures	20	**0.2**	2.2	1.4	**–**	–
		3,183.4	3,036.3	2,931.0	**1,375.7**	1,218.9
Current assets						
Inventories	21	**6.4**	5.8	6.6	**–**	–
Trade and other receivables	22	**194.9**	178.3	164.7	**84.5**	70.2
Derivative financial instruments	23	**3.4**	–	11.9	**3.4**	–
Current tax recoverable	26	**–**	–	–	**1.3**	2.4
Cash and cash deposits	24	**493.9**	353.3	357.4	**174.6**	168.7
		698.6	537.4	540.6	**263.8**	241.3
Liabilities						
Current liabilities						
Borrowings	27	**(229.0)**	(262.9)	(57.7)	**(351.2)**	(486.0)
Derivative financial instruments	23	**(3.6)**	(3.6)	(17.0)	**–**	(1.4)
Trade and other payables	25	**(195.8)**	(166.8)	(204.0)	**(17.3)**	(7.6)
Current tax liabilities	26	**(83.6)**	(44.8)	(44.1)	**–**	–
Provisions	31	**(21.5)**	(18.8)	(18.1)	**–**	–
		(533.5)	(496.9)	(340.9)	**(368.5)**	(495.0)
Net current assets/(liabilities)		**165.1**	40.5	199.7	**(104.7)**	(253.7)
Non-current liabilities						
Borrowings	27	**(2,160.2)**	(1,982.4)	(2,062.8)	**(462.8)**	(189.5)
Other non-current liabilities	28	**(16.0)**	(3.7)	(4.0)	**(8.7)**	(8.7)
Derivative financial instruments	23	**(14.1)**	(16.5)	(0.5)	**–**	–
Retirement benefit obligations	29	**(107.9)**	(66.0)	(26.3)	**(11.7)**	(7.3)
Deferred tax liabilities	30	**(311.2)**	(328.4)	(307.4)	**–**	–
Provisions	31	**(78.2)**	(79.2)	(84.2)	**–**	–
		(2,687.6)	(2,476.2)	(2,485.2)	**(483.2)**	(205.5)
Net assets		**660.9**	600.6	645.5	**787.8**	759.7
Shareholders' equity						
Share capital	32	**145.3**	144.5	144.5	**145.3**	144.5
Share premium account	33	**10.9**	11.7	11.7	**10.9**	11.7
Capital redemption reserve	34	**144.2**	144.2	144.2	**144.2**	144.2
Retained earnings and other reserves	35	**360.5**	300.2	345.1	**487.4**	459.3
Total shareholders' equity		**660.9**	600.6	645.5	**787.8**	759.7

The notes on pages 59 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 24 June 2010 and were signed on its behalf by:

K G HARVEY Chairman

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

Group	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings and other reserves (Restated note 5) £m	Total equity (Restated note 5) £m
At 1 April 2008	144.5	11.7	144.2	345.1	645.5
Profit for the year	–	–	–	89.8	89.8
Other comprehensive loss for the year	–	–	–	(69.1)	(69.1)
Total comprehensive income for the year	–	–	–	20.7	20.7
Transactions with equity shareholders					
Dividends paid or approved	–	–	–	(69.1)	(69.1)
Adjustment in respect of share-based payments	–	–	–	1.9	1.9
Proceeds from treasury shares re-issued	–	–	–	1.6	1.6
Total transactions with equity shareholders	–	–	–	(65.6)	(65.6)
At 31 March 2009	144.5	11.7	144.2	300.2	600.6
Profit for the year	–	–	–	139.5	139.5
Other comprehensive loss for the year	–	–	–	(30.2)	(30.2)
Total comprehensive income for the year	–	–	–	109.3	109.3
Transactions with equity shareholders					
Dividends paid or approved	–	–	–	(73.4)	(73.4)
Adjustment for shares issued under the scrip dividend alternative	0.8	(0.8)	–	9.6	9.6
Adjustment in respect of share-based payments	–	–	–	2.9	2.9
Proceeds from treasury shares re-issued	–	–	–	1.9	1.9
Equity component of convertible bond issued	–	–	–	10.0	10.0
Total transactions with equity shareholders	0.8	(0.8)	–	(49.0)	(49.0)
At 31 March 2010	**145.3**	**10.9**	**144.2**	**360.5**	**660.9**

Company	Share capital £m	Share premium account £m	Capital redemption reserve £m	Retained earnings and other reserves £m	Total equity £m
At 1 April 2008	144.5	11.7	144.2	394.0	694.4
Profit for the year	–	–	–	140.1	140.1
Other comprehensive loss for the year	–	–	–	(7.7)	(7.7)
Total comprehensive income for the year	–	–	–	132.4	132.4
Transactions with equity shareholders					
Dividends paid or approved	–	–	–	(69.1)	(69.1)
Adjustment in respect of share-based payments	–	–	–	0.4	0.4
Proceeds from treasury shares re-issued	–	–	–	1.6	1.6
Total transactions with equity shareholders	–	–	–	(67.1)	(67.1)
At 31 March 2009	144.5	11.7	144.2	459.3	759.7
Profit for the year	–	–	–	81.6	81.6
Other comprehensive loss for the year	–	–	–	(2.3)	(2.3)
Total comprehensive income for the year	–	–	–	79.3	79.3
Transactions with equity shareholders					
Dividends paid or approved	–	–	–	(73.4)	(73.4)
Adjustment for shares issued under the scrip			–		
dividend alternative	0.8	(0.8)	–	9.6	9.6
Adjustment in respect of share-based payments	–	–	–	0.7	0.7
Proceeds from treasury shares re-issued	–	–	–	1.9	1.9
Equity component of convertible bond issued	–	–	–	10.0	10.0
Total transactions with equity shareholders	0.8	(0.8)	–	(51.2)	(51.2)
At 31 March 2010	**145.3**	**10.9**	**144.2**	**487.4**	**787.8**

The notes on pages 59 to 108 form part of these financial statements.

	Notes	Group 2010 £m	Group 2009 (Restated note 5) £m	Company 2010 £m	Company 2009 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	36	**363.4**	300.6	**(113.8)**	(5.8)
Interest paid		**(84.2)**	(103.9)	**(19.4)**	(48.4)
Tax (paid)/repaid		**(3.8)**	(30.8)	**(0.2)**	6.0
Net cash generated/(outflow) from operating activities		**275.4**	165.9	**(133.4)**	(48.2)
Cash flows from investing activities					
Interest received		**14.5**	23.8	**20.7**	22.6
Dividends received		**–**	–	**80.6**	128.6
Acquisition of subsidiary undertakings (net of cash acquired)	38	**(9.3)**	(3.4)	**–**	–
Investments in subsidiary undertakings		**(0.1)**	–	**(45.0)**	–
Loans advanced to joint ventures		**(30.7)**	–	**–**	–
Proceeds from investment disposal		**–**	–	**–**	100.0
Purchase of property, plant and equipment		**(195.2)**	(237.9)	**(0.1)**	–
Proceeds from sale of property, plant and equipment		**3.5**	2.6	**–**	–
Net cash (used in)/from investing activities		**(217.3)**	(214.9)	**56.2**	251.2
Cash flows from financing activities					
Proceeds from treasury shares re-issued		**1.9**	1.6	**1.9**	1.6
Convertible bond issued (net proceeds)		**121.9**	–	**121.9**	–
(Deposit)/return of restricted funds (net)		**(73.3)**	93.0	**(0.5)**	(0.3)
Proceeds from new borrowing		**237.2**	100.0	**238.9**	304.9
Repayment of borrowings		**(234.9)**	(14.9)	**(215.8)**	(321.4)
Finance lease sale and lease back		**38.9**	49.8	**–**	–
Finance lease principal repayments		**(18.5)**	(16.8)	**–**	–
Dividends paid	12	**(63.8)**	(69.1)	**(63.8)**	(69.1)
Net cash received/(outflow) from financing activities		**9.4**	143.6	**82.6**	(84.3)
Net increase in cash and cash equivalents		**67.5**	94.6	**5.4**	118.7
Cash and cash equivalents at beginning of the year	24	**322.0**	227.4	**167.8**	49.1
Cash and cash equivalents at end of the year	24	**389.5**	322.0	**173.2**	167.8

The notes on pages 59 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 2006. The address of the registered office is given on page 40. Pennon Group's business is operated through two main subsidiaries. South West Water Limited holds the water and sewerage services appointments for Devon, Cornwall and parts of Dorset and Somerset. Viridor Limited's business is waste management, recycling and renewable energy.

2. PRINCIPAL ACCOUNTING POLICIES

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

(a) Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union, with those parts of the Companies Act 2006 applicable to companies reporting under IFRS and the requirements of the Financial Services Authority. A summary of the principal accounting policies is set out below, together with an explanation where changes have been made to previous policies on the adoption of new accounting standards and interpretations in the year.

The following revisions and amendments to existing standards together with new standards and interpretations have been adopted as of 1 April 2009 and are relevant to the Group:

IAS 1 "Presentation of financial statements" (revised)

The revised standard requires non-owner changes in equity to be presented separately from owner changes in equity. The Group has elected to present two statements; an income statement and a statement of comprehensive income.

IFRS 7 "Financial Instruments: Disclosures" (amendment)

The amended standard requires the classification of fair value measurements using a fair value hierarchy which reflects the significance of the inputs used in making the measurement. Additional disclosure has been made in these financial statements.

IFRS 8 "Operating segments"

The adoption of this standard has not required any change in reported segments.

IFRIC 14 "IAS 19 – the limit on a defined benefit asset, minimum funding requirements and their interaction"

The application of this interpretation restricts the circumstances under which a defined benefit scheme asset (surplus) may be recognised. During the year the Group's acquisition of Greater Manchester Waste Limited involved two defined benefit pension schemes which had a combined surplus of £6.9m at 31 March 2010. This surplus was not recognised in accordance with requirements of IFRIC 14.

The following new interpretation is mandatory for the first time in the financial year beginning 1 April 2009 and the Group's accounting policies have been amended accordingly:

IFRIC 12 "Service concession arrangements"

The application of this interpretation has necessitated a restatement of amounts for prior years. Where a contract for the provision of public services meets the scope of IFRIC 12 the service concession is to be treated as a contract receivable, split between the profit on the construction of assets, operation of the service and provision of finance through interest receivable. The Group's existing contract with West Sussex County Council for the provision of waste collection and disposal services falls within the scope of IFRIC 12 and accordingly comparatives have been restated. The effect of the restatement on the comparative figures is set out in note 5.

The following revised standards, amended standards and interpretations, which are mandatory for the first time in the financial year beginning 1 April 2009, are relevant to the Group but have no material impact:

IAS 23	"Borrowing costs" (revised)
IFRS 2	"Share-based payment" (amendment)
IAS 32	"Financial instruments: presentation" (amendment) and consequential amendments to IAS 1 "Presentation of financial statements"
Improvements to IFRS 2008	
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 9 & IAS 39	"Embedded derivates" (amendments to IFRIC 9 and IAS 39)

2. PRINCIPAL ACCOUNTING POLICIES *continued*

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

IAS 27 "Consolidated and separate financial statements" (revised)
IFRS 3 "Business combinations" (revised)
Improvements to IFRS 2009
IFRS 1 "First-time adoption of IFRS" (revised)
IFRS 2 "Share-based payment" (amendment)
IAS 32 "Financial instruments: presentation"
IFRS 9 "Financial instruments"
IAS 24 "Related party disclosures"
IFRS 1 "First-time adoption of IFRS" (amendment)
IFRIC 14 "Prepayments of a minimum funding requirement" (amendment)
IFRIC 15 "Agreements for the construction of real estate"
IFRIC 16 "Hedges of a net investment in a foreign operation"
IFRIC 17 "Distribution of non-cash assets to owners"
IFRIC 18 "Transfers of assets from customers"
IFRIC 19 "Extinguishing financial liabilities with equity instruments"

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 exercises joint control under a contractual arrangement.

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

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.

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

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

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(c) Revenue recognition *continued*

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

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

(d) Landfill tax

Landfill tax is included within both revenue and operating costs. 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.

(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.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(h) Property, plant and equipment *continued*

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.

(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.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

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

(m) Cash and cash deposits

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

(n) Derivatives and other financial instruments

The Group classifies its financial instruments in the following categories:

i) Loans and receivables

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

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

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

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

ii) Derivative financial instruments and hedging activities

The Group uses derivative financial instruments, principally interest rate swaps, to hedge 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 ongoing basis. This effectiveness testing is reperformed at the end of each reporting period to ensure that the hedge remains highly effective.

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

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

iii) 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.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(n) Derivatives and other financial instruments *continued*

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.

(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 re-issued any consideration received, net of any directly attributable transaction costs, is included in equity.

The Group balance sheet includes the shares held by the Pennon Employee Share Trust 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.

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 comprehensive income.

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

ii) Share-based payment

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

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

(t) Pre-contract 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.

(v) Service concession arrangements

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

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 65% of net borrowings were at fixed rates (including 50% of South West Water's borrowings fixed for the period to March 2015) and 23% index-linked after the impact of financial derivatives. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not therefore an exposure for the Group. These instruments are analysed in note 27.

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

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

For 2010 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 £2.3m (2009 £2.0m).

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 27.

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

The Group and South West Water have entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on South West Water Limited's Regulatory Capital Value and Viridor Limited's EBITDA) and interest cover. More details are provided in the Directors' Report on page 31.

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 2010					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	197.3	31.7	425.2	949.6	1,603.8
Interest payments on borrowings	27.1	22.9	43.0	348.2	441.2
Finance lease liabilities	46.9	47.0	193.7	2,322.9	2,610.5
Derivative financial liabilities					
Derivative contracts – net payments	14.3	8.3	12.9	–	35.5
31 March 2009					
Non-derivative financial liabilities					
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
Derivative financial liabilities					
Derivative contracts – net payments	17.9	4.4	3.2	0.3	25.8
Company					
31 March 2010					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	70.6	10.6	351.9	99.8	532.9
Interest payments on borrowings	19.3	14.5	13.9	–	47.7
31 March 2009					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	205.8	80.0	10.0	100.0	395.8
Interest payments on borrowings	11.3	7.2	0.1	–	18.6
Derivative financial liabilities					
Derivative contracts – net payments	1.5	–	–	–	1.5

iii) Credit risk

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

Counterparty risk arises from the investment of surplus funds and from the use of derivative financial instruments. The Board has agreed a policy for managing such risk which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures. The Group has no other significant concentration of credit risk. The Group's surplus funds are 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 Aa2 (Moody's) or AA (Standard and Poor's).

iv) Foreign currency risk

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

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

The gearing ratios at the balance sheet date were:

	2010 £m	2009 (Restated note 5) £m
Net borrowings (note 37)	**1,895.3**	1,892.0
Total shareholders' equity	**660.9**	600.6
Total capital	**2,556.2**	2,492.6
Gearing ratio	**74.1%**	75.9%

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%.

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

	2010 £m	2009 £m
Regulatory Capital Value	**2,555.0**	2,461.0
Net borrowings	**1,547.2**	1,571.1
Net borrowings/Regulatory Capital Value	**60.6%**	63.8%

(c) Determination of fair values

Effective 1 April 2009. The Group adopted the amendment to IFRS 7 for financial instruments which are measured in the balance sheet at fair value. This requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

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

The disclosures are set out in note 23.

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 a more useful comparison of business trends and performance. The term underlying is not a defined term under IFRS, and may not be comparable with similarly-titled profit measurements reported by other companies. Reconciliations between underlying and reported measures are included in the Directors' Report on page 5 and in note 11 for earnings per share.

Environmental and landfill restoration provisions
Restoration and aftercare provisions are recognised in the financial statements at the net present value of the estimated future expenditure required to settle the Group's restoration and aftercare obligations. A discount is applied to recognise the time value of money and is unwound over the life of the provision. This is included in the income statement as a financial item within finance costs. As at 31 March 2010 the Group's environmental and landfill restoration provisions were £96.4m.

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 joint ventures for the construction of Energy from Waste plants 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 29 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:

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

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

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

4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES *continued*

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.

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 2010 was £2,822.7m. In the year ended 31 March 2010 additions totalled £190.2m and the depreciation charge was £136.5m. 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. Asset lives and residual values are reviewed annually and historically changes to remaining estimates of useful lives have not been material.

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

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

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

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

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

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

Provision for doubtful debts
At each balance sheet date each subsidiary evaluates the collectability of trade receivables and records provisions for doubtful debts based on experience including comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of debt collected may differ from the estimated levels of recovery and could impact future operating results positively or negatively. As at 31 March 2010 the Group's current trade receivables were £174.5m, against which £50.6m 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.

Taxation
The Group corporation tax provision of £83.6m reflects management's estimation of the amount of tax payable for fiscal years with open tax computations where liabilities remain to be agreed with Her Majesty's Revenue and Customs.

5. PRIOR YEAR ADJUSTMENT

Accounting policy for service concession arrangements

The application of IFRIC 12 "Service concession arrangements" has required a restatement of amounts for prior years. Where a contract for the provision of public services meets the scope of IFRIC 12 the service concession is to be treated as a contract receivable, split between the profit on the construction of assets, operation of the service and provision of finance through interest receivable. The Group's existing contract with West Sussex County Council for the provision of waste collection and disposal services falls within the scope of IFRIC 12.

As a result of the above change in accounting policy and other restatements required, comparative figures have been restated :

	Year ended 31 March 2009		
	Previously reported £m	Application of IFRIC 12 £m	Restated now reported £m
INCOME STATEMENT			
Revenue	952.9	5.3	958.2
Other operating expenses	(394.2)	(8.0)	(402.2)
Depreciation	(132.0)	0.7	(131.3)
Finance income	43.5	2.3	45.8
Taxation – current tax	(30.7)	(0.6)	(31.3)
Taxation – deferred tax	(36.9)	(1.4)	(38.3)
Profit for the year	91.5	(1.7)	89.8

	31 March 2009			31 March 2008		
	Previously reported £m	Application of IFRIC 12 £m	Restated now reported £m	Previously reported £m	Application of IFRIC 12 £m	Restated now reported £m
BALANCE SHEET						
Non-current assets						
Property, plant and equipment	2,774.2	(28.4)	2,745.8	2,665.8	(21.1)	2,644.7
Other non-current assets	10.6	35.6	46.2	10.4	28.0	38.4
Current liabilities						
Current tax	(43.2)	(1.6)	(44.8)	(43.1)	(1.0)	(44.1)
Non-current liabilities						
Deferred tax	(326.3)	(2.1)	(328.4)	(306.7)	(0.7)	(307.4)
Shareholders' equity						
Retained earnings						
Brought forward	341.3	5.2	346.5	318.2	2.9	321.1
Profit for the year	91.5	(1.7)	89.8	133.6	2.3	135.9
Carried forward	317.6	3.5	321.1	341.3	5.2	346.5
CASH FLOW STATEMENT						
Cash generated from operations						
Profit for the year	91.5	(1.7)	89.8	133.6	2.3	135.9
Depreciation charge	132.0	(0.7)	131.3	127.9	(0.7)	127.2
Finance income	(43.5)	(2.3)	(45.8)	(42.0)	(1.8)	(43.8)
Taxation	67.6	2.0	69.6	16.0	0.4	16.4
Increase in trade and other receivables	(15.4)	(5.3)	(20.7)	(29.9)	(4.4)	(34.3)
Purchase of property, plant and equipment	(245.9)	8.0	(237.9)	(219.2)	4.2	(215.0)

During the year the Group's joint venture Viridor Laing (Greater Manchester) Limited was established; its operations also fall within the scope of IFRIC 12.

6. OPERATING SEGMENTS

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

The water and sewerage business comprises the regulated water and sewerage services undertaken by South West Water Limited. The waste management business is the waste treatment, recycling and renewable energy services provided by Viridor Limited. 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.

	2010 £m	2009 (Restated note 5) £m
Revenue		
Water and sewerage	**444.2**	431.7
Waste management	**626.5**	528.0
Other	**8.5**	8.7
Less intra-segment trading*	**(10.3)**	(10.2)
	1,068.9	958.2
Segment result		
Underlying operating profit before depreciation and amortisation (EBITDA)		
Water and sewerage	**290.1**	281.4
Waste management	**114.8**	105.2
Other	**(0.2)**	1.7
	404.7	388.3
Underlying operating profit		
Water and sewerage	**196.5**	191.6
Waste management	**73.1**	63.5
Other	**–**	1.9
	269.6	257.0
Operating profit		
Water and sewerage	**191.5**	186.6
Waste management	**72.8**	62.3
Other	**–**	1.9
	264.3	250.8
Underlying profit before tax		
Water and sewerage	**132.5**	121.9
Waste management	**55.4**	41.1
Other	**1.2**	2.6
	189.1	165.6
Profit before tax		
Water and sewerage	**127.5**	116.9
Waste management	**55.1**	39.9
Other	**1.2**	2.6
	183.8	159.4

* 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 5 and in note 11 for earnings per share.

6. OPERATING SEGMENTS *continued*

	Water and sewerage £m	Waste management (Restated note 5) £m	Other (Restated note 5) £m	Eliminations £m	Group (Restated note 5) £m
Balance sheet					
31 March 2010					
Assets (excluding investments in joint ventures)	2,751.2	1,018.8	901.1	(789.3)	3,881.8
Investments in joint ventures	–	0.2	–	–	0.2
Total assets	2,751.2	1,019.0	901.1	(789.3)	3,882.0
Liabilities	(1,985.8)	(777.2)	(1,247.4)	789.3	(3,221.1)
Net assets/(liabilities)	**765.4**	**241.8**	**(346.3)**	**–**	**660.9**
31 March 2009					
Assets (excluding investments in joint ventures)	2,684.9	848.2	809.6	(771.2)	3,571.5
Investments in joint ventures	–	2.2	–	–	2.2
Total assets	2,684.9	850.4	809.6	(771.2)	3,573.7
Liabilities	(1,959.7)	(710.2)	(1,074.4)	771.2	(2,973.1)
Net assets/(liabilities)	**725.2**	**140.2**	**(264.8)**	**–**	**600.6**

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 (Restated note 5) £m	Other £m	Group (Restated note 5) £m
Other information				
31 March 2010				
Amortisation of other intangible assets (note 16)	–	0.3	–	0.3
Capital expenditure (including acquisitions)	143.3	55.9	0.3	199.5
Depreciation	93.6	41.7	(0.2)	135.1
Finance income (note 8)	18.1	12.2	4.1	34.4
Finance costs (note 8)	82.2	31.0	2.8	116.0
31 March 2009				
Amortisation of other intangible assets (note 16)	–	1.2	–	1.2
Capital expenditure (including acquisitions)	147.8	87.4	–	235.2
Depreciation	89.8	41.7	(0.2)	131.3
Finance income (note 8)	29.8	7.2	8.8	45.8
Finance costs (note 8)	99.5	30.4	8.1	138.0

Geographical segments

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

7. OPERATING COSTS

	2010 £m	2009 (Restated note 5) £m
Manpower costs (note 13)	**132.3**	108.6
Raw materials and consumables	**76.3**	59.1
Other operating expenses include:		
Profit on disposal of property, plant and equipment	**(3.6)**	(2.1)
Operating lease rentals payable:		
– Plant and machinery	**7.7**	6.9
– Property	**6.3**	5.2
Research and development expenditure	**0.2**	0.2
Trade receivables impairment	**7.9**	6.7
Depreciation of property, plant and equipment:		
– Owned assets	**98.8**	97.1
– Under finance leases	**36.3**	34.2
Amortisation of other intangible assets (note 16)	**0.3**	1.2

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

	2010 £000	2009 £000
Fees payable to the Company's auditors for the audit of the Company's accounts	**47**	47
Fees payable to the Company's auditors for other services to the Group:		
Audit of the Company's subsidiaries pursuant to legislation	**360**	316
Total audit fees	**407**	363
Other services pursuant to legislation	**103**	130
Tax services	**199**	135
Services relating to corporate finance transactions	**1,346**	570
All other services	**31**	37
	2,086	1,235
Fees payable to the Company's auditors in respect of Pennon Group pension schemes:		
Audit	**24**	24

Expenses reimbursed to the auditors in relation to the audit of the Group were £38,000 (2009 £31,000).

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

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

8. NET FINANCE COSTS

	2010 £m	2009 (Restated note 5) £m
Finance income		
Interest receivable	**6.1**	18.8
Interest receivable on shareholder loans to joint ventures	**3.1**	2.3
Interest receivable on service concession arrangements	**2.7**	2.3
Expected return on defined benefit pension schemes' assets (note 29)	**22.5**	22.4
	34.4	45.8

8. NET FINANCE COSTS *continued*

	2010 £m	2009 (Restated note 5) £m
Finance costs		
Bank borrowings and overdrafts	**(41.6)**	(48.9)
Interest element of finance lease rentals	**(45.7)**	(54.6)
Other finance costs	**(2.2)**	(1.5)
Interest cost on retirement benefit obligations (note 29)	**(24.8)**	(24.0)
Unwinding of discounts in provisions (note 31)	**(3.8)**	(4.5)
	(118.1)	(133.5)
Net gains/(losses) on derivative instruments:		
Ineffectiveness on derivatives designated as cash flow hedges (note 23)	**–**	0.4
On derivatives deemed held for trading (note 23)	**2.1**	(4.9)
	(116.0)	(138.0)
Net finance costs	**(81.6)**	(92.2)

9. TAXATION

	2010 £m	2009 (Restated note 5) £m
Analysis of charge in year		
UK corporation tax	**43.0**	31.3
Deferred tax – other	**1.3**	13.4
Deferred tax arising on abolition of industrial buildings allowances	**–**	24.9
Total deferred tax (note 30)	**1.3**	38.3
Tax charge for year	**44.3**	69.6

UK corporation tax is calculated at 28% (2009 28%) of the estimated assessable profit for the year.

The deferred tax charge for the year ended 31 March 2009 was 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 as contained in the 2008 Finance Act.

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:

	2010 £m	2009 (Restated note 5) £m
Profit before tax	**183.8**	159.4
Profit before tax multiplied by the standard rate of UK corporation tax of 28% (2009 28%)	**51.5**	44.6
Effects of:		
Expenses not deductible for tax purposes	**1.3**	2.1
Other	**(3.5)**	(1.0)
Capital gains reduced by capital losses	**–**	(0.7)
Tax relief no longer available on industrial buildings	**–**	24.9
Adjustments to tax charge in respect of prior years	**(5.0)**	(2.3)
Tax charge for year	**44.3**	69.6

The average applicable tax rate for the year was 24% (2009 44%).

In addition to the amount debited to the income statement, a deferred tax credit relating to actuarial losses on defined benefit pension schemes of £12.4m (2009 credit of £18.7m on actuarial losses) and a deferred tax credit relating to gains/losses on cash flow hedges of £5.0m (2009 nil), has been credited directly to equity. A deferred tax credit relating to share-based payments of £0.2m (2009 charge £0.8m) has been taken directly to equity.

10. PROFIT OF PARENT COMPANY

	2010 £m	2009 £m
Profit attributable to equity shareholders dealt with in the accounts of the parent company	**81.6**	140.1

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

11. EARNINGS PER SHARE

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

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

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

	2010	2009
Number of shares (millions)		
For basic earnings per share	**350.0**	348.1
Effect of dilutive potential ordinary shares from share options	**1.5**	1.7
For diluted earnings per share	**351.5**	349.8

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:

	2010			2009 (Restated note 5)		
	Profit after tax £m	Earnings per share Basic p	Earnings per share Diluted p	Profit after tax £m	Earnings per share Basic p	Earnings per share Diluted p
Statutory earnings per share	**139.5**	**39.9**	**39.7**	89.8	25.8	25.7
Restructuring costs (net of tax)	**4.4**	**1.2**	**1.2**	3.3	0.9	0.9
Amortisation of intangibles	**0.3**	**0.1**	**0.1**	1.2	0.3	0.3
Deferred tax	**1.3**	**0.4**	**0.4**	38.3	11.1	11.0
Underlying earnings per share	**145.5**	**41.6**	**41.4**	132.6	38.1	37.9

12. DIVIDENDS

	2010 £m	2009 £m
Amounts recognised as distributions to equity holders in the year:		
Interim dividend paid for the year ended 31 March 2009 : 6.75p (2008 6.25p) per share	**23.6**	21.8
Final dividend paid for the year ended 31 March 2009 : 14.25p (2008 13.56p) per share	**49.8**	47.3
	73.4	69.1
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2010 : 6.95p (2009 6.75p) per share	**24.5**	23.6
Proposed final dividend for the year ended 31 March 2010 : 15.60p (2009 14.25p) per share	**55.1**	49.8
	79.6	73.4

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

The proposed interim dividend for 2010 was paid on 1 April 2010 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting.

13. EMPLOYMENT COSTS

	2010 £m	2009 £m
Wages and salaries	**117.4**	95.9
Social security costs	**10.7**	9.2
Pension costs	**15.9**	13.2
Share-based payments	**2.7**	2.7
Total employment costs	**146.7**	121.0
Charged:		
Manpower costs	**132.3**	108.6
Capital schemes	**10.0**	10.3
Restructuring costs	**4.4**	2.1
Total employment costs	**146.7**	121.0

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

	2010	2009
Employees (average number)		
The average monthly number of employees (including Executive Directors) was:		
Water and sewerage	**1,191**	1,227
Waste management	**2,853**	2,154
Other	**43**	41
Group totals	**4,087**	3,422

The total number of employees at 31 March 2010 was 4,089 (2009 3,417).

14. DIRECTORS' EMOLUMENTS

	2010 £000	2009 £000
Executive Directors:		
Salary	975	975
Performance-related cash bonus paid or payable	458	257
Share-based payments	847	689
Other emoluments	65	67
Payment in lieu of pension provision	95	95
Non-executive Directors	399	376
	2,839	2,459

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

The aggregate gains on vesting of Directors' share-based awards amounted to a total of £378,000 (2009 £569,000).

Total gains made by Directors on the exercise of share options were £3,000 (2009 nil).

Total emoluments include £1,301,000 (2009 £995,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2010 retirement benefits were accruing to two Directors under defined benefit pension schemes (2009 two). The accrued pension entitlement at 31 March 2010 under defined benefit schemes of the highest paid Director was £146,000 (2009 £122,000). 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.

15. GOODWILL

	£m
Cost:	
At 1 April 2008	235.9
Recognised on acquisition of subsidiaries	0.6
At 31 March 2009	236.5
Disposals	(0.6)
Recognised on acquisition of subsidiaries (note 38)	18.5
At 31 March 2010	254.4
Carrying amount:	
At 31 March 2009	236.5
At 31 March 2010	**254.4**

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

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

The recoverable amount of the waste management segment is determined from value in use calculations. 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 based on growth rates and margins achieved historically and expectations for market development. Beyond this period long-term growth rates for the waste sector are based on UK Gross Domestic Product. The cash flows have been discounted using a pre-tax discount rate of 12.5% (2009 12.5%) which reflects the overall business risks associated with the waste management segment activities.

16. OTHER INTANGIBLE ASSETS

	Customer contracts £m	Patents £m	Total £m
Acquired intangible assets			
Cost:			
At 1 April 2008	12.5	0.2	12.7
At 31 March 2009	12.5	0.2	12.7
At 31 March 2010	12.5	0.2	12.7
Amortisation:			
At 1 April 2008	6.1	–	6.1
Charge for year	1.2	–	1.2
At 31 March 2009	7.3	–	7.3
Charge for year	0.3	–	0.3
At 31 March 2010	7.6	–	7.6
Carrying amount:			
At 31 March 2009	5.2	0.2	5.4
At 31 March 2010	**4.9**	**0.2**	**5.1**

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

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

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

17. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers (Restated note 5) £m	Landfill restoration £m	Construction in progress £m	Total (Restated note 5) £m
Group							
Cost:							
At 1 April 2008	331.8	1,260.8	585.5	1,136.8	44.7	134.7	3,494.3
Arising on acquisitions	2.4	–	–	0.7	–	–	3.1
Additions	40.3	53.7	1.7	27.9	–	108.2	231.8
Other	–	–	–	–	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	1,197.7	46.1	147.6	3,721.1
Arising on acquisitions	8.7	–	–	13.5	–	–	22.2
Additions	20.7	36.0	0.8	33.3	–	99.4	190.2
Other (note 31)	–	–	–	–	2.6	–	2.6
Grants and contributions	–	(0.4)	–	–	–	–	(0.4)
Disposals	–	(0.7)	(0.2)	(19.8)	–	–	(20.7)
Transfers/reclassifications	1.9	36.3	8.1	97.5	–	(143.8)	–
At 31 March 2010	417.4	1,417.1	606.4	1,322.2	48.7	103.2	3,915.0
Depreciation:							
At 1 April 2008	137.3	55.4	142.3	505.0	9.6	–	849.6
Charge for year	19.5	18.7	10.8	80.8	3.0	–	132.8
Disposals	(0.1)	(0.7)	–	(6.3)	–	–	(7.1)
At 31 March 2009	156.7	73.4	153.1	579.5	12.6	–	975.3
Charge for year	15.8	20.5	10.9	86.9	2.4	–	136.5
Disposals	–	(0.7)	(0.2)	(18.6)	–	–	(19.5)
At 31 March 2010	172.5	93.2	163.8	647.8	15.0	–	1,092.3
Net book value:							
At 31 March 2009	229.4	1,272.5	444.6	618.2	33.5	147.6	2,745.8
At 31 March 2010	**244.9**	**1,323.9**	**442.6**	**674.4**	**33.7**	**103.2**	**2,822.7**

Of the total depreciation charge of £136.5m (2009 £132.8m), £1.4m (2009 £1.5m) has been charged to capital projects and £135.1m (2009 £131.3m) against profits.

Asset lives and residual values are reviewed annually.

17. PROPERTY, PLANT AND EQUIPMENT *continued*

Assets held under finance leases included above were:

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Landfill restoration £m	Construction in progress £m	Total £m
Cost:							
At 31 March 2009	–	350.1	444.9	335.3	–	14.8	1,145.1
At 31 March 2010	–	355.0	459.9	322.8	–	8.1	1,145.8
Depreciation: At 31 March 2009	–	15.4	73.8	172.0	–	–	261.2
At 31 March 2010	–	20.6	81.4	165.3	–	–	267.3
Net book amount: At 31 March 2009	–	334.7	371.1	163.3	–	14.8	883.9
At 31 March 2010	**–**	**334.4**	**378.5**	**157.5**	**–**	**8.1**	**878.5**

	Fixed and mobile plant, vehicles and computers £m
Company	
Cost	
At 1 April 2008	0.3
At 31 March 2009	0.3
Additions	0.1
At 31 March 2010	0.4
Depreciation:	
At 1 April 2008	0.1
At 31 March 2009	0.1
Charge for year	0.1
At 31 March 2010	0.2
Net book value:	
At 31 March 2009	0.2
At 31 March 2010	**0.2**

Asset lives and residual values are reviewed annually.

18. FINANCIAL INSTRUMENTS BY CATEGORY

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

		Fair value		Amortised cost		
	Note	Derivatives used for hedging £m	Derivatives deemed held for trading £m	Loans and receivables £m	Trade receivables and trade payables £m	Total £m
Group						
31 March 2010						
Financial assets						
Trade and other receivables	22	–	–	–	123.9	123.9
Derivative financial instruments	23	3.4	–	–	–	3.4
Cash and cash deposits	24	–	–	493.9	–	493.9
Total		3.4	–	493.9	123.9	621.2
Financial liabilities						
Borrowings	27	–	–	(2,389.2)	–	(2,389.2)
Derivative financial instruments	23	(17.6)	(0.1)	–	–	(17.7)
Trade and other payables	25	–	–	–	(82.1)	(82.1)
Total		(17.6)	(0.1)	(2,389.2)	(82.1)	(2,489.0)
31 March 2009						
Financial assets						
Financial assets						
Trade and other receivables	22	–	–	–	111.8	111.8
Derivative financial instruments	23	0.2	–	–	–	0.2
Cash and cash deposits	24	–	–	353.3	–	353.3
Total		0.2	–	353.3	111.8	465.3
Financial liabilities						
Borrowings	27	–	–	(2,245.3)	–	(2,245.3)
Derivative financial instruments	23	(17.9)	(2.2)	–	–	(20.1)
Trade and other payables	25	–	–	–	(77.2)	(77.2)
Total		(17.9)	(2.2)	(2,245.3)	(77.2)	(2,342.6)
Company						
31 March 2010						
Financial assets						
Derivative financial instruments	23	3.4	–	–	–	3.4
Cash and cash deposits	24	–	–	174.6	–	174.6
Total		3.4	–	174.6	–	178.0
Financial liabilities						
Borrowings	27	–	–	(814.0)	–	(814.0)
Trade and other payables	25	–	–	–	(0.2)	(0.2)
Total		–	–	(814.0)	(0.2)	(814.2)
31 March 2009						
Financial assets						
Cash and cash deposits	24	–	–	168.7	–	168.7
Total		–	–	168.7	–	168.7
Financial liabilities						
Borrowings	27	–	–	(675.5)	–	(675.5)
Derivative financial instruments	23	(1.4)	–	–	–	(1.4)
Trade and other payables	25	–	–	–	(0.1)	(0.1)
Total		(1.4)	–	(675.5)	(0.1)	(677.0)

19. OTHER NON-CURRENT ASSETS

	Group		Company	
	2010	2009 (Restated note 5)	2010	2009
	£m	£m	£m	£m
Amounts owed by subsidiary undertakings	–	–	337.5	271.3
Amounts owed by related parties (note 43)	45.9	10.6	–	–
Other receivables	55.1	35.6	1.0	–
	101.0	46.2	338.5	271.3

Other receivables include site development and pre-contract costs of £15.6m (2009 nil).

Non-current assets were due:

	Group		Company	
	2010	2009 (Restated note 5)	2010	2009
	£m	£m	£m	£m
Between 1 and 2 years	16.6	0.6	83.8	67.8
Between 2 and 5 years	6.2	2.1	254.7	203.5
Over 5 years	78.2	43.5	–	–
	101.0	46.2	338.5	271.3

The fair values of other non-current assets were:

	Group		Company	
	2010	2009 (Restated note 5)	2010	2009
	£m	£m	£m	£m
Amounts owed by subsidiary undertakings	–	–	336.9	271.3
Amounts owed by related parties	90.9	17.3	–	–
Other receivables	55.1	35.6	1.0	–
	146.0	52.9	337.9	271.3

The fair value of amounts owed by related parties is based on cash flows using a rate based on the borrowings rate of 2.5% (2009 5.7%). The discount rate is equal to London Interbank Offered Rate plus an allowance to reflect an appropriate credit margin.

The effective interest rate on amounts owed by related parties was 11.3% (2009 15.0%).

20. INVESTMENTS

Subsidiary undertakings

	£m
Company	
At 1 April 2008	1,044.8
Disposals	(100.0)
At 31 March 2009	944.8
Additions	87.2
At 31 March 2010	**1,032.0**

20. INVESTMENTS *continued*

Joint ventures

	Shares £m
Group	
At 1 April 2008	1.4
Share of profit	0.8
At 31 March 2009	2.2
Additions	0.1
Share of profit	1.1
Share of other comprehensive loss	(3.2)
At 31 March 2010	**0.2**

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

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

	Assets		Liabilities		Income		
	Non-current £m	Current £m	Non-current £m	Current £m	Revenues £m	Profit £m	Other comprehensive income £m
2010							
Lakeside Energy from Waste Holdings Limited	84.2	2.6	(0.3)	(86.3)	14.4	1.0	(3.1)
Viridor Laing (Greater Manchester) Limited	16.0	81.0	(7.0)	(90.0)	44.0	0.1	(0.1)
2009							
Lakeside Energy from Waste Holdings Limited	76.4	8.4	(5.8)	(75.2)	3.9	0.8	–

21. INVENTORIES

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Raw materials and consumables	**6.4**	5.4	**–**	–
Finished goods and goods for resale	**–**	0.4	**–**	–
	6.4	5.8	**–**	–

22. TRADE AND OTHER RECEIVABLES – CURRENT

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Trade receivables	**174.5**	154.9	**–**	–
Less: provision for impairment of receivables	**(50.6)**	(43.1)	**–**	–
Trade receivables	**123.9**	111.8	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**84.2**	68.9
Other receivables	**8.1**	23.3	**0.3**	1.3
Other prepayments and accrued income	**62.9**	43.2	**–**	–
	194.9	178.3	**84.5**	70.2

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:

	2010 £m	2009 £m
Group		
Past due 1 – 30 days	**27.4**	25.2
Past due 31 – 120 days	**10.3**	10.2
More than 120 days	**71.7**	61.7

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

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

	2010 £m	2009 £m
At 1 April	**43.1**	36.2
Provision for receivables impairment	**7.9**	6.7
Receivables written-off during the year as uncollectible	**(6.9)**	(5.1)
Cumulative amounts previously excluded from debt	**6.5**	4.9
Arising on acquisitions	**–**	0.4
At 31 March	**50.6**	43.1

Other receivables and prepayments include site development and pre-contract costs of £4.0m (2009 £18.0m).

23. DERIVATIVE FINANCIAL INSTRUMENTS

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Derivatives used for hedging				
Non-current assets	**–**	0.2	**–**	–
Current assets	**3.4**	–	**3.4**	–
Current liabilities	**(3.5)**	(1.4)	**–**	(1.4)
Non-current liabilities	**(14.1)**	(16.5)	**–**	–
Derivatives deemed held for trading				
Current liabilities	**(0.1)**	(2.2)	**–**	–

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

The ineffective portion recognised in the income statement arising from cash flow hedges amounts to a gain of nil (2009 £0.4m).

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 2010 65% of Group net borrowings were at fixed rate (2009 57%).

At 31 March 2010 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £775.0m and a weighted average maturity of 4.4 years (2009 £760.0m, with 2.4 years). The weighted average interest rate of the swaps for their nominal amount was 4.0% (2009 4.5%).

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

Derivatives held for trading relate to interest rate swaps which no longer qualify for hedge accounting.

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

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

	31 March 2010				31 March 2009			
	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets								
Derivatives used for hedging	**–**	**3.4**	**–**	**3.4**	–	0.2	–	0.2
Total assets	**–**	**3.4**	**–**	**3.4**	–	0.2	–	0.2
Liabilities								
Derivatives used for hedging	**–**	**17.6**	**–**	**17.6**	–	17.9	–	17.9
Derivatives deemed held for trading	**–**	**0.1**	**–**	**0.1**	–	2.2	–	2.2
Total liabilities	**–**	**17.7**	**–**	**17.7**	–	20.1	–	20.1

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

24. CASH AND CASH DEPOSITS

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Cash at bank and in hand	**9.2**	10.2	**11.8**	77.0
Short-term bank deposits	**232.8**	144.6	**151.4**	80.8
Other deposits	**251.9**	198.5	**11.4**	10.9
	493.9	353.3	**174.6**	168.7

The effective interest rate on Group short-term deposits was 0.7% (2009 1.4%) and these deposits have an average maturity of one day.

The effective interest rate on Group other deposits was 0.9% (2009 2.3%) and these deposits have an average maturity of 39 days.

Group other deposits include restricted funds of £33.5m (2009 £16.7m) to settle long-term lease liabilities (note 27) and £56.3m (2009 nil) relating to letters of credit.

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

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Cash and cash deposits as above	**493.9**	353.3	**174.6**	168.7
Bank overdrafts (note 27)	**(12.7)**	(12.9)	**–**	–
	481.2	340.4	**174.6**	168.7
Less: deposits with a maturity of three months or more (restricted funds)	**(91.7)**	(18.4)	**(1.4)**	(0.9)
	389.5	322.0	**173.2**	167.8

25. TRADE AND OTHER PAYABLES – CURRENT

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Trade payables	**82.1**	77.2	**0.2**	0.1
Amounts owed to subsidiary undertakings	**–**	–	**7.6**	2.4
Amounts owed to joint venture (note 43)	**5.0**	–	**5.0**	–
Other tax and social security	**49.3**	39.4	**0.2**	0.3
Other creditors	**17.2**	7.7	**3.9**	4.4
Accruals	**42.2**	42.5	**0.4**	0.4
	195.8	166.8	**17.3**	7.6

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

26. CURRENT TAX LIABILITIES/(RECOVERABLE)

	Group		Company	
	2010 £m	2009 (Restated note 5) £m	**2010 £m**	2009 £m
UK corporation tax	**83.6**	44.8	**(1.3)**	(2.4)

27. BORROWINGS

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Current				
Bank overdrafts	**12.7**	12.9	**–**	–
Short-term loans	**170.0**	205.0	**70.0**	205.0
European Investment Bank	**14.1**	14.1	**–**	–
Unsecured loan stock notes	**–**	0.8	**–**	0.8
Amounts owed to subsidiary undertakings	**–**	–	**281.2**	280.2
	196.8	232.8	**351.2**	486.0
Obligations under finance leases	**32.2**	30.1	**–**	–
Total current borrowings	**229.0**	262.9	**351.2**	486.0
Non-current				
Bank and other loans	**568.9**	507.5	**350.2**	189.5
Convertible bond	**112.6**	–	**112.6**	–
European Investment Bank	**273.6**	287.7	**–**	–
	955.1	795.2	**462.8**	189.5
Obligations under finance leases	**1,205.1**	1,187.2	**–**	–
Total non-current borrowings (note 37)	**2,160.2**	1,982.4	**462.8**	189.5
Total borrowings	**2,389.2**	2,245.3	**814.0**	675.5

The Company issued £125m 4.625% convertible bonds on 20 August 2009. The bonds mature five years from the issue date at their nominal value of £125m or can be converted into shares at the holders option at the maturity date on the conversion price of 597.81 pence per ordinary share.

The values of the liability component and the equity conversion component were determined at issuance of the bond. The value of the equity conversion component was determined to be £10m, using the Black-Scholes valuation model and has been recognised in shareholders' equity in retained earnings (note 35).

The fair values of non-current borrowings were:

	2010		2009	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Group				
Bank and other loans	**568.9**	**533.3**	507.5	445.0
Convertible bond	**112.6**	**127.6**	–	–
European Investment Bank	**273.6**	**235.5**	287.7	245.6
	955.1	**896.4**	795.2	690.6
Obligations under finance leases	**1,205.1**	**967.7**	1,187.2	1,070.2
	2,160.2	**1,864.1**	1,982.4	1,760.8
Company				
Bank and other loans	**462.8**	**471.1**	189.5	194.7

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

27. BORROWINGS *continued*

The maturity of non-current borrowings was:

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Between 1 and 2 years	**55.0**	233.5	**10.0**	80.0
Between 2 and 5 years	**516.2**	206.4	**352.9**	10.0
Over 5 years	**1,589.0**	1,542.5	**99.9**	99.5
	2,160.2	1,982.4	**462.8**	189.5

The weighted average maturity of non-current borrowings was 22 years (2009 23 years).

Finance lease liabilities – minimum lease payments:

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Within one year	**47.9**	62.0	**–**	–
In the second to fifth years inclusive	**242.6**	319.7	**–**	–
After five years	**2,323.2**	1,970.2	**–**	–
	2,613.7	2,351.9	**–**	–
Less: future finance charges	**(1,376.4)**	(1,134.6)	**–**	–
	1,237.3	1,217.3	**–**	–

Included above are accrued finance charges arising on obligations under finance leases totalling £135.3m (2009 £135.9m), of which £11.9m (2009 £13.8m) 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, £24.1m at 31 March 2010 (2009 £16.7m), are being held to settle the lease liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

During 2010 the period for repayment of certain existing leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The deposit at 31 March 2010 of £9.4m (2009 nil) is being held to settle the lease liability at the end of the lease term, subject to rights to release by negotiation with the lessor.

27. BORROWINGS *continued*

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

	Effective rate %	6 months or less £m	6–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Group						
31 March 2010						
Bank overdrafts	1.5	12.6	–	–	–	12.6
European Investment Bank	1.0	287.7	–	–	–	287.7
Bank and other loans	3.9	381.7	218.7	251.0	–	851.4
Finance leases	2.9	246.4	700.9	198.9	91.2	1,237.4
		928.4	919.6	449.9	91.2	2,389.1
Effect of swaps	4.0	(813.8)	255.0	508.8	50.0	–
		114.6	1,174.6	958.7	141.2	2,389.1
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
Company						
31 March 2010						
Bank and other loans	2.3	281.7	–	251.0	–	532.7
Effect of swaps	3.7	(38.8)	–	38.8	–	–
		242.9	–	289.9	–	532.7
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

Undrawn committed borrowing facilities:

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Floating rate:				
Expiring within one year	**25.0**	94.0	**25.0**	80.0
Expiring after one year	**175.0**	110.0	**65.0**	–
	200.0	204.0	**90.0**	80.0

In addition the Group has short-term uncommitted bank facilities of £60.0m available to the Company or South West Water Limited.

28. OTHER NON-CURRENT LIABILITIES

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Amounts owed to subsidiary undertakings	**–**	–	**8.7**	8.7
Other creditors	**16.0**	3.7	**–**	–
	16.0	3.7	**8.7**	8.7

29. RETIREMENT BENEFIT OBLIGATIONS

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

During the year the acquisition of Greater Manchester Waste Limited resulted in the Group participating in two further defined benefit pension schemes. The amounts acquired are shown in the analysis of the fair value of the schemes' assets and the present value of the schemes' defined benefit obligations below.

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

Defined contribution schemes
Pension costs for defined contribution schemes were £2.4m (2009 £1.9m).

Defined benefit schemes

Assumptions
The principal actuarial assumptions at 31 March were:

	2010 %	2009 %
Expected return on scheme assets	**7.3**	7.0
Rate of increase in pensionable pay	**4.1**	3.75
Rate of increase for current and future pensions	**3.6**	2.75
Rate used to discount schemes' liabilities	**5.5**	6.5
Inflation	**3.6**	2.75

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

The average life expectancy in years of a member having retired at age 62 on the balance sheet date is projected at:

	2010	2009
Male	**22.0**	21.9
Female	**25.4**	25.4

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

	2010	2009
Male	**23.4**	23.4
Female	**26.6**	26.5

29. 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 current and future pensions	+/– 0.5%	+/– 5.7%
Rate used to discount schemes' liabilities	+/– 0.5%	+/– 9.0%
Inflation	+/– 0.5%	+/– 8.3%
Life expectancy	+/– 1 year	+/– 2.8%

The amounts recognised in the income statement were:

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Current service cost	**(10.5)**	(10.2)	**(0.8)**	(0.8)
Past service cost	**(1.1)**	(1.1)	**–**	–
Total included in employment costs	**(11.6)**	(11.3)	**(0.8)**	(0.8)
Expected return on pension schemes' assets	**22.5**	22.4	**2.2**	2.3
Interest cost on retirement benefit obligations	**(24.8)**	(24.0)	**(2.6)**	(2.6)
Total included within net finance costs	**(2.3)**	(1.6)	**(0.4)**	(0.3)
Total charge	**(13.9)**	(12.9)	**(1.2)**	(1.1)

The actual return on schemes' assets was a profit of £98.5m (2009 loss of £79.2m).

The amounts recognised in the statement of comprehensive income were:

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Actuarial losses recognised in the year	**(44.4)**	(66.8)	**(4.3)**	(8.0)

The amounts recognised in the balance sheet were:

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Fair value of schemes' assets	**402.4**	276.4	**37.3**	29.6
Present value of defined benefit obligations	**(510.3)**	(342.4)	**(49.0)**	(36.9)
Net liability recognised in the balance sheet	**(107.9)**	(66.0)	**(11.7)**	(7.3)

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

	2010			2009		
	Expected return %	**Value £m**	**Fund %**	Expected return %	Value £m	Fund %
Equities	**8.5**	**244.5**	**61**	8.75	128.2	46
Property	**9.0**	**23.3**	**6**	7.9	21.2	8
Bonds	**5.0**	**125.8**	**31**	5.2	96.1	35
Other	**4.5**	**8.8**	**2**	8.75	30.9	11
		402.4	**100**		276.4	100

Other assets principally represent cash contributions received from the Group towards the year-end which are invested during the subsequent financial year.

29. RETIREMENT BENEFIT OBLIGATIONS *continued*

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

	2010 £m	2009 £m
Equities	**22.9**	13.6
Property	**2.3**	2.3
Bonds	**11.8**	10.2
Other	**0.3**	3.5
	37.3	29.6

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

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

– holding of bonds which is expected to be less volatile than most other asset classes and reflects the schemes' liabilities

– a proportion of equities, with fund managers having freedom in making investment decisions to maximise returns

– investment of a relatively small proportion of the schemes' assets (circa 10%) in alternative asset classes which give the potential for gaining higher returns (property and currency).

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

Movements in the net liability were:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 1 April	**(66.0)**	(26.3)	**(7.3)**	(2.9)
Income statement	**(13.9)**	(12.9)	**(1.2)**	(1.1)
Statement of comprehensive income	**(44.4)**	(66.8)	**(4.3)**	(8.0)
Regular contributions	**3.2**	1.3	**–**	–
Other employer contributions	**13.2**	38.7	**1.1**	4.7
At 31 March	**(107.9)**	(66.0)	**(11.7)**	(7.3)

Movements in the fair value of schemes' assets were:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 1 April	**276.4**	331.5	**29.6**	33.9
Expected return on schemes' assets	**22.5**	22.4	**2.2**	2.3
Actuarial gains/(losses)	**65.7**	(101.6)	**6.3**	(9.6)
Acquisition	**38.2**	–	**–**	–
Members' contributions	**1.0**	0.4	**–**	0.1
Benefits paid	**(17.8)**	(16.3)	**(1.9)**	(1.8)
Group regular contributions	**3.2**	1.3	**–**	–
Other employer contributions	**13.2**	38.7	**1.1**	4.7
At 31 March	**402.4**	276.4	**37.3**	29.6

29. RETIREMENT BENEFIT OBLIGATIONS *continued*

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

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
At 1 April	**(342.4)**	(357.8)	**(36.9)**	(36.8)
Service cost	**(11.6)**	(11.3)	**(0.8)**	(0.8)
Interest cost	**(24.8)**	(24.0)	**(2.6)**	(2.6)
Actuarial (losses)/gains	**(110.1)**	34.8	**(10.6)**	1.6
Acquisition	**(38.2)**	–	**–**	–
Members' contributions	**(1.0)**	(0.4)	**–**	(0.1)
Benefits paid	**17.8**	16.3	**1.9**	1.8
At 31 March	**(510.3)**	(342.4)	**(49.0)**	(36.9)

The future cash flows arising from the payment of the defined benefits are expected to be settled primarily in the period between 15 and 40 years from the balance sheet date.

The five-year history of experience adjustments is:

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Group					
Fair value of schemes' assets	**402.4**	276.4	331.5	347.6	317.5
Present value of defined benefit obligations	**(510.3)**	(342.4)	(357.8)	(388.8)	(359.2)
Net liability recognised	**(107.9)**	(66.0)	(26.3)	(41.2)	(41.7)
Experience gains/(losses) on schemes' assets					
Amount (£m)	**65.7**	(101.6)	(44.7)	1.5	34.2
Percentage of schemes' assets	**16.3%**	(36.7)%	(13.5)%	0.4%	10.8%
Experience gains/(losses) on defined benefit obligations					
Amount (£m)	**2.3**	34.8	49.8	(2.7)	(37.0)
Percentage of defined benefit obligations	**0.4%**	10.2%	13.9%	(0.7)%	(10.3)%

The cumulative actuarial gains recognised in the Group statement of comprehensive income at 31 March 2010 were £19.4m (2009 gains of £63.8m).

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Company					
Fair value of schemes' assets	**37.3**	29.6	33.9	27.0	25.4
Present value of defined benefit obligations	**(49.0)**	(36.9)	(36.8)	(30.4)	(28.7)
Net liability recognised	**(11.7)**	(7.3)	(2.9)	(3.4)	(3.3)
Experience gains/(losses) on schemes' assets					
Amount (£m)	**6.0**	(9.6)	4.0	0.1	3.9
Percentage of schemes' assets	**16.1%**	(32.4)%	11.8%	–	15.3%
Experience gains/(losses) on defined benefit obligations					
Amount (£m)	**0.4**	1.6	(5.3)	(0.4)	(0.3)
Percentage of defined benefit obligations	**0.8%**	4.3%	(14.4)%	(1.3)%	(1.0)%

The cumulative actuarial gains recognised in the Company statement of comprehensive income at 31 March 2010 were £1.9m (2009 gains of £6.2m).

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 updated the valuation of the main scheme to 31 March 2009 and has made deficit recovery contributions of £13.2m during the year (2009 £38.7m). The Group monitors funding levels on an annual basis and expects to pay total contributions of £34.4m during the year ended 31 March 2011.

30. DEFERRED TAX

Deferred tax is provided in full on temporary differences under the liability method using a tax rate of 28% (2009 28%).

Movements on deferred tax were:

	Group		Company	
	2010 £m	2009 (Restated note 5) £m	2010 £m	2009 £m
Liabilities/(assets) at 1 April	**328.4**	307.4	**(2.6)**	(1.6)
Charged/(credited) to the income statement	**1.3**	38.3	**(1.5)**	1.0
Credited to equity	**(17.6)**	(17.9)	**(0.9)**	(2.0)
Arising on acquisitions	**(0.9)**	0.6	**–**	–
Liabilities/(assets) at 31 March	**311.2**	328.4	**(5.0)**	(2.6)

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.

The movements in deferred tax assets and liabilities were:

Group

Deferred tax liabilities

	Accelerated tax depreciation			
	Owned assets (Restated note 5) £m	Leased assets £m	Other (Restated note 5) £m	Total (Restated note 5) £m
At 1 April 2008	289.6	15.5	22.2	327.3
Credited/(charged) to the income statement	26.8	0.8	(0.6)	27.0
Arising on acquisitions	0.1	–	0.5	0.6
At 31 March 2009	316.5	16.3	22.1	354.9
Charged/(credited) to the income statement	5.1	0.7	(1.9)	3.9
Arising on acquisitions	2.2	–	1.4	3.6
At 31 March 2010	**323.8**	**17.0**	**21.6**	**362.4**

Deferred tax assets

	Provisions £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 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)
(Credited)/charged to the income statement	(1.8)	0.7	(1.5)	(2.6)
Credited to equity	–	(12.4)	(5.2)	(17.6)
Arising on acquisition	(1.4)	–	(3.1)	(4.5)
At 31 March 2010	**(8.3)**	**(30.2)**	**(12.7)**	**(51.2)**
Net deferred tax liabilities:				
At 31 March 2009				328.4
At 31 March 2010				**311.2**

30. DEFERRED TAX *continued*

Company

Deferred tax assets

	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 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)
Credited to the income statement	–	(1.5)	(1.5)
(Credited)/charged to equity	(1.2)	0.3	(0.9)
At 31 March 2010	**(3.2)**	**(1.8)**	**(5.0)**

Deferred tax credited to equity during the year was:

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Actuarial losses on defined benefit schemes	**12.4**	18.7	**1.2**	2.2
Net fair value losses/(gains) on cash flow hedges	**5.0**	–	**(0.3)**	–
Deferred tax on other comprehensive loss	**17.4**	18.7	**0.9**	2.2
Share-based payments (note 35)	**0.2**	(0.8)	**–**	(0.2)
	17.6	17.9	**0.9**	2.0

31. PROVISIONS

	Environmental and landfill restoration £m	Restructuring £m	Other provisions £m	Total £m
Group				
At 1 April 2009	97.5	0.3	0.2	98.0
Charged to the income statement	4.5	5.0	–	9.5
Landfill restoration	2.6	–	–	2.6
Arising on acquisition (note 38)	3.2	–	–	3.2
Utilised during year	(11.4)	(2.2)	–	(13.6)
At 31 March 2010	**96.4**	**3.1**	**0.2**	**99.7**

The amount charged to the income statement includes £3.8m (2009 £4.5m) charged to finance costs as the unwinding of discounts in provisions.

The addition to landfill restoration provision of £2.6m 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:

	2010 £m	2009 £m
Current	**21.5**	18.8
Non-current	**78.2**	79.2
	99.7	98.0

Environmental and landfill restoration provisions are expected to be substantially utilised over the period from 2011 to beyond 2051. The provisions have been established assuming current waste management technology based upon estimated costs at future prices which have been discounted to present value. The restructuring provision related principally to severance costs and will be utilised within one year.

32. SHARE CAPITAL

	2010 £m	2009 £m
Authorised		
429,975,270 ordinary shares of 40.7p each	**175.0**	175.0

Allotted, called up and fully paid

	Number of shares		
	Treasury shares	Ordinary shares	£m
At 1 April 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 issued under the scrip dividend alternative	–	1,986,553	0.8
For consideration of £1.9m, shares re-issued under the Company's Sharesave Scheme	(631,557)	631,557	–
At 31 March 2010 ordinary shares of 40.7p each	**5,092,574**	**352,058,253**	**145.3**

Shares 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 2010	2009
9 July 2002	189p	2005 – 2009	**–**	37
8 July 2003	177p	2006 – 2010	**59**	63
6 July 2004	200p	2007 – 2011	**70**	278
5 July 2005	270p	2008 – 2012	**244**	270
4 July 2006	358p	2009 – 2013	**165**	559
3 July 2007	522p	2010 – 2014	**307**	472
8 July 2008	517p	2011 – 2015	**306**	464
6 July 2009	386p	2012 – 2016	**1,321**	–
			2,472	2,143

At 31 March 2010 there were 1,492 participants in the Sharesave Scheme (2009 1,299).

32. SHARE CAPITAL *continued*

Employee share schemes *continued*

i) Sharesave Scheme (continued)

The number and weighted average exercise price of Sharesave options are:

	2010		2009	
	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	**2,143**	**389**	2,519	322
Granted	**1,351**	**386**	495	517
Forfeited	**(371)**	**493**	(158)	431
Exercised	**(632)**	**295**	(687)	228
Expired	**(19)**	**370**	(26)	377
At 31 March	**2,472**	**396**	2,143	389

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 468p (2009 594p). The options outstanding at 31 March 2010 had a weighted average exercise price of 396p (2009 389p) and a weighted average remaining contractual life of 3.0 years (2009 1.9 years).

The aggregate fair value of Sharesave options granted during the year was £1.5m (2009 £0.8m), determined using the Black-Scholes valuation model. The significant inputs into the valuation model at the date of issue of the options were:

	2010	2009
Weighted average share price	482p	646p
Weighted average exercise price	386p	517p
Expected volatility	29.0%	21.3%
Expected life	3.8 years	3.8 years
Risk-free rate	2.5%	4.9%
Expected dividend yield	4.7%	3.3%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

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:

	2010		2009	
	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	**332**	**498**	684	449
Vested	**–**	**–**	(233)	357
Lapsed	**(332)**	**498**	(119)	494
At 31 March	**–**	**–**	332	498

The plan was succeeded in 2007 by the Performance and Co-investment Plan.

32. SHARE CAPITAL *continued*

Employee share schemes *continued*

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 dependent upon the achievement of conditions of the plan over the restricted period, being not less than three years.

The number and price of shares in the Performance and Co-investment Plan are:

	2010		2009	
	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	**886**	**598**	436	557
Granted	**579**	**486**	450	638
At 31 March	**1,465**	**554**	886	598

The awards outstanding at 31 March 2010 had a weighted exercise price of 554p (2009 598p) and a weighted average remaining contractual life of 1.4 years (2009 1.9 years).

The aggregate fair value of awards granted during the year was £1.9m (2009 £1.8m) determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2010	2009
Weighted average share price	**486p**	638p
Expected volatility	**29.0%**	21.3%
Risk-free rate	**2.5%**	4.9%

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:

	2010		2009	
	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	**358**	**575**	368	465
Granted	**146**	**475**	153	630
Vested	**(213)**	**545**	(163)	368
At 31 March	**291**	**547**	358	575

The awards outstanding at 31 March 2010 had a weighted average exercise price of 547p (2009 575p) and a weighted average remaining contractual life of 1.8 years (2009 1.4 years). The Company's share price at the date of the awards ranged from 473p to 620p.

The aggregate fair value of awards granted during the year was £0.7m (2009 £0.9m), determined from market value. No option pricing methodology is applied since dividends declared on the shares are receivable by the participants in the scheme.

Further details of the plans and options granted to Directors, included above, are shown in the Directors' Remuneration Report.

33. SHARE PREMIUM ACCOUNT

	£m
At 1 April 2008	11.7
At 31 March 2009	11.7
Adjustment for shares issued under the scrip dividend alternative	(0.8)
At 31 March 2010	**10.9**

34. CAPITAL REDEMPTION RESERVE

The capital redemption reserve represents the redemption of B shares and cancellation of Deferred shares arising from a capital return to shareholders undertaken during 2006.

	£m
At 1 April 2008	144.2
At 31 March 2009	144.2
At 31 March 2010	**144.2**

35. RETAINED EARNINGS AND OTHER RESERVES

	Own shares £m	Hedging reserve £m	Retained earnings (Restated note 5) £m	Total (Restated note 5) £m
Group				
At 1 April 2008	(4.5)	3.1	346.5	345.1
Profit for year	–	–	89.8	89.8
Other comprehensive loss 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)	321.1	300.2
Profit for year	–	–	139.5	139.5
Other comprehensive income/(loss) for the year	–	5.0	(35.2)	(30.2)
Dividends paid relating to 2009	–	–	(73.4)	(73.4)
Adjustment for shares issued under the scrip dividend alternative	–	–	9.6	9.6
Credit to equity in respect of share-based payments	–	–	2.7	2.7
Charge in respect of share options vesting	0.8	–	(0.8)	–
Deferred tax in respect of share-based payments	–	–	0.2	0.2
Equity component of convertible bond issued	–	–	10.0	10.0
Proceeds from treasury shares re-issued	–	–	1.9	1.9
At 31 March 2010	**(2.2)**	**(12.9)**	**375.6**	**360.5**

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.

The market value of the 596,000 ordinary shares (2009 810,000 ordinary shares) held by the trust at 31 March 2010 was £3.1m (2009 £3.3m).

35. RETAINED EARNINGS AND OTHER RESERVES *continued*

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 2008	0.5	393.5	394.0
Profit for the year	–	140.1	140.1
Other comprehensive loss 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
Profit for the year	–	81.6	81.6
Other comprehensive income/(loss) for the year	1.1	(3.4)	(2.3)
Dividends paid relating to 2009	–	(73.4)	(73.4)
Adjustment for shares issued under the scrip dividend alternative	–	9.6	9.6
Credit to equity in respect of share-based payments	–	0.7	0.7
Equity component of convertible bond issued	–	10.0	10.0
Proceeds from treasury shares re-issued	–	1.9	1.9
At 31 March 2010	**(0.3)**	**487.7**	**487.4**

36. CASH FLOW FROM OPERATING ACTIVITIES

Reconciliation of profit for the year to cash generated from operations:

Cash generated from operations

	Group		Company	
	2010 £m	2009 (Restated note 5) £m	**2010 £m**	2009 £m
Continuing operations				
Profit for the year	**139.5**	89.8	**81.6**	140.1
Adjustments for:				
Employee share schemes	**2.8**	2.7	**0.7**	0.6
Profit on disposal of property, plant and equipment	**(3.6)**	(2.1)	**–**	–
Depreciation charge	**135.1**	131.3	**0.1**	–
Amortisation of intangible assets	**0.3**	1.2	**–**	–
Share of post-tax profit from joint ventures	**(1.1)**	(0.8)	**–**	–
Finance income	**(34.4)**	(45.8)	**(22.9)**	(24.3)
Finance costs	**116.0**	138.0	**21.8**	31.8
Dividends receivable	**–**	–	**(80.6)**	(128.6)
Taxation charge/(credit)	**44.3**	69.6	**(0.2)**	(0.3)
Changes in working capital (excluding the effect of acquisition of subsidiaries):				
Decrease in inventories	**0.3**	0.8	**–**	–
Increase in trade and other receivables	**(32.4)**	(20.7)	**(123.7)**	(12.1)
Decrease/(increase) in trade and other payables	**9.3**	(24.5)	**9.7**	(9.1)
Decrease in retirement benefit obligations from contributions	**(4.8)**	(28.7)	**(0.3)**	(3.9)
Decrease in provisions	**(7.9)**	(10.2)	**–**	–
Cash generated/(outflow) from operations	**363.4**	300.6	**(113.8)**	(5.8)

37. NET BORROWINGS

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Cash and cash deposits	**493.9**	353.3	**174.6**	168.7
Borrowings – current				
Bank overdrafts	**(12.7)**	(12.9)	**–**	–
Other current borrowings	**(184.1)**	(219.9)	**(70.0)**	(205.8)
Finance lease obligations	**(32.2)**	(30.1)	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**(281.2)**	(280.2)
Total current borrowings	**(229.0)**	(262.9)	**(351.2)**	(486.0)
Borrowings – non-current				
Bank and other loans	**(681.5)**	(507.5)	**(462.8)**	(189.5)
Other non-current borrowings	**(273.6)**	(287.7)	**–**	–
Finance lease obligations	**(1,205.1)**	(1,187.2)	**–**	–
Total non-current borrowings	**(2,160.2)**	(1,982.4)	**(462.8)**	(189.5)
Total net borrowings	**(1,895.3)**	(1,892.0)	**(639.4)**	(506.8)

Bank overdrafts at the balance sheet date arise from the timing of the payment of unpresented cheques.

38. ACQUISITIONS

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 has been accounted for using the acquisition method.

Viridor Waste (Greater Manchester) Limited contributed revenues of £75.5m and a profit before tax of £6.5m for the period from 8 April 2009 to 31 March 2010. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the fair value adjustments.

The residual excess over the net assets acquired has been recognised as goodwill. The goodwill is attributed to the profitability of the acquired business.

	Book value £m	Fair value adjustment £m	Fair value £m
Other intangible assets	1.1	(1.1)	–
Property, plant and equipment	26.5	(10.6)	15.9
Inventories	0.4	–	0.4
Receivables	6.3	–	6.3
Payables	(11.4)	(19.7)	(31.1)
Retirement benefit obligations	(1.5)	1.5	–
Provisions – environmental	–	(3.2)	(3.2)
Taxation – current	0.7	(0.2)	0.5
Taxation – deferred	(0.3)	(0.6)	(0.9)
Cash and cash deposits	6.3	–	6.3
Net assets/(liabilities) acquired	28.1	(33.9)	(5.8)
Goodwill			5.8
Total consideration			–
Satisfied by:			
Cash			–
Directly attributable costs			–
			–
Net cash inflow arising on acquisition			
Cash consideration			–
Cash and cash deposits acquired			6.3
			6.3

38. ACQUISITIONS *continued*

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 £11.1m, including costs of £0.5m. The acquisition has been accounted for using the acquisition method.

Viridor London Recycling Limited contributed revenues of £7.3m and a loss before tax of £0.5m for the period from 5 June 2009 to 31 March 2010. If the acquisition had occured on 1 April 2009 Group revenues for the year would have been £1,070.3m and profit for the year would have been £139.4m. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the provisional fair value adjustments.

The residual excess over the net assets acquired has been recognised as goodwill. The provisional goodwill is attributed to the profitability of the acquired business.

	Book value £m	Fair value adjustment £m	Fair value £m
Property, plant and equipment	3.2	–	3.2
Inventories	0.1	–	0.1
Receivables	1.6	–	1.6
Payables	(0.8)	–	(0.8)
Loans	(1.2)	–	(1.2)
Leases	(0.3)	–	(0.3)
Net assets acquired	2.6	–	2.6
Goodwill			8.5
Total consideration			11.1
Satisfied by:			
Cash			10.6
Directly attributable costs			0.5
			11.1
Net cash outflow arising on acquisition			
Cash consideration			11.1
Cash and cash deposits acquired			–
			11.1

38. ACQUISITIONS *continued*

On 31 July 2009 the entire issued share capital of Intercontinental Recycling Limited (now renamed Viridor Polymer Recycling Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £4.7m, including costs of £0.5m. The acquisition has been accounted for using the acquisition method.

Viridor Polymer Recycling Limited contributed revenues of £6.9m and a loss before tax of £0.4m for the period from 31 July 2009 to 31 March 2010. If the acquisition had occured on 1 April 2009 Group revenues for the year would have been £1,071.5m and profit for the year would have been £138.9m. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the provisional fair value adjustments.

The residual excess over the net assets acquired has been recognised as goodwill. The provisional goodwill is attributed to the profitability of the acquired business.

	Book value £m	Fair value adjustment £m	Fair value £m
Property, plant and equipment	3.1	–	3.1
Inventories	0.4	–	0.4
Receivables	1.1	–	1.1
Payables	(2.3)	–	(2.3)
Taxation – deferred	1.8	–	1.8
Loans	(3.8)	–	(3.8)
Cash and cash deposits	0.2	–	0.2
Net assets acquired	0.5	–	0.5
Goodwill			4.2
Total consideration			4.7
Satisfied by:			
Cash			4.2
Directly attributable costs			0.5
			4.7
Net cash outflow arising on acquisition			
Cash consideration			4.7
Cash and cash deposits acquired			(0.2)
			4.5

39. PRINCIPAL SUBSIDIARY AND JOINT VENTURE UNDERTAKINGS AT 31 MARCH 2010

	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 (Greater Manchester) Limited	England
Viridor London Recycling Limited	England
Viridor Polymer Recycling 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 and associate

All joint ventures, the associate and the subsidiary undertakings of Lakeside Energy from Waste Holdings Limited, Viridor Laing (Greater Manchester) Holdings Limited and INEOS Runcorn (TPS) Holdings Limited are incorporated and registered in England which is also their country of operation.

	Share capital in issue	Percentage held	Activity
Lakeside Energy from Waste Holdings Limited	1,000,000 A ordinary shares	–	
	1,000,000 B ordinary shares	100%	
Lakeside Energy from Waste Limited			Waste management

Shares in Lakeside Energy from Waste Holdings Limited are held by Viridor Waste Management Limited.

	Share capital in issue	Percentage held	Activity
Viridor Laing (Greater Manchester) Holdings Limited	2 ordinary shares	50%	
Viridor Laing (Greater Manchester) Limited			Waste management

Shares in Viridor Laing (Greater Manchester) Holdings Limited are held by Viridor Waste Management Limited.

	Share capital in issue	Percentage held	Activity
INEOS Runcorn (TPS) Holdings Limited	1,000 A ordinary shares	20%	
	186,750 B1 ordinary shares	50%	
	62,250 B2 ordinary shares	–	
INEOS Runcorn (TPS) Limited			Waste management

Shares in INEOS Runcorn (TPS) Holdings Limited are held by Viridor Waste Management Limited.

40. OPERATING LEASE COMMITMENTS

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
The future aggregate minimum lease payments under non-cancellable operating leases are:				
Within one year	**7.4**	7.2	**–**	–
Later than one year and less than five years	**23.8**	19.1	**–**	–
After five years	**89.1**	81.2	**–**	–
	120.3	107.5	**–**	–

The Group leases various offices, depots and workshops under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. Property leases are negotiated for an average term of 25 years and rentals are reviewed on average at five yearly intervals.

The Group also leases plant and machinery under non-cancellable operating lease agreements.

41. CONTINGENT LIABILITIES

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	–	–	363.8	452.4
Contractors' claims on capital schemes	3.0	1.3	–	–
Performance bonds	104.8	96.6	104.8	96.6
Other	6.9	6.9	6.9	6.9
	114.7	104.8	475.5	555.9

Guarantees in respect of performance bonds are entered into in the normal course of business. No liability is expected to arise in respect of the guarantees.

Viridor Waste Management Limited has given a commitment to supply 200,000 tonnes of waste per annum (or pay market price based compensation) to the energy from waste plant of the joint venture in Lakeside Energy from Waste Holdings Limited. The Directors consider that the committed waste volume will be available in the ordinary course of business.

Other contingent liabilities relate to a possible obligation to pay further consideration in respect of a previously acquired business when the outcome of planning applications is known.

42. CAPITAL COMMITMENTS

	Group		Company	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Contracted but not provided	**104.1**	85.3	**–**	–
Share of commitment contracted but not provided by joint ventures	**135.2**	6.1	**–**	–
	239.3	91.4	**–**	–

43. RELATED PARTY TRANSACTIONS

During the year, Group companies entered into the following transactions with related parties who are not members of the Group:

	2010 £m	2009 £m
Sales of goods and services		
Lakeside Energy from Waste Limited	**0.2**	–
Viridor Laing (Greater Manchester) Limited	**49.0**	–
Purchase of goods and services		
Lakeside Energy from Waste Limited	**3.8**	–

43. RELATED PARTY TRANSACTIONS *continued*

Year end balances

	2010 £m	2009 £m
Receivables due from related parties		
Viridor Laing (Greater Manchester) Limited	**20.7**	–
Lakeside Energy from Waste Limited	**19.5**	10.6
INEOS Runcorn (TPS) Limited	**5.7**	–
	45.9	10.6
Payables due to related parties		
Lakeside Energy for Waste Limited	**5.0**	–

The £5.0m payable relates to consortium relief due to Lakeside Energy from Waste Limited.

The £45.9m (2009 £10.6m) relates to loans to related parties included within receivables and due for repayment in instalments between 2011 and 2033. Interest is charged at an average of 11.3% (2009 15%).

Company

The following transactions with subsidiary undertakings occurred in the year:

	2010 £m	2009 £m
Sales of goods and services (management fees)	**7.1**	7.3
Purchase of goods and services (support services)	**0.5**	0.5
Interest receivable (loans)	**19.4**	17.6
Interest payable (short-term funding)	**0.1**	1.7
Dividends received	**80.6**	128.6

Sales of goods and services to subsidiary undertakings are at cost. Purchases of goods and services from subsidiary undertakings are under normal commercial terms and conditions which would also be available to unrelated third parties.

Year end balances

	2010 £m	2009 £m
Receivables due from subsidiary undertakings		
Loans	**420.6**	339.1
Trading balances	**0.9**	0.9

Interest on £104.8m of the loans has been charged at a fixed rate of 5.0% and on £104.3m at a fixed rate of 6.0% (2009 £76.2m, 6.0%). Interest on the balance of the loans is charged at 12 month LIBOR + 1.5% (2009 Barclays Bank Plc base rate +1%). The loans are due for repayment in instalments over the period 2011 to 2014. During the year there were no further provisions (2009 £0.1m) in respect of loans to subsidiaries not expected to be repaid.

	2010 £m	2009 £m
Payables due to subsidiary undertakings		
Loans	**281.2**	280.2
Trading balances	**16.3**	11.1
Payables due to joint venture		
Trading balances	**5.0**	–

The loans from subsidiary undertakings are unsecured and interest-free without any terms for repayment.

	2010 £m	2009 (Restated note 5) £m	2008 (Restated note 5) £m	2007* £m	2006* £m
Income statement					
Revenue	**1,068.9**	958.2	879.4	748.3	645.7
Underlying operating profit	**269.6**	257.0	243.0	202.1	176.7
Net finance costs	**(81.6)**	(92.2)	(85.6)	(69.2)	(64.3)
Share of profit in joint ventures	**1.1**	0.8	0.2	0.3	0.1
Underlying profit before tax and exceptional items	**189.1**	165.6	157.6	133.2	112.5
Non-underlying and exceptional items (before tax)	**(5.3)**	(6.2)	(5.3)	(2.1)	(58.4)
Taxation	**(44.3)**	(69.6)	(16.4)	(37.2)	(16.3)
Profit for the year	**139.5**	89.8	135.9	93.9	37.8
Dividends proposed	**79.6**	73.4	69.1	65.6	61.0
Underlying earnings per share (basic):					
From continuing operations					
Earnings per share	**39.9p**	25.8p	38.9p	26.5p	9.9p
Non-underlying and exceptional items (net of tax)	**1.3p**	1.2p	1.3p	0.6p	10.4p
Deferred tax	**0.4p**	11.1p	(2.6p)	3.8p	5.3p
Underlying earnings per share	**41.6p**	38.1p	37.6p	30.9p	25.6p
Declared dividends per share	**22.55p**	21.0p	19.81p	18.55p	17.2p

	2010 £m	2009 (Restated note 5) £m	2008 (Restated note 5) £m	2007* £m	2006* £m
Capital expenditure					
Acquisitions	**9.3**	3.4	89.0	37.0	45.8
Property, plant and equipment	**190.2**	231.8	207.7	245.1	249.7
Balance sheet					
Non-current assets	**3,183.4**	3,036.3	2,931.0	2,728.6	2,527.5
Net current assets/(liabilities)	**165.1**	40.5	199.7	(56.7)	(61.2)
Non-current liabilities	**(2,687.6)**	(2,476.2)	(2,485.2)	(2,044.7)	(1,885.1)
Net assets	**660.9**	600.6	645.5	627.2	581.2
Number of employees (average for year)					
Water and sewerage business	**1,191**	1,227	1,276	1,301	1,299
Waste management	**2,853**	2,154	2,059	1,686	1,388
Other businesses	**43**	41	42	38	35
	4,087	3,422	3,377	3,025	2,722

* Prior to the application of IFRIC 12 "Service concession arrangements".

FINANCIAL CALENDAR

Financial year-end	31 March
Twenty-first Annual General Meeting	29 July 2010
Ex-dividend date for 2010 Final dividend	11 August 2010*
Record date for 2010 Final dividend	13 August 2010*
2010 Final dividend payable	8 October 2010*
2010/11 Half yearly financial report announcement	November 2010
2011 Interim dividend payable	April 2011
2011 Preliminary results announcement	May 2011
Twenty-second Annual General Meeting	July 2011
2011 Final dividend payable	October 2011

* the above dates are subject to obtaining shareholder approval at the 2010 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2010.

SCRIP DIVIDEND ALTERNATIVE

Subject to obtaining shareholder approval at the 2010 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2010, the timetable for offering the Scrip Dividend Alternative will be as follows:

11 August 2010	Ordinary shares quoted ex dividend
13 August 2010	Record date for final cash dividend
27 August 2010	Posting of Scrip dividend offer
20 September 2010	Final date for receipt of Forms of Election/Mandate
7 October 2010	Posting of dividend cheques and share certificates
8 October 2010	Final cash dividend payment date
8 October 2010	First day of dealing in the new ordinary shares

London Stock Exchange
LISTED
PREMIUM

Pennon Group Plc is listed on the London Stock Exchange and meets the requirements of a Premium Listing. This is a listing that meets the more stringent UK 'super-equivalent standards' compared with a 'standard listing' which meets EU minimum standards.

SHAREHOLDERS' ANALYSIS AT 31 MARCH 2010

Range	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1 - 100	2,441	10.06	0.02
101 - 1,000	9,555	39.40	1.41
1,001 - 5,000	10,492	43.26	6.29
5,001 - 50,000	1,433	5.91	4.40
50,001 - 100,000	80	0.33	1.58
100,001 - HIGHEST	252	1.04	86.30
	24,253	100.00	100.00
Individuals	20,602	84.95	8.67
Companies	223	0.92	3.54
Trust companies (pension funds etc)	3	0.01	0.00
Banks and nominees	3,425	14.12	87.79
	24,253	100.00	100.00

SUBSTANTIAL SHAREHOLDINGS

At 14 June 2010 interests in the issued share capital had been notified pursuant to the Financial Service Authority's Disclosure and Transparency Rules:

Invesco Ltd	11.98%
Ameriprise Financial Inc	9.98%
Pictet Asset Management SA	7.24%
AXA SA and its Group Companies	6.14%
Legal & General Group Plc	5.91%
Prudential Plc	5.39%

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 CO107. Commission is 0.5% (subject to a minimum charge of £17.50) to £10,000, then 0.2% thereafter.

Change of Registrar

On 10 May 2010 the Company changed its registrar from Equiniti to Capita Registrars. Capita Registrars can be contacted as follows:

Capita Registrars
Northern House
Woodsome Park
Fenay Bridge
Huddersfield
HD8 0GA

Telephone: 0871 664 9234*
Overseas telephone: +44 800 141 2951
Email: **pennon@capitaregistrars.com**

**(calls cost 10p per minute plus network extras)*
Lines are open 8:30am - 5.30pm Mon - Fri

Share gift service

Through Sharegift, an independent charity share donation scheme, shareholders who only have a small number of shares with a value that makes it uneconomical to sell them, can donate such shares to charity. Donations can be made by completion of a simple share transfer form which is available from the Company's registrars, Capita Registrars.

Individual Savings Accounts

By holding their shares in the Company in an Individual Savings Account (ISA), shareholders may gain tax advantages.

Scrip Dividend Alternative

The Company operates a Scrip Dividend Alternative. The Scrip Dividend Alternative provides shareholders with an opportunity to invest the whole of, or part of, the cash dividend they receive on their Pennon Group Plc shares to buy further shares in the Company without incurring stamp duty or dealing expenses. Subject to obtaining shareholder approval at the 2010 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2010, full details of the Scrip Dividend Alternative, including how to join, will be sent out to shareholders on 27 August 2010. The full timetable for offering the Scrip Dividend Alternative is given opposite on page 110.

Online portfolio service

The online portfolio service provided by Capita Registrars gives shareholders access to more information on their investments. Details of the portfolio service are available online at **capitashareportal.com**

Electronic communications

The Company has passed a resolution which allows it to communicate with its shareholders by means of its website.

Shareholders currently receiving a printed copy of the Annual Report who now wish to sign up to receive all future shareholder communications electronically, can do so by registering with Capita Registrars' share portal. Go to **capitashareportal.com** to register, select 'Account Registration' and then follow the on-screen instructions by inputting your surname, your Investor Code (which can be found on your Form of Proxy) and your postcode as well as entering an e-mail address and selecting a password. Some facilities will require an activation code which will be sent to you in the post following registration.

Electronic Proxy voting

Shareholders also have the opportunity to register the appointment of a proxy for any general meeting of the Company once notice of the meeting has been given and may do so via **capitashareportal.com** Shareholders who register an 'e-mail' preference will not receive a paper proxy form. Instead they will receive an e-mail alert advising them of general meetings of the Company, with links to the Notices of Meetings and annual and half yearly accounts.

The Pennon website

Pennon's website **pennon-group.co.uk** provides news and details of the Company's activities plus links to its business websites. The Investor Information section contains up-to-date information for shareholders including comprehensive share price information; financial results; dividend payment dates and amounts; and Stock Exchange announcements. There is also a comprehensive share services section on the website which includes information on buying, selling and transferring shares; and on the action to be undertaken by shareholders in the event of a change in personal circumstances, for example, a change of address.

'Brokers' Contacting Shareholders – Boiler Room Scams

A number of companies, including Pennon Group Plc, continue to be aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters which imply a connection to the company concerned. These are typically from overseas based 'brokers' who target UK shareholders offering to sell them what can turn out to be worthless or high risk shares in US or UK investments. They can be very persistent and extremely persuasive and a 2006 survey by the Financial Services Authority (FSA) has reported that the average amount lost by investors is around £20,000. It is not just the novice investor who has been duped in this way; many of the victims had been successfully investing for several years.

Shareholders are advised to be wary of any unsolicited advice, offers to buy shares at a discount or offers of free reports into the Company. If you are contacted in this manner, please make sure you obtain the correct name of the person and organisation and where they are based. You should also check that they are properly authorised by the FSA before getting involved and should call the organisation back using their details in the FSA register to verify their authorisation - you can check online **fsa.gov.uk/register/home.do** If you deal with an unauthorised firm, you would not be eligible to receive any payment under the Financial Services Compensation Scheme. The FSA can be contacted by completing an online form at **fsa.gov.uk/pages/Doing/Regulated/Law/Alerts/overseas.shtml**

Details of any share dealing facilities that the Company endorses will be included in Company mailings.

More detailed information on this or similar activity can be found on the FSA website **moneymadeclear.fsa.gov.uk/consumer**

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