Investing for quality

Annual Report and Accounts 2012

Investing for future growth

Introduction

Who we are

Pennon Group Plc is an environmental utility infrastructure company at the top end of the FTSE 250 which owns South West Water Limited and Viridor Limited. The Group has assets of around £4.3 billion and a workforce of over 4,500 people.

Group strategy

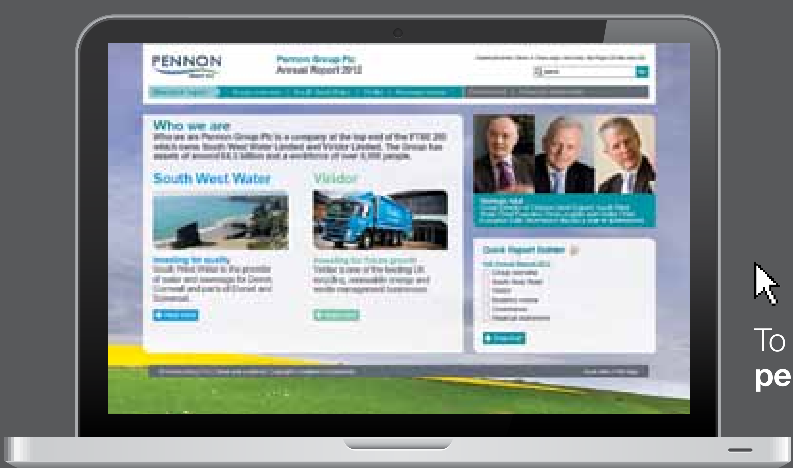
Our strategy is to promote the success of the Group for the benefit of our shareholders, customers and other stakeholders through our focus on water and sewerage services, recycling, renewable energy and waste management. We aim to be a pre-eminent provider of customer services to high standards of quality,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

What we do

We carry out our business through:

South West Water Limited – the provider of water and sewerage services for Devon, Cornwall and parts of Dorset and Somerset.

Viridor Limited – one of the leading UK recycling, renewable energy and waste management businesses.



To view our online report visit:
pennonannualreport2012.co.uk

Cover photos
Top: Porthcurno beach, West Cornwall
Bottom: Greater Manchester mechanical biological treatment facility

Pennon Group

We create value for our shareholders by developing our two environmental utility infrastructure businesses, South West Water and Viridor, and by efficient financing and strong management of the Group as a whole.

PENNON
GROUP PLC

Financial highlights

Revenue

£1,233.1m
+6.4%

Profit before tax

£200.5m
+6.4%

Key Group facts

Assets

£4.3bn

Employees

4,500

Strategy

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

Highlights of the year

- continued to deliver shareholder value – 7.6% dividend increase
- further reduction in interest cost from the Group's effective management of interest rates
- over £1 billion cash and facilities at 31 March 2012 including over £0.5 billion new/refinanced facilities sourced during the year
- winner of the 'Achievement in Sustainability' award at the 2012 PLC Awards.

Strategy in action

We are committed to an annual dividend increase of 4% above inflation up to at least the end of 2014/15

We have strong sustainability credentials which make a positive impact on communities and the environment

We maintain high standards of ethical business conduct

We foster open and positive relationships with suppliers, customers and other stakeholders

We seek to protect and promote the interests of all our employees.

Further details on page 24

South West Water

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

SOUTH WEST WATER

Financial highlights

Revenue

£474.0m

+5.6%

Profit before tax

£141.5m

+9.8%

Strategy

South West Water is committed to its vision of 'Pure Water, Pure Service and Pure Environment', underpinned by a strategy of striking the right balance between:

- investing to improve service
- customer affordability
- the needs of stakeholders.

Highlights of the year

- industry-leading performance in tackling leakage
- 15th consecutive year without water restrictions (16th expected in 2012/13)
- repeated best ever drinking water quality at 99.98%
- further improvements in Service Incentive Mechanism (SIM) performance – customer complaints halved over two years
- record percentage (95.1%) of bathing waters achieved EU Guideline standard (excellent status).

Strategy in action

Pure Water – providing safe and reliable water supplies

Pure Service – increasing levels of customer satisfaction and maintaining reliability of assets to protect the service improvements made over the last 20 years

Pure Environment – protecting and enhancing the environment

Financial Management – outperforming the regulatory contract and rigorously controlling costs with efficient funding.

Further details on page 12

Viridor

One of the leading UK recycling, renewable energy and waste management businesses.

Viridor

Financial highlights

Revenue

£761.1m

+6.9%

Profit before tax

£57.6m

-8.4%

Strategy

Viridor's strategy is to add value by:

- growing in recycling
- growing in Public Private Partnerships (PPPs)/energy from waste (EfW)
- capitalising in the long-term on its strong position in the landfill market.

Highlights of the year

- investing for future growth – capital expenditure and investment in joint ventures of £140 million mainly to deliver additional renewable power generation and recycling capacity
- acquisition of five high quality recycling, collection and transport businesses for around £40 million
- volumes of recyclate traded increased by 7.2% to over 1.8 million tonnes with continuing improvement in the quality and value mix
- total renewable energy production increased to 760GWh.

Strategy in action

Contribution to profits from recovering the value in waste grew to around 50% as landfill fell to 18% (from 69% in 2001)

Viridor consolidated its position as the UK's largest operator of materials recycling facilities (MRFs)

Construction of Runcorn combined heat and power (CHP) EfW project on schedule

Construction commenced on Ardley (Oxfordshire) and Exeter EfWs and on Walpole anaerobic digestion (AD) facility in Somerset

Announced as preferred bidder for South London, Glasgow and South Lanarkshire† PPP contracts.

† subject to legal challenge.

Further details on page 18

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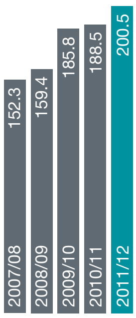
Key performance indicators

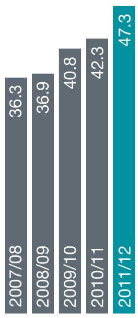
Pennon Group Plc

Profit before tax
£m



£200.5m
+6.4%

Earnings per share before deferred tax
pence



47.3p
+11.8%

Dividend per share
pence

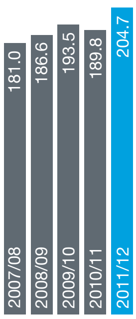
26.52p
+7.6%

Interest rate on average net debt
%

3.9%

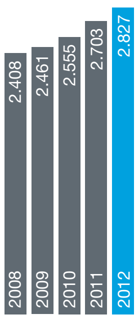
South West Water

Operating profit
£m



£204.7m
+7.9%

Regulatory Capital Value
£bn as at 31 March



£2.827bn
+4.6%

Drinking water quality
% Mean Zonal Compliance (MZC) calendar year

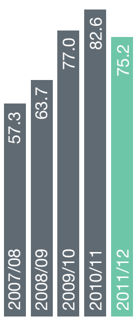
99.98%

Service Incentive Mechanism (SIM)
%

66.9
+15%

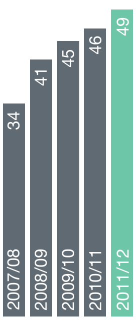
Viridor

Operating profit plus joint ventures
£m



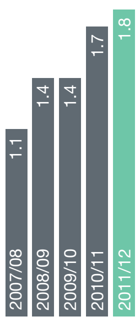
£75.2m
-9.0%

Profits from recovering value in waste
%



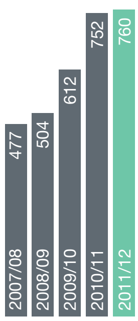
49%

Recyclates traded
million tonnes



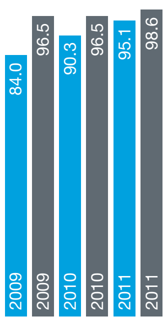
1.8m tonnes
+7.2%

Total renewable energy generation
GWh



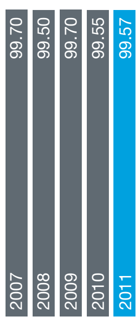
760GWh
+1.1%

Bathing water compliance with EU Mandatory and Guideline standards % calendar year



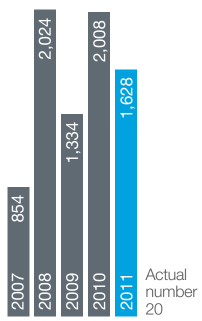
■ Mandatory
■ Guideline

Population equivalent sanitary compliance % calendar year

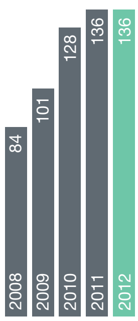


99.57%

RIDDOR incidence rate per 100,000 employees calendar year

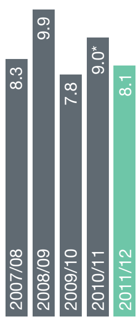


Renewable energy generation capacity MW as at 31 March



136MW

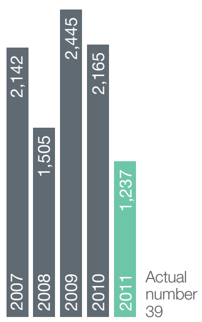
Total waste handled million tonnes



8.1m tonnes

* 2010/11 figure reassessed.

RIDDOR incidence rate per 100,000 employees calendar year



Chairman's statement

Dear shareholder

Our Group financial performance for the year has again been strong notwithstanding the challenging economic environment.

Ken Harvey
Chairman, Pennon Group Plc

Revenue
£m

£1,233.1m +6.4%

Profit before tax
£m

£200.5m +6.4%

Financial review

Group revenue rose by 6.4% to £1,233.1 million and our profit before tax increased by 6.4% to £200.5 million. Our earnings per share before deferred tax increased by 11.8% to 47.3p.

The Group has substantial cash resources and undrawn facilities and is well positioned for the future.

South West Water's Regulatory Capital Value (RCV) grew by a further 4.6% during 2011/12 to £2.83 billion. RCV has grown by an average of around 5% per annum since the beginning of the K4 (2005-2010) period. Viridor's profit before tax at £57.6 million was a reduction of 8.4% on the previous year. Around 50% of Viridor's profit contribution came from recovering the value in waste.

Dividend

The Board is committed to delivering consistent returns for our shareholders and to this end continues with its progressive dividend policy to grow the Group dividend by 4% above inflation per annum up to at least the end of 2014/15. This reflects our confidence that Pennon Group remains well positioned to deliver strong growth in the medium and long-term.

We are recommending a final dividend per share of 18.30p, which represents a 6.7% increase on last year's final dividend. This will result in a total dividend for the year of 26.52p, an increase of 7.6% (reflecting inflation of 3.6%) on the total dividend for 2010/11. We will also once again offer a Scrip Dividend Alternative to shareholders in respect of the final dividend. The timetable for the Scrip Dividend Alternative is given on page 113.

Business performance

South West Water continued its strong operational performance against the 2010-2015 regulatory contract with further advances in operating efficiency and customer service. The company is front-end loading delivery of the operating cost efficiencies required by Ofwat (an average 2.8% per annum over the five-year period) with an average 5.1% per annum delivered in the first two years. These efficiencies are being achieved through improving operational ways of working, right-sourcing and innovative contracting arrangements, energy procurement and reduced usage, and the rationalisation of administration and support services.

Viridor grew its profits from recycling, contracts and joint ventures, offset by a reduction in the contribution from landfill plus increased bid costs associated with its developing project pipeline. Recyclate prices fell in the second half of 2011/12 compared with the first half year peak, reflecting world economic conditions. More than 50% of the impact was mitigated by actions taken by Viridor to address costs and, although we are cautious about the prospect for a recovery in recyclate prices in the short-term, Viridor's growing Public Private Partnership (PPP) pipeline and energy from waste (EfW) planning successes will form the basis for future growth. Renewable energy generation will also remain a significant contributor to profits.

Health and safety
We continue to focus on the safety and well-being of all our employees. There have been a number of initiatives during the year, such as our TAP (Think, Act, Prevent) behavioural safety campaign for Pennon and South West Water staff and Viridor's Safety Information Database, both of which are designed to ensure high standards of safety across the businesses. We are pleased to see a reduction in the reportable number of incidents within both South West Water and Viridor. The Board, together with the Boards of South West Water and Viridor, remains committed to fostering a culture and working environment where accidents are unacceptable. The Group's goal is zero accidents.

Sustainability and governance
Our businesses demonstrate a responsible approach to environmental, social and governance (ESG) matters. This was recognised when we received the prestigious 'Achievement in Sustainability' award at the annual PLC Awards for our sustainable activities which include renewable energy generation at waste water treatment works, landfill gas control and significant funding being provided for community and environmental projects through the Pennon Environmental Fund and Viridor Credits Environmental Body. The Business review and our Group Sustainability report set out more fully our commitment to ESG and the highlights during the year which include carbon reduction, water security, water catchment management and resource security and efficiency.

The Board has an annual programme which is focused on continuing to develop and improve our governance structures and practices. This ensures that we apply best practice to enable us to operate in the best interests of our shareholders and other stakeholders.

Our business model
One of our key objectives is to ensure that we are at the forefront of company reporting. Overleaf we have set out our business model to assist shareholders in understanding how we generate and preserve value in our businesses. I hope it is a useful introduction to this year's Business review and succinctly explains how our business strategy is followed through into action.

Diversity
The Board is committed to promoting equality and diversity and a culture that actively values difference and recognises that people from different backgrounds and experiences can bring valuable insights to the workplace at all levels and enhance the way we work. We have an established Workplace Policy which provides for equal opportunity and diversity throughout the Group. In support of this policy and of the recommendations of the Davies Review 'Women on Boards', the Board has also established a Boardroom Equality & Diversity Policy. We will endeavour to achieve a minimum of 25% female representation on the Board by 2015 (whilst maintaining our current 14% representation in the meantime) and achieve a minimum of 25% female representation in our senior management team by 2015.

Board succession
Two of our three Non-executive Directors are coming towards the end of their nine-year tenure. The Board wishes to ensure a seamless transition and does not wish to lose the considerable knowledge and experience of the departing Directors, particularly as it is satisfied that they remain independent in character and judgement while continuing in their role on the Board. It is therefore intended that Dinah Nichols will retire from the Board at the 2013 Annual General Meeting (AGM) and Gerard Connell, the Senior Independent Director, will retire from the Board at the 2014 AGM. The search for one new Non-executive Director is well under way and a further Non-executive Director will be sought during 2013. This process will ensure that the new members, of what is a small board, are fully acquainted with the Company's practices and procedures before the two retiring Non-executive Directors leave the Board.

Our customers
A key priority for both our businesses is providing the highest possible levels of services to our customers. This is also reflected in our Group strategy.

Over the year South West Water has successfully moved into new territory in meeting the demand for information, advice and assistance from its household and business customers. The 'Source for Business' service is providing extra support for commercial customers. South West Water is now providing online accounts, a smartphone app and web-based services for all customers. The company recognises that affordability is an issue for a number of our customers and we continue to provide advice and assistance through a number of schemes.

Within Viridor there is a particular need to meet the changing requirements of our customers where the focus is increasingly on recycling, energy recovery and the reduction of waste to landfill to meet Government targets. The fact that around 50% of Viridor's profits are now from recovering the value in waste demonstrates that Viridor is living up to its new branding 'transforming waste'.

Our employees
We know that our success continues to be due to the talent, commitment and hard work of our employees, and I would like to thank every one of them for their outstanding contribution to the Group.

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

Outlook
The Board's priority continues to be the creation of shareholder value through its strategic focus on water and sewerage services, recycling, renewable energy and waste management.

South West Water has continued its excellent start to K5 with robust operational delivery, high standards of customer service and a strong financial performance.

Viridor is successfully leading the way in exploiting opportunities arising from the Government's landfill diversion, recycling and renewable energy targets – around 50% of its profits already come from recovering value in waste. Although we are cautious about the prospect for a recovery in recyclate prices in the short-term, the company's strong PPP pipeline and major EfW successes underpin its expected long-term profit momentum from 2013/14 onwards and are already making a significant contribution to Viridor's profitability.

I am therefore confident that Pennon is well positioned to continue to succeed in its chosen business areas for the benefit of our shareholders and other stakeholders.

Ken Harvey
Chairman
Pennon Group Plc
18 June 2012

Our business model

How we generate and preserve value

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

How we create value

We create value for our shareholders by developing our two environmental utility infrastructure businesses, South West Water and Viridor, and by efficient financing and strong management of the Group as a whole.

South West Water, the water and sewerage services provider for Devon, Cornwall and parts of Dorset and Somerset, is focused on delivering further efficiencies, improving operating standards and providing a high quality service to its customers.

Viridor is focused on transforming waste into a resource, having developed from being a traditional waste management company to a leading UK recycling, renewable energy and resource management business.

South West Water

Provides water and sewerage services in Devon, Cornwall and parts of Dorset and Somerset.

South West Water's business model is based on delivering its 'Pure Water, Pure Service and Pure Environment' strategy while ensuring long-term profitability, resilience and sustainability.

Viridor

One of the leading UK recycling, renewable energy generation and waste management businesses.

Viridor's business model is based on growing and adding value by proactively expanding its recycling operations, growing its EfW and PPP operations and exploiting the huge potential inherent in waste-based renewable energy generation, whilst capitalising in the long-term on its strong position in landfill waste disposal.

How we manage our businesses to create value

To achieve our strategy we are focused on the key areas of customer satisfaction, financial performance, maximising shareholder returns, strong governance and employee engagement.

Customer satisfaction

Both South West Water and Viridor are fully committed to meeting the needs of their customers which are key to the success of each business. How we respond to the needs of our customers and assess customer satisfaction is set out on pages 15, 17, 22 and 36 of the Business review.

Financial performance

Our Group has set itself challenging financial targets. Financial performance is measured through a range of key performance indicators including profit before tax, dividend per share, earnings per share before deferred tax and the interest rate on average net debt. Our focus on setting such targets is to achieve sustainable performance over the short, medium and long-term. Pages 24 to 27 explain in more detail our financial performance.

Maximising shareholder returns

We are committed to maximising shareholder returns, including our policy to grow the Group dividend by 4% above inflation per annum up to at least the end of 2014/15.

Strong governance

We are aware that our businesses can, and do, have a material impact on the environment and communities in which they operate. We take a responsible and transparent approach to environmental, social and governance (ESG) matters. Our sustainable practices not only benefit communities, but also enable our businesses to be more successful. More information on our sustainability targets and our achievements over the past twelve months are set out on pages 34 to 39 in the Group's Sustainability report.

Employee engagement

We are aware that the success of our Group is due to the talent, commitment and hard work of our employees and we aim to be a responsible employer. We are focused on ensuring workforce well-being, continuity, efficiency and productivity and we carefully manage the successful integration of employees into Viridor following acquisitions. More information on the initiatives we have introduced to improve employee engagement in each of our businesses is set out on pages 17, 23, 40 and 41 of the Business review.

Our operating framework and risk management

Essential to achieving our strategic aims and creating value within our businesses is our operating framework which is based on the principles of good governance as described in the Governance section.

Our operating framework includes a comprehensive and fully embedded risk management process which assists us in managing our risks and opportunities to deliver the Group's strategy and the other essential elements of our business model.

Further information on our control and risk management environment is described on page 30. Our principal risks and uncertainties and how we mitigate them are set out on pages 28 to 33.

Strategic Q&A

Delivering on our strategy

Overall 2011/12 was another successful twelve months for Pennon. Group Director of Finance David Dupont, South West Water Chief Executive Chris Loughlin and Viridor Chief Executive Colin Drummond discuss a year of achievement and outline their strategic approach to the main challenges they face.

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

David Dupont

Group financial performance was once again very strong, notwithstanding tough economic conditions. South West Water's profit increase reflected further substantial efficiency gains and while Viridor's profits were a little lower than last year, this was in part due to higher bid costs linked to its growing pipeline of future projects. Viridor achieved some notable contract wins during the year which lay the foundation for significant growth in the future. The Group continued to effectively manage financing costs which outturned at a lower level than the previous year despite higher average net debt.

Overall the results demonstrate the successful Group strategy of developing its infrastructure utility businesses, with South West Water continuing to outperform the targets set by its regulator and Viridor building its business through a combination of long-term contract wins and construction now under way on four significant energy from waste plants.

In tougher economic times, how vulnerable are South West Water and Viridor to an economic downturn?

DD

While neither business is immune, both businesses have demonstrated their resilience in recent difficult conditions. South West Water experienced a small reduction in demand, but this reflected the trend in recent years as more customers switch to meters and our larger users, with our assistance, focus on improving their water use efficiency. The bad debt charge increased slightly in the first half of the year but has since stabilised.

As expected, the full year profits for Viridor were below those of last year because the company was impacted by lower recyclate prices in the second half of the year, reflecting world economic conditions. We took action to recover more than 50% of the impact of this through cost reductions and, while we are cautious about the recovery of recyclate prices in the short-term, Viridor's recent contract wins and long-term investment are laying the foundation for significant growth in subsequent years.

"The Group policy is to grow the dividend by 4% above RPI up to at least the end of 2014/15."

David Dupont, Group Finance Director
Pennon Group

Your dividend continues to be very strong in the sector. How long can you sustain this performance?

DD

The Group policy is to grow the dividend by 4% above RPI up to at least the end of 2014/15. This policy reflects the actual and expected financial performance of both South West Water and Viridor. As usual the Board expects to review the dividend policy at the start of the next South West Water regulatory review period taking account of Ofwat's next price Determination, and the expected growth from Viridor's long-term contracts and energy from waste plants which are expected to come on stream around this time.

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

DD

At the year-end the Group had cash and facilities of £1,084 million, including £123 million restricted cash, with £566 million of new/renewed facilities secured during the year. These provide very substantial resources to support the investment in Viridor over the next few years. We are continuing to talk to a wide range of finance providers and expect to source the remaining funding required on a timely basis.

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

Chris Loughlin

South West Water achieved its best ever leakage control results and maintained its 15th consecutive year without water restrictions. We had repeated best ever drinking water quality and saw a record number of the region's bathing waters meeting the EU's highest compliance standard.

We were able to exceed our leakage control targets through early detection and swift response times. In addition our new remote working system allowed our leak detection inspectors to work more dynamically in the field by substantially reducing the amount of time needed to process leakage reports.

South West Water's ongoing programme of capital investment in water resources meant we had adequate supplies to prevent a water shortage. Similarly, our investment in both drinking and waste water treatment ensured continued high standards.

Alongside our strong operational performance we achieved a significant increase in customer service levels. Our Service Incentive Mechanism score – which includes the number of written complaints and the results of customer satisfaction surveys – indicated a 15% improvement on the year before and a 78% improvement over the last two years.

"South West Water achieved its best ever leakage control results and maintained its 15th consecutive year without water restrictions."

Chris Loughlin, Chief Executive
South West Water

Earlier this year there was a lot of commentary in the press about likely water shortages in England in 2012. How are you placed in the South West?

CL

Based on our current position we are confident of a 16th consecutive summer without water restrictions. As would be expected, South West Water is monitoring the situation and will make the best use of its resources accordingly.

Last year we avoided any shortages through a combination of utilising new resources such as Park and Stannon reservoirs – both former china clay pits – and careful resource planning. The region did experience a drier winter than average but we tackled this through the use of pumped storage schemes. This involves abstracting water from rivers while levels are healthy to supplement the natural inflow to our reservoirs.

The recent national concerns over drought serve to highlight the importance of efficient water use. South West Water is committed to a strategy that optimises its use of supplies and assets and we continue to raise awareness with our customers about how to use water wisely.

What has been the impact of the adoption of private sewers so far? Do you expect further investment over the next couple of years?

CL

On 1 October 2011 the Private Sewer Transfer legislation resulted in South West Water's sewer network increasing by more than 50%. This had a knock-on benefit for the majority of our customers who are no longer at risk of high sewer maintenance costs and now are only responsible for drains located within, and serving, their properties.

The company was well placed to manage the transfer. Operational plans to manage customer contacts and deliver service to our customers through two new contractors were implemented smoothly and activity has been at the lower end of the expected range.

South West Water will continue to maintain and improve the adopted network over the coming years starting with a capital investment programme focused on problematic assets. The operating and capital costs incurred so far have been over £3 million; these efficiently incurred costs will be funded through future adjustments to price limits, with the submission of an application to Ofwat for an Interim Determination of K anticipated in 2013.

How will the funds promised by Government to help support customer bills from 2013/14 be paid? Will shareholders lose out in any way?

CL
Legislation first proposed in December 2011 will enable South West Water to receive funding from the Government so that we can cut all household bills by £50 per year until at least the end of the next spending review period.

We welcome the reduction which is due to come into force in April 2013. It directly benefits customers – it will be passed straight through to them and as such there is no impact on the interests of our shareholders.

What is South West Water's position on targeted efficiency savings?

CL
The Company is targeted with achieving a step-change in operational cost efficiency for K5. As planned, delivery of the Ofwat efficiency targets of an average of 2.8% per annum is front-end loaded with an average 5.1% per annum delivered in the first two years of this K period.

How will industry reforms, as signalled by the Government, affect South West Water?

CL
The direction of Government policy and Ofwat's regulatory reform proposals will provide new opportunities, challenges and responsibilities. There is a clear emphasis on the efficient use of water resources, providing sustainable solutions to water pollution problems through catchment-based approaches, the removal of barriers to competition, secure and stable financing and customer-centred activity. In each case South West Water's long-term strategy and successes to date mean we are well placed to deliver these proposals.

The signals are that industry reform will be evolutionary rather than revolutionary, with timescales for change over a period to 2025 and beyond. To date, the details of reforms have been limited. However draft legislation is anticipated for 2012/13 with an initial focus on extending competition for commercial customers. We are preparing for the development of competition in this area and have recently extended our new 'Source for Business' activities, offering enhanced services to our commercial customers.

How are you preparing for the 2014 Periodic Review?

CL
Having already reviewed our long-term strategy as part of the 2009 Periodic Review, South West Water is well placed for the 2014 Periodic Review (PR14). We have already rolled out our initial phases of customer engagement and work is under way to determine investment scenarios for the next period. Our dedicated PR14 team is continuing to raise awareness both internally and externally about the review process.

A new development has been the recent implementation of our 'WaterFuture' customer challenge panel which comprises representatives from various stakeholder and consumer groups. Designed to ensure our customers' priorities are kept central to our plans, the panel's involvement will help shape our forthcoming updated Strategic Direction Statement which will provide a long-term context for the five-year, 2015-2020 business plan.

What are the key trends currently impacting Viridor?

Colin Drummond
We are seeing an intensification of the long-term trends which have been evident for the past number of years and upon which Viridor's strategy is built. The total amount of waste generated in the UK is falling, impacted by Government policies, public pressure to reduce waste and current weak economic conditions. More importantly for Viridor, within the total amount of waste, the proportion being recycled and the demand for recycling services continue to grow. At the same time it is becoming increasingly clear that the most economic and environmentally beneficial solution for the residues which cannot be recycled is provided by EfW facilities.

The year's results were impacted by lower prices for recyclates. What are the prospects for the coming year and how do you manage volatility in this area?

CD
Viridor has seen substantial trend growth in its recyclate prices over the past five years as it continues to improve quality, and customers increasingly recognise the value of recyclate as a low-cost raw material. 2011/12 was a year of two halves as far as recyclate prices were concerned. The first half saw recyclate prices well above long-term trends and, as I commented at the time, this was not sustainable in a weakening world economy. In the second half prices did indeed fall back, reflecting weakness in the Eurozone economies and slightly slower growth in China. We were able to offset more than 50% of the impact of reduced recyclate prices under the terms of our customer supply contracts and from other cost reductions. However we are cautious about any recovery in recyclate prices in the short-term as Eurozone worries continue.

What have been the key achievements this year in developing your project pipeline?

CD
We have had a series of major wins in our pipeline of long-term Public Private Partnership (PPP) contracts and EfW facilities. The final legal challenge to

our planned EfW facility at Ardley was successfully resolved and construction has commenced meeting the needs of the Oxfordshire PPP contract. The Exeter PPP contract was signed and construction of the associated EfW is under way. We have signed the Engineering Procurement and Construction (EPC) contract for our planned EfW plant in Cardiff and construction will commence shortly. The final legal challenge against planning permission for our proposed EfW facility at Avonmouth has also been successfully resolved.

We have become preferred bidder for three further major waste PPPs. These are for the South London Waste Partnership, for Glasgow and, subject to legal challenge, for South Lanarkshire. We are down to one of two shortlisted bidders on five other waste PPPs.

Viridor has been very successful at securing contracts to build and operate new EfW facilities. When will Runcorn come on stream and is it on target? More generally, how do you ensure that these new projects are brought to completion on time and on budget?

CD
These are major construction contracts and we are fully aware of the challenges involved and have planned accordingly. Our general policy is to invest in modern robust and proven technologies and to use high quality suppliers without putting too much business with any individual one of them. We ensure clear contract terms on a fixed price basis passing back relevant risks to our suppliers and back this up with careful contract management and independent certification. This approach worked well on our highly successful Lakeside joint venture project and we are following a similar policy for Runcorn. We are on track to take over the first phase of Runcorn by March 2013 with the second phase following in mid 2014. We are taking a similar approach on the other projects in our pipeline.

What is the scope of the remaining opportunities with county councils and other municipal authorities? What proportion have not entered into long-term contracts to manage their waste?

CD
Municipal contracts provide the base load for facilities which can also serve the somewhat larger commercial and industrial (C&I) market. Much of the long-term municipal procurement for residual waste treatment has either already taken place or is under way. I have already mentioned some of our recent successes. We are on track in five years' time to have a network of strategic EfW facilities, mainly backed by municipal contracts with surplus capacity for the C&I market, in most of the major regions in the UK (including London and the South East, the North West, the South West, South Wales, and the central belt of Scotland).

Do you have the capacity to take on many more of these projects?

CD
The key question with any project is how to create shareholder value. We believe we have already targeted many of the most attractive contracts where the market is large and we can establish a competitive advantage. If we identify similar further opportunities to create shareholder value, we have the management resources in place and can continue to procure additional consultancy expertise as required.

What will be the impact on Viridor's profitability when all of the current projects come on stream?

CD
Within the next five years our project pipeline could more than double Viridor's EBITDA.

Around 50% of Viridor's profits are now from transforming waste. Do you expect this percentage to increase in the coming years?

CD
Yes, this percentage is likely to increase. Viridor's strategy is to transform waste into a resource. Recycling and renewable energy are good for the environment, for the UK economy and for our shareholders.

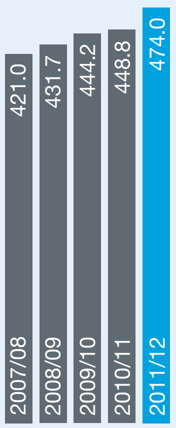
"We have had a series of major wins in our pipeline of long-term PPP contracts and EfW facilities."

Colin Drummond, Chief Executive
Viridor

South West Water Investing in quality

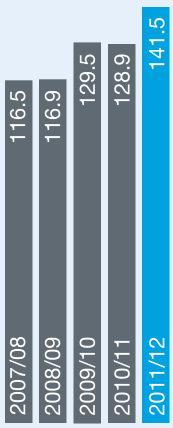
Key facts and figures

Revenue
£m



£474.0m
+5.6%

Profit before tax
£m



£141.5m
+9.8%

Operational highlights

- strong performance against 2010-2015 regulatory contract
- a 15th consecutive summer without water restrictions in 2011 and a 16th anticipated in 2012
- best ever leakage results
- repeated best ever drinking water quality (99.98%)
- record percentage (95.1%) of bathing waters achieving EU Guideline standard (excellent status)
- increased customer service (written customer complaints down 25% and Service Incentive Mechanism score up 15% from 2010/11)
- accelerated pace of delivery for targeted operating cost reductions and capital programme efficiencies
- high levels of drinking water and sewerage services maintained (stable serviceability).

2011/12 notable achievements

- smooth transition of private sewers adoption on 1 October 2011. Estimated network length increased by over 50%
- introduction of specialist 'Source for Business' service
- Government support for household customer bills from 2013/14 welcomed
- Water Industry Achievement Awards for 'Upstream Thinking' (Partnership Initiative of the Year) and 'BeachLive' (Community Project of the Year).

Where we operate

1.67m
resident population

14,710km
of sewers

645
waste water treatment works

15,146km
of water mains

39
drinking water treatment works

Strategy and performance

The company's vision of 'Pure Water, Pure Service and Pure Environment' represents our ongoing ambition to achieve and sustain the highest standards possible in every sphere of our activity. We see innovation and forward-thinking investment as key to our long-term success and we remain committed to a strategy that values our business, our customers and the world around us in equal measure.

Strategy

Pure Water
Providing safe and reliable water supplies

Performance

Repeated best ever drinking water quality and a 15th consecutive year without water restrictions. Best ever and industry-leading leakage control performance

Pure Service
Increased levels of customer satisfaction

Performance

Increased average level of customer satisfaction score with 25% fewer written complaints than the previous year. 'Source for Business' launched

'Stable serviceability' maintained

Pure Environment
Protecting and enhancing the environment

Performance

Record high in the number of bathing waters meeting the EU's highest standard. Renewable energy generation increased with the installation of additional solar, hydro and wind turbine schemes

Financial
Outperformance of the regulatory contract

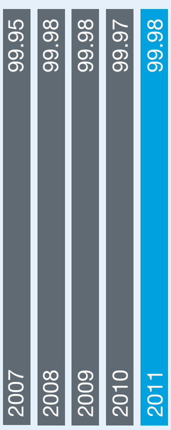
Performance

Outperformance of the targeted operating cost reductions alongside increased operating profit and efficient funding

Capital programme efficiencies remain on track to achieve 5% outperformance

KPI

Drinking water quality
% Mean Zonal Compliance (MZC) calendar year



99.98%

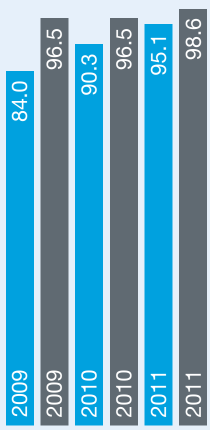
KPI

Customer service score Service Incentive Mechanism (SIM) %

66.9
+15%

KPI

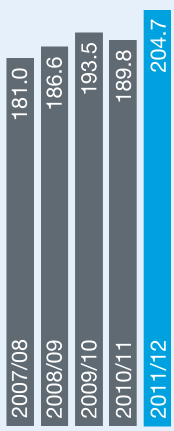
Bathing water compliance with EU Mandatory and Guideline standards %
calendar year



■ Mandatory
■ Guideline

KPI

Operating profit
£m



£204.7m
+7.9%

Financial strength and operational excellence

Top: Construction under way on the new Coswarth Reservoir, near Newquay, Cornwall.

Bottom: Mel Selvester, one of our leakage inspectors, checks the status of mains on Plymouth seafront.

Business performance

South West Water has continued its excellent start to K5 with strong operational delivery and high standards of customer service coupled with strong financial performance. The company continues to outperform targeted operating cost reductions and capital programme efficiencies.

An increase in revenue and good operational cost control has resulted in South West Water's operating profit increasing by £14.9 million. With consistently low financing costs, profit before tax has increased 9.8% from last year.

The company is front-end loading delivery of the required 2.8% per annum average operating cost efficiencies with 5.1% per annum delivered in the first two years of this K period (2010-2015). This is being achieved through changing operational ways of working; right-sourcing and innovative contracting arrangements; energy procurement and reduced usage; and the rationalisation of administration and support services.

Capital expenditure in the year was £131 million, a 5% increase on last year. The main focus of investment remains on the maintenance of existing assets. The reliability of our network is illustrated by our operating assets achieving 'stable serviceability'(1) for all operational areas. Other key areas are: increasing our water resource availability and ensuring the resilience of our network even in extreme weather conditions; improving drinking water quality; delivering environmental improvements; and achieving high standards of bathing water quality.

Efficiency performance on the K5 capital programme remains on track to deliver 5%(2) outperformance of the Ofwat 2009 Final Determination.

Pure Water

Drinking water quality

South West Water prides itself on achieving industry-leading water quality results. In 2011 the quality of our water, as measured by Mean Zonal Compliance (MZC), was equal to its best ever. This marks the third year out of the past five in which a score of 99.98% has been attained.

The continued high standards of our drinking water can be directly attributed to our ongoing investment and innovation in our treatment processes. In addition our water quality has benefited from a rigorous mains improvement programme and the implementation of a taste and odour strategy.

In 2011/12 South West Water made significant investments in drinking water quality, including upgrades to water treatment works at Drift (Cornwall) and Tottiford (Devon).

Leakage control

South West Water has maintained its exemplary industry-leading performance in leakage control, as it has done every year since targets were introduced. In 2011/12 we successfully surpassed our previous record to achieve a record low of 81.3 megalitres lost on

(1) 'Serviceability' is the capability of a system of assets to deliver a reference level of service to customers and to the environment now and into the future. Serviceability is deemed to be stable when the assessment of trends in a defined set of service and asset performance indicators demonstrates that service is in line with the reference level of service and, by inference, is likely to remain so into the future.

(2) Using 2009 Final Determination estimates of Construction Output Price Index (COPI).

South West Water continues to outperform targeted operating cost reductions and capital programme efficiencies while investing in the long-term resilience of its network assets.

average per day over a twelve month period. In addition we have beaten the rolling three-year average.

The strong leakage control performance has been due to a number of combined factors including swift leak detection and response times; the efficiency of our remote Phased Utilisation of Remote Operating Systems (PUROS); and improved communication with our customers using both traditional and web-based platforms.

Water resources

Despite below average rainfall last year, South West Water avoided putting water restrictions in place for a 15th consecutive summer. This was achieved primarily as a result of strategic investment in expanding our reservoir system and distribution network. Now fully operational, Park and Stannon lakes in Cornwall played a key role in ensuring resources were maintained during 2011/12.

In addition South West Water also made use of pumped storage schemes at Wimbleball, Stithians and Colliford reservoirs. This involves abstracting water from rivers, while levels are healthy, to supplement the natural inflow to our reservoirs.

South West Water's resource network has been further expanded in the past year, most notably through the addition of Coswarth service reservoir, near Newquay, Cornwall which will supply around 9,000 homes. South West Water is also developing its first new borehole in 18 years at Greatwell, East Devon.

Our 2012 position

The national concerns over drought in 2012 serve to highlight the importance of efficient water use. South West Water is committed to a strategy that maximises the yield of its supplies and assets and we continue to raise awareness about how to use water wisely.

Based on our current position we are confident of a 16th consecutive summer without water restrictions. As would be expected, South West Water is monitoring the situation and will make the best use of its resources accordingly.

Pure Service

Customer satisfaction

At the core of South West Water's 'Pure Service' strategy are the needs of our customers. Since 2010/11 customer satisfaction has been measured by the Service Incentive Mechanism (SIM). This takes into account various customer service measures including the number of written complaints and the results of customer satisfaction surveys.

South West Water achieved a 15% improvement in customer service between 2010/11 and 2011/12 based on its SIM score (2010/11: 58.1, 2011/12: 66.9) and a 78% improvement over two years.

There were 25% fewer written complaints than the previous year. Over the last two years written customer complaints have halved.

Top: Stannon Lake, Cornwall.

Bottom: Eleanor Dodd, helping a customer at the Source customer contact centre at Peninsula House, Exeter, Devon.

Top: South West Water's bathing water results reached a record high last year. Bedruthan Steps, Cornwall.

Bottom: Joe Colton-Dyer, one of South West Water's new apprentices.

Private sewers

On 1 October 2011 the Government transferred the ownership of the majority of private sewers to water and sewerage companies. As a result South West Water's sewer network increased by over 50%. This had a knock-on benefit for the majority of our customers who are no longer at risk of high sewer maintenance costs and are now only responsible for drains located within and serving their properties.

South West Water is continuing to evaluate the impact of the private sewer transfer. We are confident that our smooth transition into the new role was the result of careful planning, an effective communications strategy and efficient operational activity.

£50 bill reduction for South West Water customers

Since privatisation in 1989 South West Water customers have effectively been paying for the protection and upkeep of a third of the nation's bathing waters. Highlighted in the 2009 Walker Review and pursued vigorously by South West Water alongside regional MPs, consumer groups and media organisations, this sensitive regional issue was addressed by the Government in late 2011, with a pledge to reduce household bills in the region by £50 per year. This reduction is due to come into effect in April 2013.

Pure Environment

2011/12 was a year of continued investment in environmental projects and initiatives. In addition to the refurbishment of a number of waste water treatment works South West Water has successfully trialled grit and screenings composting to reduce the amount of waste sent to landfill.

We also expanded our use of renewable energy through solar, wind and hydro power schemes at more than 20 of our sites and we continue to promote energy saving through in-house campaigns such as 'PowerDown'.

Coastal waters

The quality of beaches and bathing waters in the South West plays a key role in the region's economy, culture and lifestyle. With 144 designated bathing waters along more than 500 miles of coastline, South West Water's activities have a potential effect on more bathing waters than any other water company in England or Wales.

The number of bathing waters in our region now achieving the EU's highest standard is at an all time high. 95.1% of our beaches are achieving the EU Guideline standard (excellent status) with 98.6% obtaining the Mandatory standard (good status).

South West Water continues to work with a number of partner organisations to protect the coastal environment. In June 2011 the company launched its 'BeachLive' website to provide live information on bathing water quality around the region.

Energy generation

In 2011/12 our investment in renewable energy included the installation of solar panels at 23 of our sites (nineteen 50kW schemes and four 100kW schemes) and the development of hydro-electric schemes at Colliford Dam, Cornwall and Avon Dam, Devon.

Our continuing focus for K5 is to strike the right balance for customers, investors and other stakeholders.

At Lowermoor water treatment works in North Cornwall we erected a single 100kW wind turbine which is expected to generate approximately 60% of the site's power needs.

Our goal is to generate 30GWh from renewable sources by 2015. Ultimately South West Water aims to source 50% of its energy from renewables by 2050.

Upstream Thinking

Focused on improving raw water quality in river catchments in order to reduce treatment costs, 'Upstream Thinking' is an award-winning South West Water-led initiative that seeks to maintain and improve the ecological health of our region's river network.

During 2011/12 South West Water has continued to work with partner organisations, the agricultural community, landowners, researchers from the region's universities and other stakeholders to implement a range of projects that target water quality and water storage at its natural source. These include farm management improvements and engagement with farmers; habitat management; and landscape restoration in specific river catchment areas.

In March 2012 'Upstream Thinking' won the 'Partnership Initiative of the Year' category at the Water Industry Achievement Awards.

Our employees

South West Water attaches considerable value to the safety and training needs and ambitions of its employees.

In addition to rigorous attention to health and safety, the company provides thorough training and support with opportunities for staff to develop their careers through a number of schemes. These include our internal graduate development programme (GROW) and our Management Academy.

South West Water is a key player in the local economy and we remain committed to nurturing fresh talent for the future. During 2011/12 our apprenticeship scheme has gathered momentum and our strategic investment in both people and technology – in the form of our centrally-operated remote PUROS system and other innovations – means we are reaping the rewards of improved productivity delivered by a highly trained and motivated workforce.

Key relationships

Regulators and others

South West Water actively engages with a wide range of environmental and regulatory stakeholders. We take steps to ensure that communication is handled in the most appropriate way and that the information we provide is high quality and consistent. We use a range of commercial channels including traditional and online platforms to communicate with our stakeholders.

The company contributes to national policy on developing issues through its membership of Water UK, the industry trade body, and we work with the Consumer Council for Water to ensure that customers' issues and concerns are addressed and a full understanding of the company's activities is maintained.

WaterFuture customer panel

As part of the 2014 Periodic Review process, following guidance from Ofwat, we have created an independent 'WaterFuture' customer challenge panel, comprising a group of representatives from various regulatory, stakeholder and public bodies. Its role in the coming year will be to ensure our business plan adequately reflects an understanding of our customers' priorities and that our planned activities are socially, economically and environmentally sustainable.

Procurement and suppliers

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

Looking ahead

In December 2011 the 'Water for Life' White Paper outlined the Government's vision for a resilient, customer-focused and environmentally sustainable water sector. South West Water welcomed this commitment from Government and we believe that both our long-term strategy and successes to date are already making headway in realising these ambitions.

The company has delivered substantial efficiencies which benefit all stakeholders and is focusing on continued delivery of efficiencies while satisfying regulatory and legislative obligations and improving services to customers. Specifically the strategy:

- targets outperformance of the regulatory contract
- continues to rigorously control costs
- delivers investment in the asset base to secure improvements made over the last 20 plus years while preparing for the next 20 plus years.

The company is working towards the next Price Review, (PR14), and is actively engaged in the development of Ofwat's regulatory reform agenda.

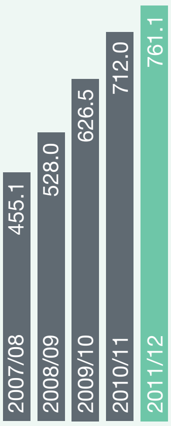
We have already rolled out our initial phases of customer engagement and work is under way to determine investment scenarios for the next period.

Our 'WaterFuture' customer challenge panel will assist in ensuring customers' priorities are kept central to our plans. The panel's involvement will help shape our forthcoming Strategic Direction Statement which will provide a long-term context for the next business plan.

Viridor
Investing for future growth

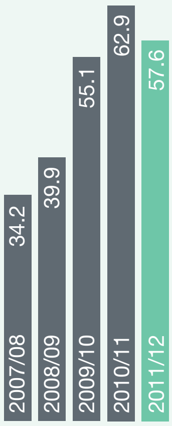
Key facts and figures

Revenue
£m



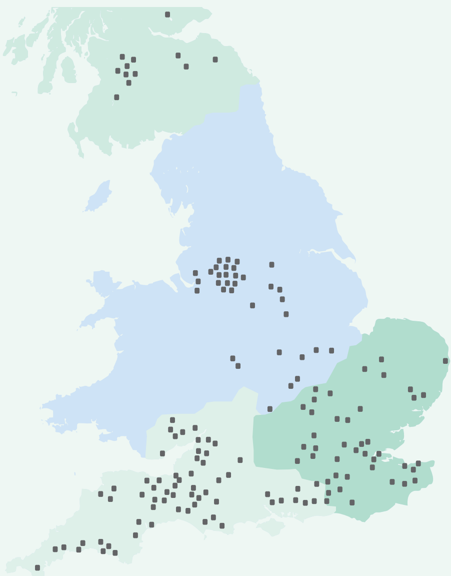
£761.1m
+6.9%

Profit before tax
£m



£57.6m
-8.4%

Where we operate



2011/12 operational highlights:

- profit before tax decreased by 8.4% to £57.6 million, with performance less strong in the second half of 2011/12 than in the first half of the year reflecting world economic conditions
- contribution to profits of recovering the value in waste grew to around 50%, as landfill fell to 18% (from 69% in 2001)
- volumes of recyclate traded increased by 7.2% to over 1.8 million tonnes, with continuing improvements in quality and value mix
- total renewable energy production increased to 760GWh (752GWh 2010/11)
- revenue increased by 6.9% to £761.1 million
- capital expenditure and investment in joint ventures of £140 million mainly to deliver additional renewable power generation and recycling capacity.

2011/12 notable achievements:

- acquisition of five high-quality recycling, collection and transport businesses for around £40 million, strategically sited to complement existing UK operations and international recyclate sales
- announced as preferred bidder for South London, Glasgow and South Lanarkshire* PPP contracts, and one of last two bidders for five others
- by the year-end 39 of the 43 new facilities for the Greater Manchester joint venture PFI contract were operational
- phases one and two of the construction of the combined heat and power (CHP) energy from waste (EfW) plant at Runcorn on schedule
- construction commenced on Ardley (Oxfordshire) and Exeter EfW projects and on Walpole anaerobic digestion facility in Somerset
- construction contract signed on Cardiff EfW project and final planning consent achieved on Avonmouth EfW and recycling facility
- Lakeside joint venture EfW plant, near Heathrow airport, announced as winner of 2011 Chartered Institution of Wastes Management 'Peel People's Cup' for best run waste management facility in the UK, and of 'EfW Facility of the Year' and 'Best Designed Renewable Energy Facility' at the UK Renewable Infrastructure Awards.

* subject to legal challenge.

Viridor's network of recycling, renewable energy and waste management operations is strategically located across the UK, with particular strengths in the South West; South East and North West of England, East Anglia, South East Wales, and Central Scotland.

The company sells its high-quality recyclate in the UK and internationally, with established relationships across Europe and in Asian countries including China, Indonesia and India.

327
operating facilities

25
materials recycling facilities (MRFs)

34
landfill gas power plants

3
energy from waste (EfW) plants

8.1
million tonnes of material handled in 2011/12

Strategy and performance – transforming waste

Viridor's strategy is to add value by:

- growing recycling capacity and services
- growing energy from waste capacity and services
- selectively gaining more PPP contracts
- capitalising on its long-term strong position in the landfill market.

Viridor consolidated its position as the UK's largest operator of materials recycling facilities (MRFs) in 2011/12. The company made five further acquisitions of recycling, collection and transfer businesses during the year.

In the short-term Viridor's financial performance will continue to be influenced by trends in recycling and landfill.

Recycling remains a very profitable business for Viridor and the roll-out of its EfW pipeline (operations commencing 2013/14 onwards) could more than double EBITDA within five years.

Strategy

Transforming waste: to grow Viridor's recycling capacity and services

Performance

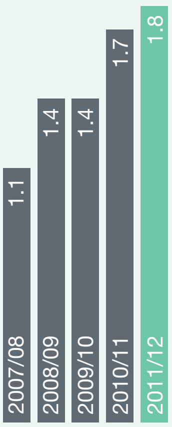
Volumes of traded recyclate increased by 7.2% with continuing improvement in quality and value mix. Revenue per tonne was up 6.8% year on year although prices fell back in the second half of the year. Further acquisitions strengthened recycling capacity and volume

Performance

Runcorn, Exeter and Ardley EfW facilities and Walpole AD plant under construction. Construction contract signed for Cardiff EfW plant. Total power generation output increased to 760GWh

KPI

Recycylates traded
million tonnes



+7.2%

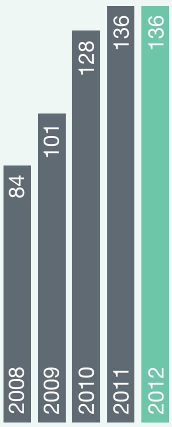
KPI

Profits from recovering value in waste %

49%

KPI

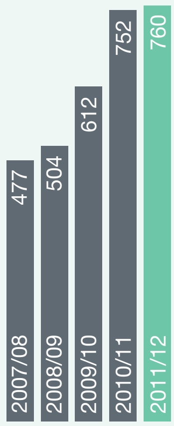
Renewable energy generation capacity
MW as at 31 March



136MW

KPI

Total renewable energy generation
GWh



760GWh

Viridor

Group

Governance

Financial statements

A year of investment and progress

Top: Lakeside energy from waste facility.
Bottom: Viridor collection services.

Strategy

The UK is required under the EU Landfill Directive to reduce the amount of biodegradable municipal waste going to landfill sites. This is being achieved by a major increase in recycling, with residual waste increasingly being used for energy recovery. The Government's main mechanism for diverting waste from landfill and providing incentives for recycling and energy recovery is landfill tax, supported by a range of other policy and legislative measures. Many leading corporate organisations are also looking to improve environmental and business performance through recycling and resource efficiency. All of these factors underline the key aims and long-term trends in UK waste management that Viridor has been pre-empting and responding to in its services and continued business transformation. The strategic position and ability of the company to capitalise on these favourable trends is therefore strong.

Business performance

Viridor's revenue increased by £49.1 million to £761.1 million. Acquisitions accounted for £23.1 million of this, while existing business increased by £26.0 million (including an increase in landfill tax of £17.8 million).

Since 2007/08 and up until the first half of 2011/12 our strong growth in recycling profits had been more than offsetting the decline in annual landfill profits. However, recyclate prices fell in the second half of the year reflecting world economic conditions, although Viridor was able to offset more than 50% of the impact of this fall under the terms of its customer supply contracts and by other cost reductions. The year on year growth in recycling profits, combined with strong performances in contracts and joint ventures, was unable to offset the on-going decline in landfill coupled with increased contract bid costs associated with Viridor's expanding PPP/EfW pipeline. Notwithstanding this the company produced a robust performance during a year of continuing difficult economic conditions. The proportion of our profits that come through recovering the value in waste continues to grow, and was around 50% in 2011/12. This compares with just 16% eleven years ago.

Despite the challenging UK and global economic climate, Viridor remains convinced that embracing the environmental agenda has been an effective driver for long-term growth. Being green is good for business. We are confident that our strategy will continue to drive long-term growth and produce value for Viridor and its stakeholders. Recycling will be key to profits in the next couple of years, with long-term momentum underpinned by our growing PPP and EfW pipeline.

Investment and awards

2011/12 was a year of major long-term investment from Viridor, including the completion of a further five acquisitions for a total of around £40 million, complementing the existing business and in line with the company's recycling and collection strategies. These comprised the acquisition of Community Waste Recycling Limited for a total of £18.5 million, JWS Churngold Limited for £14.3 million, Storm Recycling Limited for £1.7 million, and two separate acquisitions of trade waste collection interests of Veolia in the South West of England for a combined sum of £8.2 million, the latter bringing excellent synergistic opportunities for Viridor's business in that region.

Viridor continues its transformation into a progressive recycling-led resource management business, with a growing focus on recovering the value in waste through materials recycling and the generation of renewable energy from waste sources.

Investments in the future capabilities and strength of our business included capital expenditure and investment in joint ventures of £140 million, of which £93 million was for new projects in EfW, recycling and waste treatment infrastructure. This included £58.3 million on Phase II of the Runcorn EfW combined heat and power (CHP) facility. An additional £13.4 million was invested in joint ventures.

During the year Viridor's Lakeside EfW joint venture, near Heathrow airport, won the Chartered Institution of Wastes Management's Peel Peoples Cup for the best run waste management facility in the UK. Lakeside also won the 'EfW Facility of the Year' and 'Best Designed Renewable Energy Facility' categories at the Renewable Infrastructure Awards 2011. Viridor, along with West Sussex County Council, Horsham District Council and sub-contractor, Olus, also won the Association for Organic Recycling's Partnership Award.

These awards, and the robust position and performance of the business, are recognition of the commitment, professionalism, innovation and hard work of our employees, for which we thank them.

Recycling

Year on year growth in recycling volumes and profits continued, reflecting organic growth, acquisitions and an improved mix between higher and lower value recyclates produced.

Volumes of recyclate traded during the year increased by 124,000 tonnes (7.2%) to 1.84 million tonnes. Higher value recyclate volumes increased by 198,000 tonnes (17.4%), including 110,000 tonnes through acquisitions, while lower value recyclates decreased by 74,000 tonnes (12.8%). Viridor continues to focus on investments and operational improvements to ensure the highest possible quality of output from its recycling activities. This strengthens our long-term relationships with customers via our global trading platform (Viridor Resource Management) and allows flexibility in changing market conditions.

The acquisition of Community Waste Recycling Limited included two MRFs, in Milton Keynes and Oxfordshire, and a business processing up to 90,000 tonnes of recyclates. Storm Recycling Limited brought an additional 20,000 tonnes of quality recyclates into the business in the North West of England. The acquisition of two trade waste collection businesses of Veolia in parts of the South West reflected the increasing role that Viridor's collection fleet has in feeding the company's recycling operations.

The long-term economics of recycling (and energy recovery) are enhanced by the rate of landfill tax increasing by £8 a year from the current £64 per tonne to £80 per tonne by 1 April 2014. The profit per tonne in recycling remains appreciably higher than the level in landfill operations. Quality recyclates also remain attractively priced commodities when compared with virgin materials.

Contracts and joint ventures

2011/12 was the third year of operation of the 25-year Greater Manchester Waste PFI contract, a joint venture that remains the UK's largest combined recycling-focused waste and renewable energy project. Some 39 out of the 43 now planned facilities required to service the contract are now operational. The project aims to recycle over 50% of Greater Manchester's waste and divert at least 75% from landfill.

Phase I of the Runcorn EfW CHP plant, which is being constructed to treat solid recovered fuel produced from Greater Manchester's residual waste, is on schedule to open at the end of 2012/13. Phase II of the Runcorn facility is also under construction and is scheduled to open during 2014. This additional capacity is designed to serve the North West market more generally. Runcorn will be one of the largest and most efficient EfW CHP plants in Europe.

Towards the end of the year Viridor completed its £45 million investment in infrastructure to serve the West Sussex County Council recycling and waste handling PFI contract. The opening of the final recycling site at East Grinstead completed a seven year programme to deliver a network of modern recycling facilities across the county. The contract is on track to deliver its target of a 45% recycling rate, three years ahead of schedule. The acquisition of JWS Churngold Limited strengthened contract services in the North West.

2011/12 was the second full year of operation of the Lakeside EfW plant, a joint venture with Grundon Waste Management, with a capacity to treat 410,000 tonnes of residual waste a year and an electricity generation capacity of 37MW. This is the first of Viridor's pipeline of EfW plants and it has performed consistently strongly in terms of its electrical output and its on-going profitability, with a total contribution of £7.8 million.

The total contribution from Viridor joint ventures increased by 4.5% to £11.5 million.

Landfill gas power generation

Viridor has 34 landfill gas power plants generating renewable power by harnessing methane produced as organic material which is anaerobically broken down in contained landfill cells. The total power generated by these plants in 2011/12 rose slightly to 576GWh (from 566GWh in 2010/11). The average price achieved per MWh was also up slightly (1%) at £83.50 but this was offset by unit cost increases, leaving profits flat year on year.

Viridor estimates that its landfill gas power generation is approaching peak output. The company had an overall generating capacity of 107MW[1] on 31 March 2012. Electricity produced is sold under the Government's Renewables Obligation Certificates (ROCs), or the older Non-Fossil Fuel Obligation (NFFO) schemes. The proportion of electricity generated at Viridor plants sold under the higher value ROCs, increased from 69% to 74% during the year, with the remaining 26% sold under NFFO contracts. Around 60% of the NFFO component will migrate to ROCs in 2013/14, with the remaining balance migrating by 2016/17.

[1] Excludes 3MW capacity at sub-contract sites in Suffolk.

Landfill and collection services

Landfill continues to provide an important disposal option for a significant – but declining – proportion of UK wastes. Total volumes received at Viridor sites decreased by 0.4 million tonnes (11.4%) to 3.1 million tonnes, broadly in line with the UK market. Approximately half of this decline in volume was accounted for by the closure of Horton landfill in West Sussex, with the remainder from reduced third party industrial and commercial inputs.

Average gate fees at Viridor sites increased by 5.8% to £23 per tonne, but the gain was offset by increased costs on lower volumes. Consented landfill capacity fell from 69.0 million cubic metres at 31 March 2011 to 65.4 million cubic metres at 31 March 2012, reflecting usage during the year.

Profits from collection services were flat year on year. Two acquisitions during the year (of Veolia trade waste collection businesses) strengthened capacity in core service areas. This reflects our drive for controlled growth in industrial and commercial collection within key areas, to provide materials for our recycling and EfW operations.

Renewable energy developments

Viridor believes that there is potential for the UK to generate up to 6% of its total electricity from energy derived from waste as fuel (from current contribution approaching 2%). Energy security remains a vitally important issue for the UK and utilising waste to generate renewable power presents opportunities for diversity of supply, with the additional benefits of landfill diversion and carbon reduction. Viridor currently has a generating capacity of 136MW and is confident that it can grow this capacity to over 300MW in four years. This would represent 3-4% of UK renewable energy supply.

To that end, Viridor's strong pipeline of opportunities in the EfW and renewable energy sector continues to progress. The Runcorn facility, for example, will have a total capacity of 750,000 tonnes a year and a CHP capacity of 120MW (a proportion of which will be provided under joint venture).

During the year Viridor secured planning consent for its Ardley EfW facility. Construction has now begun on this plant which will largely serve the Oxfordshire PPP contract, treating 300,000 tonnes of residual waste a year with an electricity generating capacity of 24MW. The construction of the Exeter EfW facility also began during the year. It is designed to treat 60,000 tonnes of residual waste for Devon County Council with a generating capacity of 3MW.

At the end of the year Viridor signed an EPC contract for the Trident Park EfW scheme in Cardiff, with construction beginning in the first half of 2012/13. This facility will have a waste treatment capacity of 350,000 tonnes a year, and an electricity generating capacity of 28MW. The company also has planning consent for two further EfW projects in Dunbar and Avonmouth and is seeking consent for a further plant at Beddington in South London.

Towards the end of the year a contract was signed for the construction of an anaerobic digestion (AD) facility at Walpole in Somerset. This plant will be capable of treating up to 30,000 tonnes of organic waste, mostly sourced from the existing PPP contract with Somerset Waste Partnership, and will have an electricity generating capacity of over 1MW. Viridor is commissioning four other AD plants as part of the Greater Manchester waste PFI contract.

PPP pipeline

Viridor's bidding team for long-term PPP contracts has performed strongly in recent years. During 2011/12 we were announced as preferred bidder for the South London Waste Partnership's 25-year PPP residual waste contract for the treatment of up to 200,000 tonnes of residual waste. Similarly the company achieved preferred bidder status for the Glasgow PPP contract requiring treatment and disposal of up to 200,000 tonnes of residual waste a year via an energy recovery facility.

Viridor was also named preferred bidder for the South Lanarkshire PPP contract (currently subject to legal challenge) and is one of the last two bidders for contracts in Peterborough (for recycling and for residual waste), West Lothian (residual waste), South East Wales (residual waste), Central Bedfordshire (residual waste) and Edinburgh and Midlothian (food waste).

Key relationships

Environmental permits are required for all waste and recycling facilities in England and Wales, with waste management licences or pollution, prevention and control (PPC) permits required in Scotland. These are issued and monitored by the Environment Agency and the Scottish Environment Protection Agency respectively. Viridor maintains a positive working relationship with the regulators by means of proactive liaison and issues management, at both a site and strategic level.

The company has developed an innovative data sharing portal named 'Openspace', with the Environment Agency in England, which supplies online environmental monitoring data live to the regulator, replacing the need to supply huge volumes of written quarterly and annual reports. This ground-breaking project is part of the Agency's 'better regulation' agenda and has substantial cost and resource saving potential.

Local authorities remain Viridor's largest single customer group accounting in total for 32% of the company's revenue, although no individual authority accounts for more than 11%. Viridor's ROC energy contracts account for 6% of revenue, primarily with one customer.

No supplier accounts for more than 5% of Viridor's revenue. The company sources from competitive markets.

Our employees

We are proud of the achievements of our employees. Viridor's operational priority remains the safety, health and positive professional development of our employees. It is the on-going commitment, motivation and professionalism of our employees that enables the company to continue to grow, develop and deliver results. Particular attention has been paid during the year to improving further training capacity and personal development opportunities and to health and safety. Our overall RIDDOR incidence rate has fallen by 43% during the year.

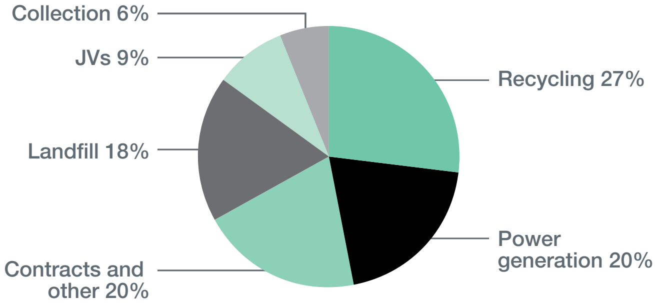
The company continues to focus on supporting new employees joining Viridor to ensure quick and effective integration into our company culture, especially our health and safety and business management systems. This also enables all new employees to contribute to the company's success from the beginning of their Viridor career.

Looking ahead we intend to increase further the proportion of profits generated by recovering the value in waste.

Recycling operations will be key to profits in the short-term with Viridor's pipeline of PPP/EfW projects underpinning its long-term profit momentum.

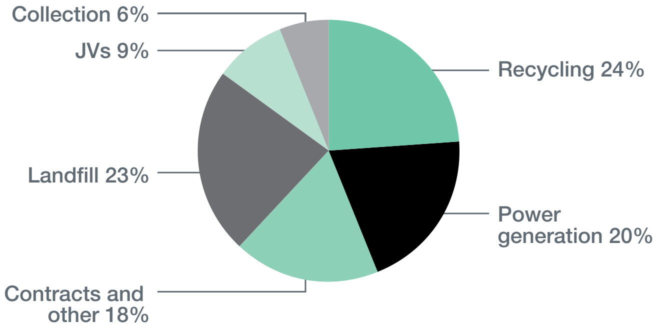
Profit contribution by segment

2011/12



Around 50% of profits from recovering value in waste (including more than 2% energy generation/recycling in JVs and Contracts and other).

2010/11



Looking ahead

During the year the UK Government completed its Waste Policy Review for England – with similar themes enshrined in the Scottish and Welsh 'zero waste' strategies and plans. These underline the governments' commitment to moving towards a 'zero waste economy' via higher levels of recycling, energy recovery and resource efficiency. Viridor awaits with interest the National Waste Management Plan (due in 2013) setting out updated guidance on the delivery of waste infrastructure. There has already been good progress in the delivery of planning consents for recycling and waste facilities and we believe that the current market-friendly approach to recycling and generating energy form waste should continue to be encouraged.

The seventh Environment Action Programme (EAP) is also due to be adopted by the European Commission (EC) in 2012. This will emphasise the need for waste prevention, recycling and greater resource efficiency, as well as better implementation of environmental legislation at all levels – including waste management.

Within the context of EC policy and legislative trends, we believe that Viridor is well placed to benefit from additional requirements to increase renewable energy generation, carbon reduction and overall resource efficiency.

The waste sector will continue to be driven by a regulatory environment in which Viridor has been able to take an entrepreneurial approach. As we target further growth, particularly in our recycling and EfW businesses, we believe it is important that the current light touch is maintained to give us the operational freedoms we need to benefit our clients, the environment at large and our investors.

Looking ahead we intend to increase further the proportion of profits generated by recovering value in waste. The company strategy has been successful to date and recycling operations will be key to profits in the short-term. Long-term profit momentum will be underpinned by our growing PPP and EfW pipeline. This gives us confidence that Viridor can continue to deliver long-term growth in shareholder value.

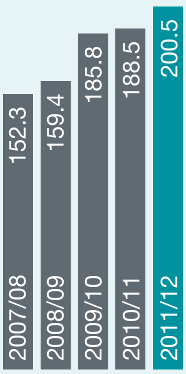
Anaerobic digestion facility, Greater Manchester.

Financial review

Pennon Group continued to deliver revenue and profit growth in 2011/12

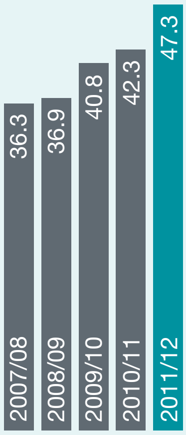
Performance overview

Profit before tax £m



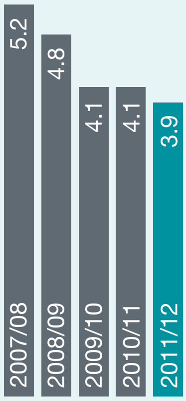
£200.5m
+6.4%

Earnings per share before deferred tax pence



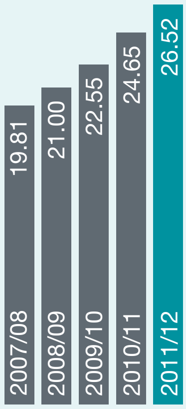
47.3p
+11.8%

Interest rate on average net debt %



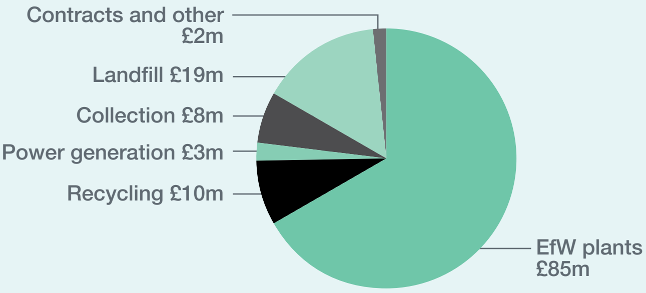
3.9%

Dividend per share pence

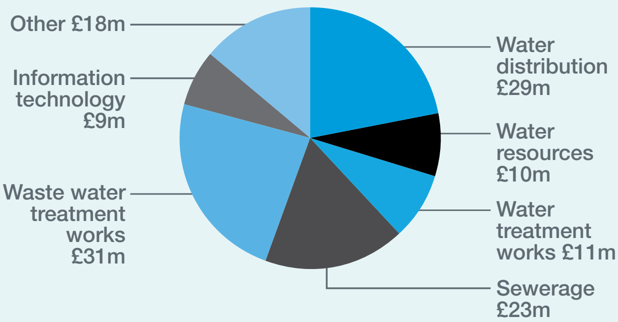


26.52p
+7.6%

Viridor capital expenditure



South West Water capital expenditure



Reconciliation of earnings per share	2011/12 p	2010/11 p	Growth %
Earnings per share – pence			
Statutory earnings per share	48.1	48.4	(0.6)
Deferred tax	(0.8)	(6.1)	
Earnings per share before deferred tax – pence	47.3	42.3	11.8

Note: Earnings per share figures in this Business review exclude deferred tax. The Directors believe that this measure provides a more useful comparison on business trends and performance since deferred tax distorts earnings per share through the effects of changes in corporation tax rates and the level of long-term capital investment.

Continuing interest outperformance coupled with raising cash and facilities to fund future growth:

£1,084 million cash and facilities at 31 March 2012, including £566 million of new/refinanced facilities sourced during the year.

The year's financial highlights

Pennon Group performed well overall. South West Water recorded a strong performance compared with the 2010-2015 regulatory contract. Continuing growth in Viridor recycling, contracts and joint ventures was offset by a reduction in landfill contribution plus increased bid costs associated with its developing project pipeline.

During the year we secured further funding to finance continuing growth. By the year-end we had £1,084 million in cash and facilities in place to fund major growth in Viridor's project pipeline and South West Water's K5 (2010-2015) capital programme.

We have secured funding at a cost that is low in absolute terms. The Group interest rate on average net debt improved to 3.9% (2010/11 4.1%). In addition South West Water's interest rate of 4.1% (pre-tax, nominal) is substantially lower than the 6.2% assumed by Ofwat for the 2010-2015 regulatory period. This is a significant advantage compared with a number of our competitors which will help drive value for the Group and our shareholders for years to come.

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

Revenue

Group revenue increased by 6.4% to £1,233.1 million.

South West Water's revenue rose by 5.6% to £474.0 million as a result of tariff increases and new connections, partially offset by a further reduction in revenue from customers switching from unmeasured to metered charges and from lower demand.

Viridor's revenue rose by 6.9% to £761.1 million. Approximately half of the increase was accounted for by acquisitions.

Operating profit

Group operating profit increased by 3.0% to £268.8 million with South West Water up by 7.9% to £204.7 million, but Viridor down by 11.0% to £63.7 million.

Net finance costs

We continued our effective management of interest rates in 2011/12 with net interest payable on average net debt equating to 3.9% (2010/11 4.1%). During the year net finance costs (excluding pensions, net interest, discount unwind on provisions and IFRIC 12 contract interest receivable) were £74.9 million (2010/11 £77.2 million) covered 3.6 times (2010/11 3.4 times) by Group operating profit.

Profit before tax

Profit before tax was £200.5 million, an increase of 6.4%. Pages 12 and 18 give a detailed description of the financial performance of each company.

Taxation

The Group's UK corporation tax charge for the year was £30.9 million (2010/11 £38.6 million). Deferred tax for the year was a credit of £2.8 million (2010/11 credit £21.7 million), which included a credit of £26.4 million from the impact of the reduction in the rate of corporation tax from April 2012.

Earnings per share

Earnings per share before deferred tax increased by 11.8% to 47.3p. The weighted average number of shares in issue during the year was 358.7 million (2010/11 354.6 million). Net assets per share at book value at 31 March 2012 were 228p.

Dividends and retained earnings

The statutory net profit of £172.4 million has been transferred to reserves.

The Directors recommend the payment of a final dividend of 18.30p per share for the year ended 31 March 2012. With the interim dividend of 8.22p per share paid on 3 April 2012, this gives a total dividend for the year of 26.52p, an increase of 7.6% over 2010/11 (reflecting 4% real growth plus RPI of 3.6% at March 2012).

Proposed dividends totalling £95.9 million are covered 1.8 times by net profit (excluding deferred tax) (2010/11 1.7 times). Dividends are charged against retained earnings in the year in which they are paid.

Dividend policy

The Board's previously announced intention is to increase the dividend each year by 4% above inflation up to at least the end of 2014/15. The Group is well positioned to meet future challenges and to continue delivering shareholder value. We remain committed to this increase.

Operating costs

Operating costs for the year totalled £964 million. The most significant areas of expenditure were:

Expenditure	£m
Landfill tax	166
Manpower	155
Depreciation	146
Raw materials and consumables[1]	102
Transport	63
Power	27
Business rates	27
Abstraction and discharge consents	8

[1] Excludes elements of transport costs.

Asset value opinion

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

Group investment

During the year the Group's capital expenditure on property, plant and equipment increased by 29% to £257 million (2010/11 £199 million). The major categories of expenditure for both main businesses are shown on page 24.

Cash flow

In 2011/12 the Group once again had a strong operating cash flow. Net borrowings increased by £171 million primarily due to capital investments and acquisitions.

Summarised cash flow	2011/12 £m	2010/11 £m
Cash inflow from operations	374	412
Pension contributions	(49)	(36)
Net cash inflow from operations	325	376
Net interest paid	(61)	(64)
Dividends and tax paid	(111)	(100)
Capital expenditure	(258)	(186)
Acquisitions/investment in joint ventures	(43)	(38)
Loan repayments received from joint ventures	4	4
Net cash outflow	(144)	(8)
Shares issued	2	2
Debt acquired with acquisitions	–	(22)
Debt indexation/interest accruals	(29)	(11)
Increase in net borrowings	(171)	(39)

Liquidity and debt profile

The Group has a strong liquidity and funding position with £1,084 million cash and facilities at 31 March 2012. This includes cash and deposits of £425 million (including £123 million of restricted funds representing deposits with lessors against lease obligations) and undrawn facilities of £659 million. These totals include £566 million in new or renewed debt facilities arranged during the year, being:

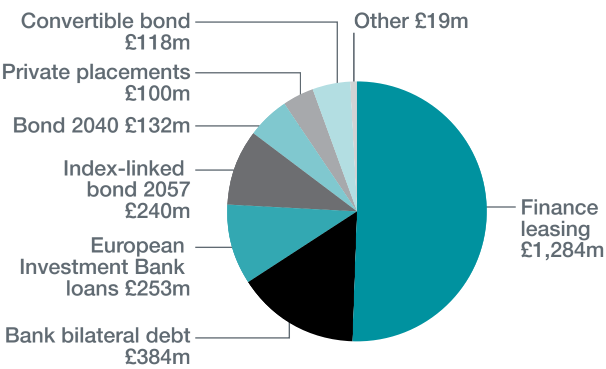
- £125 million European Investment Bank loan for South West Water
- £205 million leasing facilities
- £181 million of new term loans and Revolving Credit Facilities
- renewal of £55 million Revolving Credit Facility.

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

At 31 March 2012 the Group's loans and finance lease obligations totalled £2,530 million. After the £425 million held in cash this gives a net debt figure of £2,105 million, up by £171 million during the year.

Debt incurred for the construction in progress of Viridor's portfolio of EfW plants at Runcorn Phase II, Ardley – Oxfordshire PPP and Exeter increased by £97 million to £143 million at 31 March 2012.

Major components of the Group's debt finance at 31 March 2012



The Group's debt has a maturity of up to 45 years, with an average maturity of 23 years.

The Group has fixed or put swaps in place to fix the interest rate on at least 50% of South West Water's debt for the entire K5 period up to 2015, at an average interest rate of 3.4%. A further 24% of South West Water's debt is index-linked to 2041-2057, at an overall real rate of 1.66%. As a result of these initiatives, South West Water's cost of finance is amongst the lowest in the industry.

During the year the Group recorded fair value losses of £25 million on swaps (2011 nil), as indicated in the Statement of comprehensive income on page 63. These swaps are expected to be held to maturity and hence these losses will reverse over time.

Pennon Group Plc's and South West Water's interest rates on average net debt for the year to 31 March 2012 were 3.9% and 4.1% respectively.

Just over half of the Group's gross debt is finance leasing, giving us a long maturity profile with interest payable benefiting from the fixed credit margins which were secured at the inception of each lease.

At 31 March 2012 the fair value of the Group's non-current borrowings was £200 million less than its book value (2010/11 £261 million) as detailed in note 26 to the financial statements.

Capital structure – overall position

At the end of the financial year the Group's net debt of £2,105 million gave a ratio of net debt to (equity plus net debt) of 71.9% (2010/11 71.3%).

South West Water's debt to Regulatory Capital Value (RCV) was 56.1% at 31 March 2012 (2010/11 57.1%) which is within Ofwat's optimum range of 55% – 65%.

Viridor is funded by a combination of Pennon Group equity and debt (raised by Pennon Group) and direct borrowing by Viridor. At the year-end Viridor's net debt was £517 million (2010/11 £487 million) equivalent to 4.7 times EBITDA (2010/11 4.2 times).

Treasury policies

The role of the Group's treasury function is to ensure that we have the funding to meet foreseeable needs to maintain reasonable headroom for future contingencies and to manage interest rate risk. The Group enters into certain structured financing transactions that have and are expected to provide an improved return on surplus funds and overall interest rate performance. It operates only within policies approved by the Board and undertakes no speculative trading activity.

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

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

Internal borrowing

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

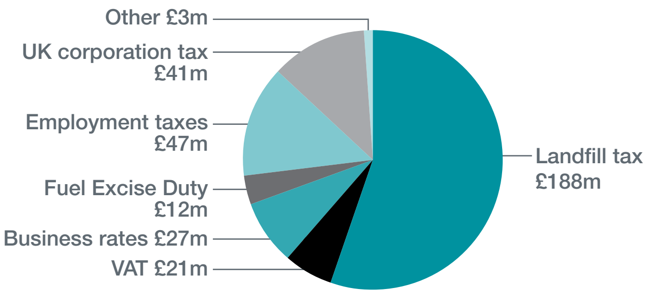
Going concern

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

Taxation objectives and policies

Our tax strategy, as approved by the Board, is to enhance shareholder value by legally minimising the taxes we pay while having regard to our long-term relationship with the tax authorities. We will consider bona fide arrangements which are integral to our business and which qualify for tax exemption or relief.

Tax contribution 2011/12



The total tax charge for the year of £28.1 million was less than the charge which would have arisen from the accounting profit before tax of £200.5 million taxed at the statutory rate of 26%. A reconciliation is provided in note 8 to the financial statements.

The Group made a net payment of £41.4 million of UK corporation tax in the year (2010/11 £43.2 million).

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

Total taxes amounted to £339 million of which £55 million was collected on behalf of the authorities for net VAT and employee payroll taxes.

In addition to corporation tax the most significant taxes involved together with their profit impact were:

- landfill tax of £166 million was collected by the Group on behalf of HM Revenue & Customs (HMRC). Landfill tax is an operating cost which is recovered from customers and is recognised in revenue. In addition the Group incurred landfill tax of £22 million on the disposal of waste to third parties. This is an operating cost for the Group and reduces profit before tax
- Value Added Tax (VAT) of £21 million (net) collected by the Group and paid to HMRC; VAT has no material impact on profit before tax
- business rates of £27 million paid to local authorities. This is a direct cost to the Group and reduces profit before tax
- employment taxes of £47 million including employees' Pay As You Earn (PAYE) and total National Insurance Contributions (NICs). Employer NICs of £13 million were charged approximately 94% to operating costs with 6% capitalised to property, plant and equipment
- Fuel Excise Duty of £12 million related to transport costs. This reduces profit before tax.

The corporation tax rate for 2011/12 used to calculate the current year's tax is 26%. The corporation tax rate, as enacted into law on 26 March 2012, has been reduced to 24% for 2012/13 and is expected to fall by a further 1% per annum until the financial year 2014/15 when the rate will be 22%.

Pensions

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

Funding raised to support ongoing capital investment

Top: Sewage treatment works, Polperro, Cornwall.

Bottom: Mechanical biological treatment facility, Greater Manchester.

At 31 March 2012 the Group's pension schemes showed a deficit (before deferred tax) of £99 million (2010/11 £86 million). Net liabilities of £75 million (after deferred tax) represented less than 3% of the Group's total market capitalisation at 31 March 2012.

The last actuarial valuation of the main scheme was at 31 March 2010. South West Water's cash contributions to the scheme remain within Ofwat's Final Determination for the K5 period.

During the year the Group recorded losses of £52 million (2011 gain of £2 million) in the Statement of comprehensive income on page 63 from changes in actuarial assumptions, being principally the reduction in the net discount rate of 0.63%, reflecting lower AA bond yields.

Insurance

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

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

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

Principal risks and uncertainties

The risks and uncertainties set out in this section have been identified from our risk management process as potentially having a material adverse effect on our business, financial condition, results of operations and reputation. They are managed as described but are not wholly within our control and may still result in a material adverse impact on the Group. Factors beside those listed could also have a material adverse effect on our business activities.

How we manage risk

We operate a well established and fully embedded Group wide risk management process from which we seek to identify significant risks at the earliest possible stage and determine whether they are acceptable risks which we can manage and mitigate satisfactorily. More detail on our risk management process is set out on Page 50 in our Corporate Governance Report.

Risk	Commentary	Mitigation	Change
Law and regulatory **Changes in law, regulation or decisions by Governmental bodies or regulators could have a material adverse effect on our financial results or operations.**	There is a wide range of laws and regulations and policy decisions of government and regulators which could have a materially adverse effect on the results of operations of both South West Water and Viridor. Examples of laws and regulatory changes include:	The general direction of travel of Government policy in both business areas is known and each company is actively involved in consultations on regulatory changes.	
	The transfer of private sewers to South West Water which took place on 1 October 2011 and the further adoption of private pumping stations which is due to take place up to 2016.	Operational plans to manage customer contacts and deliver service to customers were implemented smoothly and activity has been at the lower end of the range. Appropriate risk management activities are undertaken to monitor progress and a strategy is in place to manage for the further adoption of pumping stations. Operating and capital costs incurred efficiently will be funded by future adjustments to price limits.	↔

Key

↔ Unchanged during year
↑ Increased during year
↓ Reduced during year

Risk Level
Green – Low
Amber – Medium
Red – High

The colouring (red, amber, green) is the Group's estimate of the inherent risk level to the Group after mitigation. It is important to note that risks are difficult to estimate with accuracy and therefore the risks may be more or less significant than indicated.

Risk	Commentary	Mitigation	Change
	Performance of South West Water against key regulatory outputs.	They are monitored on a monthly basis and where performance falls short, corrective programmes are developed and implemented to target recovery in specific areas. Internal monitoring and assurance programmes are undertaken through the year and annual data is supported by external verification through the South West Water external auditors to provide assurance on compliance.	↓
	The Government's Water White Paper signals an evolutionary approach to market and regulatory reform over a period to 2025 and beyond. Legislation is required for a number of the changes and draft legislation is anticipated in 2012/13. The development of greater competition in the water industry could reduce South West Water's revenues.	As part of its risk management and business strategic planning processes, the company evaluates developments and proposals for competition which could provide opportunities for business expansion. South West Water is prepared for the development of retail competition, with the launch of 'Source for Business', offering enhanced services to commercial customers. The company has evaluated proposals for regulatory reform and contributed fully to the Ofwat consultations on regulatory price setting and other forms of dialogue with regulators and stakeholders in order to effectively convey its views.	⇔
	Climate change and resulting increased regulatory standards could increase costs for South West Water.	The company has plans ready and will adapt the way it conducts its business to respond effectively to the changing weather conditions.	⇔
	The UK has landfill diversion, recycling and recovery targets which, together with the impact of both WEEE Regulations, higher Producer Responsibility obligations and pre-treatment requirements, plus rising landfill tax, will continue to further reduce landfill volumes for Viridor and potentially, over time, landfill asset values.	Viridor's strategy is to grow in recycling and energy from waste where margins per tonne are much higher than in landfill. Increasing landfill tax increases the economic attractiveness of recycling and energy from waste. The new Resource Efficiency Agenda emanating from the EU and the UK Government's attention to resource and electricity security are expected to provide further opportunities for Viridor.	⇔
	The ever increasing demand for higher standards, in areas such as health and safety, environmental performance and employee welfare increase costs for both South West Water and Viridor.	These issues for South West Water are addressed in the five-year regulatory price review mechanism through future adjustments to price limits but there is a risk that some additional costs will not be funded immediately, in part or at all.	⇔
		Within Viridor higher costs are sometimes but not always recovered through contractual arrangements with waste authorities and other customers. Additionally Viridor continues to develop its Business Management Systems to address costs and maintain high standards of compliance by improving its management controls. Viridor also maintains a close interest in industry developments via the waste sector trade association and therefore is often at the forefront of planned changes.	⇔

Risk	Commentary	Mitigation	Change
Economic conditions **Economic conditions could materially affect the Group's revenues and profitability.**	The Group does have exposure to reduced economic activity, inflation/deflation and the impact of the current Eurozone uncertainties. However South West Water's revenues are economically regulated through the price review mechanism and Viridor has a diversified revenue stream which includes exports to countries such as China and India whose economies are more buoyant than the UK and Europe. Examples of specific areas of impact are:		
	South West Water's revenues can be impacted by higher bad debts and customer affordability.	In addition to existing debt reduction strategies (such as WaterCare+, Restart and the Fresh Start Fund), which are kept under review, the company continues to implement new initiatives to improve and secure cash collection, including the use of third party collection agencies and introduction of a new billing and collection business 'Source Contact Management'. The Government's commitment to tackle 'unfairness' issues for the company's bill payers, where 3% of the population pay for 30% of the UKs bathing waters, has also moved forward with legislation passed for a £50 reduction in bills for householders from 2013/14.	↔
	South West Water has 73.4% of its domestic customer base metered and as a result the revenue from these customers can be more volatile from changes in usage which can be affected by a number of factors including: – abnormal weather impacts – increased water efficiency – recession impacting commercial customers.	The financial impact of changes in customer demand are mitigated through the regulatory Revenue Correction Mechanism, whereby shortfalls in revenue in one five year regulatory pricing period are adjusted in the following period.	↔
		A number of the company's other income streams are vulnerable to downturns in economic activity, particularly in the property market affecting new connections, searches and mains diversion activity.	↔
	Viridor has seen residual waste landfill and collection volumes reduce due to the recession and the long-term trend towards recycling and energy from waste.	Viridor's strategy is focused on growing in recycling and energy from waste where margins per tonne are much higher than in landfill.	↔
	Viridor's commodity trading arm (VRM) trades where the market is most favourable. However, Viridor remains susceptible to global economic demands and the weakness of the Eurozone is having a depressing effect on the prices of internationally traded recyclates. A breakdown of the Eurozone would intensify the downward pressure on prices. In addition competition for recyclables from other contractors via aggressive pricing has been a recent trend.	Under the terms of its customer supply contracts and by management action Viridor has been able to offset more than 50% of the impact of price reductions in recyclates.	↑

Risk	Commentary	Mitigation	Change
	The Government's spending Review has put pressure on local authority services, including household waste recycling centre operations which is expected to have a short-term impact.	Viridor provides best value services and competitive procurement bids to its public sector customers.	
Finance and funding **Access to finance and funding costs may be adversely affected by perceived credit rating and prolonged periods of market volatility or liquidity. There are covenant limits and restrictive obligations on borrowing and debt arrangements.**	The Group may be unable to raise sufficient funds to finance its activities or such funds may be only available at higher cost.	The Company has robust treasury policies in place which include always having pre-funded surplus cash and/or committed facilities to cover at least one year's estimated cash flow and arranging for no more than 20% of net borrowing to mature in any one year. In addition in respect of South West Water the economic regulator has a statutory duty to ensure that it is able to finance its functions in the normal course. The Group has to date obtained funding at lower effective average interest rates compared to many other companies in its sector and is well placed to meet the funding requirements of both South West Water and Viridor in the foreseeable future. The Group had £1 billion of cash and facilities as at 31 March 2012 including over £0.5 billion of new/refinanced facilities sourced during the year.	
Operating performance **Poor operating performance or a failure or interruption of our operating systems or the inability to carry out network operations or damage to infrastructure may have a material adverse impact on both our financial position and reputation.**	Poor operating performance for both South West Water or Viridor could result in enforcement action, prosecutions, loss of permits and civil action which could all result in negative publicity, regulatory penalties, loss of customer confidence due to poor performance and eventually, reduced demand for services and increased fixed costs.		
	Within South West Water a major network failure or interruption may be suffered or the company may not be able to carry out critical network operations. Operational performance could be materially adversely affected by a failure to maintain the health of the system or network which could cause South West Water to fail agreed standards of service or specified quality standards.	Specific measures taken by South West Water include: • a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs) and the promotion of conservation measures and customer water efficiency measures • a Water Resources Plan prepared every five years and which is reviewed annually for a range of climate change and demand scenarios. The current Water Resources Plan indicates that no new reservoirs are required before the planning horizon of 2035. However, due to the impacts of climate change, this position is reviewed frequently	

Risk	Commentary	Mitigation	Change
		• established procedures and controls in place, as well as contingency plans and incident management procedures. The company 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 • monitoring of significant assets by automated and remote operation and routine controls and operating procedures that are constantly kept under review. Asset management techniques are employed to pre-empt the failure of assets to maintain stable serviceability and avoid regulatory penalties.	
	From 2011/12 a financial reward/penalty could be applied to South West Water at the next price review under Ofwat's Service Incentive Mechanism (SIM). This depends on South West Water's customer service performance relative to the industry average over the remaining K5 regulatory period.	While the company has seen improvements in customer service particularly through reduced written complaints, there is uncertainty over South West Water's relative position in the industry. However there is a strategy for 2012/13 in place to improve customer service further.	↑
	Viridor operates in a competitive marketplace where price and service are key precursors to success.	Sound policies and accredited procedures are in place with internal and external inspections, to maintain operations and achieve performance standards set.	↔
Capital investment **The failure or increased costs of capital projects or acquisitions or joint ventures not achieving predicted revenues or performance could have a material adverse effect on both our financial position and reputation.**	South West Water may not carry out its capital programme within the price limits and with the efficiencies determined by Ofwat.	The company does have a track record of delivering its capital programme in accordance with regulatory requirements and progress is regularly monitored and reviewed.	↔
	Within Viridor there are risks of project delays, cost over-runs or contract failure which could be as a result of failure or insolvency on the part of contractors or their subcontractors, or due to a new technology failing performance requirements. There is also a risk of overpaying for an acquisition. With the increase in Viridor's project pipeline, Viridor recognises that this risk is increasing and is addressing it.	The company has experienced and dedicated project/contract teams; detailed due diligence on all projects, supplies, technologies and acquisitions is carried out by experienced and qualified staff; and wherever possible back-to-back agreements with and guarantees from suppliers are entered into. There is also regular monthly reporting on performance on major contracts and post project appraisals are carried out which all assist in being able to improve future performance.	↑

Risk	Commentary	Mitigation	Change
Competitive pressures **A reduced customer base, increased competition affecting prices or reduced demand for services could have a material adverse impact on our financial position.**	Viridor is experiencing increased competitive pressures in a number of areas of its business including in particular on recyclate volume and prices, landfill gate fees and bidding for Public Private Partnership contracts (PPPs). Recycling has been recognised as an attractive business by an increasing number of competitors. Competitive pressures in respect of South West Water are referred to in the first risk set out at the beginning of this section.	Viridor provides recycling and waste management services which are locally delivered services from locally managed facilities and a significant proportion of its revenue is contracted over the medium or long-term. With regard to major competitive projects being pursued there are barriers to entry due to planning permissions being difficult to obtain and significant investment requirements.	↑
Business systems **Information technology and business continuity systems and processes may fail which may cause material disruption to the Group's businesses and could have a material adverse impact on both our financial position and reputation.**	There always remains a risk of interruption, failure or third party intervention that could have a material adverse impact on the operations of South West Water's business.	The company has well developed IT systems and continuity systems in place. The further impact of a system failure or disruption to the company has been reduced with the refurbishment of the data centre at its head office and the establishment of a geographically separate alternative data centre, which is hosted by a third party communications provider.	↓
	Some of Viridor's IT systems require replacement, development or upgrading to meet the growing requirements of the business and in some areas new technology being introduced may not operate or perform according to stated specification requirements.	Viridor has increased its IT management and technical resources accordingly. It also has a comprehensive development programme and plans in place to address the deficiencies identified and seek to ensure business continuity in the event of failure.	↔

Forward-looking statements

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

Sustainability report

Pennon is one of the largest environmental and resource management groups in the UK. Sustainability is at the heart of our business. The provision of high quality water and waste management services is fundamental to the well-being and sustainability of our society. Ensuring the availability of plentiful clean water which is used wisely and not wasted, together with effective waste water treatment, is South West Water's business. Transforming waste into a resource by recycling and generating renewable energy is Viridor's business.

Substantial investment in our water and sewerage activities and infrastructure enables us to deliver both high levels of performance and service, as well as long-term security of supply. In our recycling and waste management business we continue to invest in facilities and services to transform waste into quality recycled materials and renewable energy, helping customers from all sectors to meet their own recycling and waste management objectives, while addressing the longer term strategic imperatives of resource efficiency, protecting the environment and preserving natural resources.

We believe that a well-managed and responsible Group, with sustainability both at the core of its operations and fundamental to its business philosophy, will deliver strong performance and lasting value for our stakeholders. We contribute to the well-being of the communities that we serve, and of the environment in which we operate. Our commitment to sustainability is embedded in our operational and business practices, our relationships with our stakeholders, and in our long-term strategy.

Pennon was delighted that this commitment was recognised when the Group won the 'Achievement in Sustainability' award at the annual PLC Awards in February 2012. This award recognises accomplishments in key areas of economic, environmental and social sustainability. Judges highlighted our performance in renewable energy power generation at our waste water treatment works and landfill gas control, as well as our funding for community and environmental projects.

Our commitment to economic, social and environmental sustainability is embedded in our strategic objectives to:

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

Key environmental issues

Climate change and resource efficiency

Climate change and excessive resource use are two fundamental challenges for society which are being addressed by developments in the UK's water, waste and renewable energy policies. Pennon is proactively approaching these key issues with strategies that underpin the sustainable performance of the business.

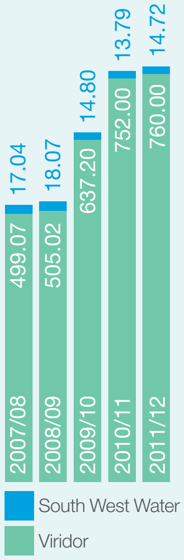
Group programmes increase the resilience of both South West Water and Viridor by protecting our assets, reducing emissions, harnessing renewable energy and maximising materials recovery.

Demand for safe drinking water and water security, and for recycling, renewable energy and resource efficiency will continue to grow as climate change impacts start to make themselves felt.

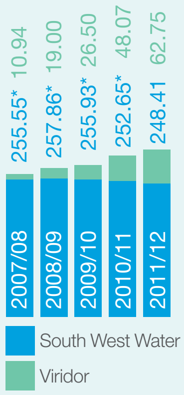
Renewable energy and carbon reduction

Both subsidiaries have detailed energy efficiency and carbon reduction plans in place. Viridor's five-year plan aims to increase energy efficiency by more than 20% by 2016, equivalent to an overall reduction of 4% in total emissions per annum. South West Water's energy and carbon management strategies to 2030 include plans for a structured energy efficiency programme and ambitions to further develop and exploit opportunities

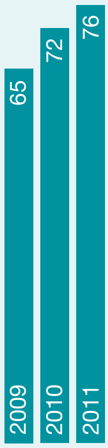
Green energy generated
Gigawatt hours (GWh)



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



Carbon Disclosure Project score
%



* Reassessed to include all imported electricity used and self-supplied renewable energy used on South West Water sites.

for renewable energy schemes. The company's 2015 carbon reduction target is to cut operational emissions from energy use by 18% compared with 2009/10 levels, with further reductions targeted in the longer term in line with national strategy.

Pennon participates in the UK Government's Carbon Reduction Commitment and has an ambitious strategy and programmes in place to continuously improve energy efficiency across the business. In the first year of audited performance, we were ranked 230th out of 2,013 participating companies.

Pennon also voluntarily participates in the internationally recognised Carbon Disclosure Project, coming 53rd out of the 236 FTSE 350 companies that responded, with an improving percentage score.

Pennon is a net producer of renewable energy, largely due to Viridor's power generation from its landfill gas and energy from waste (EfW) operations. In 2011 around 30% of renewable energy generated in the UK was derived from landfill gas and municipal solid waste combustion. Viridor's landfill gas power generation is now approaching peak capacity and will be replaced by increasing contributions from EfW and anaerobic digestion (AD) facilities. South West Water is also increasing its renewable power generation capacity using hydro-electric, combined heat and power (CHP) from biogas, and solar and wind installations. This overall generation capacity will continue to offset the Group's energy use.

Viridor invested £93 million in renewable energy and recycling plants during 2011/12. It now has a generating capacity of 136MW. It plans to have 300MW of installed capacity by 2016. The Runcorn EfW plant currently under construction will be the largest waste-generated CHP plant in the UK, with high energy efficiency levels.

As Viridor continues to expand its recycling capacity, so a growing proportion of its operations rely on energy-intensive processing equipment – though recycling generally provides net carbon and energy benefits.

South West Water's core operations also require considerable amounts of energy to treat both drinking and waste water to high standards and to pump it around the region. The cost of South West Water's energy use is around £20 million a year, and around 80% of the company's carbon emissions are associated with energy use, underlining the importance of energy efficiency in the business. The company's ongoing pump efficiency and 'PowerDown' programmes are helping to reduce energy use.

During the year Viridor achieved its target of three accreditations to the Carbon Saver Gold Standard, most notably one for the whole of its Scottish operating region. This reflected the achievement of a 10% absolute reduction in energy-related carbon emissions in Scotland over the last three calendar years.

South West Water continues its accreditation to the Certified Emissions Measurement and Reduction Scheme (CEMARS).

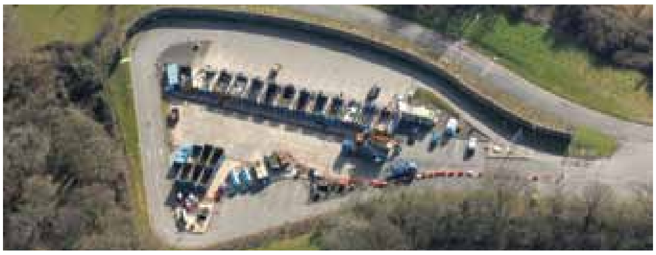
Resource security

In spite of two years of significantly reduced rainfall, resulting in the Environment Agency declaration of an environmental drought in April 2012, South West Water has ensured security of supply by investing in its ability to transfer water and converting two former china clay pits into reservoirs. This, together with our industry-leading leakage control, has led to the 15th year without water restrictions.

South West Water liaises extensively with Defra, other regulators and landowners to promote catchment management as a tool to improve raw water quality. The company's flagship environmental project 'Upstream Thinking' includes moorland restoration projects on Exmoor and Dartmoor, and catchment sensitive farming programmes to improve land management, delivered in partnership with the Westcountry Rivers Trust and the Devon and Cornwall Wildlife Trusts. Defra endorsed the company's approach in its Water White Paper published in December 2011, and 'Upstream Thinking' won the 'Partnership Initiative of the Year' category at the Water Industry Achievement Awards in March 2012.

Viridor's range of services has changed to ensure they are aligned to the waste hierarchy that is enshrined in European and UK waste policy legislation. This reflects the overall environmental benefits in the priority options for managing waste. It gives top priority to waste prevention, followed by re-use and recycling. Disposal by landfill is the least favoured option. Viridor now transforms waste into valuable, high quality commodities wherever possible, using a range of treatment technologies, including advanced materials recycling facilities, mechanical-biological treatment, composting and household waste recycling sites, often combining

Peat bog restoration under way on Exmoor as part of South West Water's award-winning 'Upstream Thinking' initiative.



Top: Billingshurst household waste recycling centre, West Sussex.
Bottom: Customer service at a Viridor household waste recycling centre.

the provision of these facilities in integrated waste management contracts. It subsequently looks to recover energy from non-recyclable and residual wastes using energy from waste and anaerobic digestion technologies to offset fossil-fuel based energy generation.

During the year Viridor continued to increase its recycling capacity through both acquisition and organic growth, recycling 2.3 million tonnes of material (2.1 million tonnes in 2010/11), with 1.8 million being traded recyclates (1.7 million tonnes in 2010/11).

Key social issues

Commitment to communities

Pennon Group recognises that it is part of, and has a responsibility towards, the communities in which it operates and it strengthened its community relations and investment policy during the year. It aims to ensure that business activities have overall positive community benefits. The Group recognises the importance of developing open and transparent engagement with communities and other organisations and its employees take part in a range of volunteer projects. Sponsorships and partnerships with community organisations also help deliver on our commitment in this important area, such as the 'Keep Britain Tidy' 'BeachCare' initiative.

Bathing water quality is vitally important to local communities and visitors across the region. Since privatisation in 1989, South West Water has invested £2 billion in 140 new waste water treatment works via our 'Clean Sweep' programme. As a result 98.6% of our 144 EU-designated bathing waters now meet or exceed the EU's 'Good' standard compared with 96.5% in 2010 and 95.1% are deemed 'Excellent' compared with 90.3% in 2010.

In 2011 South West Water launched its 'BeachLive' website. This award-winning initiative was developed in partnership with Surfers Against Sewage and others, and enables beach users to check real-time bathing water information at 21 Blue Flag or popular beaches in Devon and Cornwall every day. The number of beaches covered is being extended in 2012/13.

The investment required to deliver the bathing water improvements has resulted in higher bills than in other regions. The company understands that some customers have problems paying, and has developed an industry-leading 'Affordability Toolkit' comprising a range of practical measures, including a free debt helpline, payment plans, and water meter and water conservation advice. Its 'WaterCare+' scheme has helped its 10,000th customer since it was established in 2007. The company has also established a 'FreshStart' fund of up to £1 million, administered by Plymouth Citizens Advice Bureaux (CAB), to help those in financial crisis due to circumstances such as bereavement. South West Water partners with charities and agencies such as local Citizens Advice Bureaux and Age UK to find and help those in the most need. Our work in this area was recognised in the CAB publication, 'How to do the Right Thing'. The company is supporting the business community by sponsoring local 'Battle the Bills' sessions which help up to 1,000 small and medium-sized businesses by offering advice on water and energy use.

Challenging economic conditions lead Viridor's local authority and business customers to scrutinise costs and demand value for money in all aspects of service. Economic drivers such as the Landfill Tax, public and private sector procurement practices, as well as Viridor's customer service partnerships and provision of waste audits, ensure that the company remains keenly competitive for the benefit of its customers.

In 2011/12 Viridor (via an independent distributive Environmental Body, Viridor Credits) provided £10.3 million of funding for community, amenity and environmental projects in areas close to its landfill facilities through the Landfill Communities Fund. The company also provides direct sponsorship and community support in its operational areas.

Viridor has active community liaison groups at all of its major operational facilities, ensuring effective dialogue with local community representatives. It also consults extensively with local communities and stakeholders when looking to develop new facilities, in order to keep people informed and to enable their full involvement in the planning process. During the year Viridor opened another two education centres in Greater Manchester, helping to promote understanding and best practice in waste prevention, recycling, recovery and resource management. The company now operates or supports 10 such centres across the UK and welcomed more than 13,000 visitors during the year.

Viridor and South West Water are responsible for the management and stewardship of substantial landholdings, particularly at reservoirs and landfill sites, including 26 closed landfill sites and 17 Sites of Special Scientific Interest. These areas can have significant benefits and the companies work in partnership with the Wildlife Trusts, local communities and employees to enhance biodiversity.

Five Viridor sites have now attained the Wildlife Trust's Biodiversity Benchmark standard, with one awaiting accreditation. Three sites of low biodiversity have been identified for five-year improvement plans and a biodiversity strategy covering all sites will be developed during 2012/13. South West Water's reservoir sites are managed by the South West Lakes Trust, the region's largest combined environmental and recreational charity, which delivers a wide range of facilities, such as visitor centres and watersports facilities. These amenities attract around two million visits every year. Four flagship sites have received the gold standard in the Green Tourism Business Scheme's prestigious awards.

Engaging with other stakeholders

Pennon and its subsidiaries aim to be open and collaborative, fostering positive relationships with stakeholders and delivering long-term benefits and added-value. South West Water's Chief Executive has just completed four years as Chair of Water UK. He is now Chair of the Cornwall and Isles of Scilly Local Enterprise Partnership, and the Vice President of the Institute of Water. Viridor's Chief Executive is currently Chair of the Government's Living with Environmental Change Business Advisory Board and of the Environmental Sustainability Knowledge Transfer Network.

Both companies inform Government policy in respect of pertinent industry issues. For Viridor in 2011/12 this included liaison and responses to consultations on the Waste Policy Review for England and Wales, Scotland's Zero Waste Plan and regulation, and the London Waste Strategies. Viridor's 'OpenSpace' innovative data-sharing portal has been developed with the Environment Agency in England, meeting their 'better regulation' agenda. This ground-breaking project to supply environmental monitoring data live to the regulator has substantial cost and resource saving potential going forward.

The 2009 Walker Review highlighted the huge environmental costs water customers in the South West of England, making up just 3% of the UK population, have been paying for the clean-up and protection of 30% of the nation's bathing waters since 1989.

St Helens waste electricals recycling facility.

For four years, South West Water has worked closely alongside MPs of all parties and consumer groups to press the South West's case at the highest levels. In November 2011 the Chancellor of the Exchequer confirmed that the Government will be reducing the annual bills of household customers in the company's service area by £50 each, until at least 2020.

During the year South West Water embarked on a comprehensive research and engagement programme with customers, community and environmental representatives as part of its preparation for the 2015-2020 business plan and price setting. The WaterFuture Customer Panel has been established to assist with this process.

Commitment to employees

Employees are at the heart of the work we undertake at Pennon Group. Aiming for best practice in recruitment, training and development, talent management, health and well-being, retention and succession planning is therefore of crucial importance for the health and sustainability of the business. Both companies aim to be good employers and recognise that employees make the difference which helps us to achieve our corporate goals.

Both subsidiaries have a range of family friendly policies, equal opportunity policies and policies to ensure a healthy work-life balance. The companies undertake regular employee surveys to obtain feedback on employee satisfaction and to identify key issues for improvement. Viridor conducted a survey in 2011/12 focusing in particular on its health and safety culture. This showed good levels of employee satisfaction and identified important areas for improvement including internal communications, procedures and training. Employee representation is facilitated through trade union membership and, for South West Water, by an elected Staff Council.

A safe and healthy workforce will always be a priority for the Pennon Group. Group companies' health and safety policies and procedures are delivered through programmes which integrate with other areas of the business including operations, compliance, human resources and quality. For example South West Water introduced its Think, Act, Prevent (TAP) campaign in 2011, which delivered behavioural safety training to its employees. 'RIDDOR' incident rates in both companies reduced during the year, although neither company is complacent and zero accidents is our goal.

Pennon encourages talented people to join the Group, and to stay, by matching the right people to the right roles and by ensuring professional development opportunities throughout their careers within the Group. We have a range of training programmes aimed at different levels across the organisation. For example South West Water's 'Managing for Success' programme and Viridor's 'Fundamentals of Management' and subsequent 'Management to Leadership' programmes, try to equip our managers of the future with the necessary skills.

South West Water and Viridor appointed 22 apprentices and graduate trainees during 2011, and South West Water will be creating 20 more apprenticeships in 2012, at a time when youth unemployment is growing.

Key economic issues

Commitment to regional economies

Pennon's investment for long-term sustainable growth is delivering value for shareholders and stakeholders. The Group companies provide significant support for regional economies by working with hundreds of local suppliers to deliver essential infrastructure and to deliver and improve services for customers.

As one of the largest employers in the region, South West Water employs 1,400 people, both directly and through its contact centre subsidiary, Source Contact Management Limited. South West Water supports regional employment through a variety of external contracts with a particular focus on small businesses, as well as large service providers. Through its £2 billion Clean Sweep investment, undertaken since privatisation, the company has added significant value to the region's tourism industry by enhancing the natural environment.

South West Water's PUROS programme enables remote management of assets and centralised planning. PUROS has helped the company to deliver operational efficiencies and outperform Ofwat's Final Determination, the price limits and expenditure plans determined by Ofwat for South West Water for a five-year period.

Viridor's operations and continued growth also provide significant regional economic and community benefits throughout the UK. The company directly employs over 3,000 people and provides significant supplier opportunities. Viridor's investment programme – to gradually replace landfill services with increased recycling and renewable energy generation – creates greater value in terms of jobs and skills. For example, the Runcorn EfW facility will directly employ and provide training for up to 70 highly skilled people in the North West (compared with around 15 people required to landfill the equivalent waste volume). The construction of the project has employed a daily average of 325 people on site, rising to 700 at its peak, and many more through the supply chain.

Achievements

In addition to the 2012 PLC Sustainability Award, and to the achievements listed under each subsidiary company's business review, Pennon is listed in the FTSE4Good index. In March 2012 the Group scored 3.8 out of 5 in the FTSE4Good Environmental, Social and Governance ratings assessment. It was also the top ranked utility in four categories of the 2011 'Britain's Most Admired Company' awards.

In January 2012 Pennon was listed as one of the 100 most sustainable companies in the world by Corporate Knights the company for clean capitalism.

Governance

The Pennon Sustainability Committee (previously Corporate Responsibility Committee) is chaired by a Non-executive Director and comprises the Chief Executives of South West Water and Viridor plus two further Non-executive Directors. It is served and attended by senior management from both subsidiaries. The Committee oversees the Pennon Group's requirement to conduct its business in a responsible manner. Consequently the Committee reviews the strategies, policies, management, initiatives, objectives, targets and performance of the Pennon Group of companies in respect of environmental, social and governance aspects. During 2011/12 the Committee developed a new community relations and investment policy, scrutinised both companies' approach to carbon management, examined sustainability in supply chains, and maintained its focus on improving health and safety.

Both subsidiaries develop annual sustainability targets as part of business planning and budgeting, putting sustainability at the core of the business. Performance against these targets is reviewed quarterly at executive management meetings, and by the Pennon Group Sustainability Committee.

Delivery of sustainability targets forms part of the remuneration package of Pennon's senior executives and employees throughout the Group.

Verification

Pennon's sustainability performance for 2011/12 has been audited by Acona Partners LLP, an independent management consultancy that specialises in the areas of sustainability and corporate responsibility.

South West Water and Viridor Sustainability reports

The full 2012 Sustainability Reports for South West Water and Viridor will be published in July and August respectively and will be available to view at pennon-group.co.uk and also on the subsidiaries' websites.

PLC awards 2011 Pennon Group WINNER Achievement in Sustainability

FTSE4Good

Trigon landfill restoration, Dorset.

Reed bed at West Penwith.

Sustainability KPIs

South West Water

Renewable energy generation
GWh

Greenhouse gas emissions data
tCO_2e

* Reassessed to include all imported electricity used and self-supplied renewable energy used on South West Water sites.

Recycling volumes
tonnes of dry solids

Community support, sponsorship and donations
£

RIDDOR incidence rate
per 100,000 employees
calendar year

Actual number 20

Capital investment
£m

Viridor

Renewable energy generation
GWh

Greenhouse gas emissions data
tCO_2e

Recycling volumes
million tonnes

Community support, sponsorship and donations
£m

RIDDOR incidence rate
per 100,000 employees
calendar year

Actual number 39

Capital investment
£m

Principal activities and business review

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

In addition the Business review contains a fair and balanced review of the business of the Group, including its position and prospects, Key Performance Indicators and a description of the principal risks and uncertainties facing the Group in accordance with the requirements of the UK Corporate Governance 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 28 and 29. Further information on ESG aspects of the Group's business are included in the Group Sustainability report on pages 34 to 39. The principal subsidiaries of the Company are listed in note 38 to the financial statements on page 108.

Corporate governance and Directors' responsibilities statements

The Directors' responsibilities statements, a report on the review of, and a statement on, the Group's system of internal controls and the disclosures required by Part 6 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts & Reports) Regulations 2008 and FSA Disclosure and Transparency Rule 7.2 are set out in the Company's Corporate governance and internal control report on pages 42, 43 and 46 to 51 of this Annual Report which are hereby included within this Directors' report by reference.

Financial results and dividend

Group profit on ordinary activities after taxation was £172.4 million. The Directors recommend a final dividend of 18.3p per Ordinary share to be paid on 5 October 2012 to shareholders on the register on 10 August 2012, making a total dividend for the year of 26.25p, the cost of which will be £95.9 million, leaving a credit to reserves of £76.5 million. The Business review on pages 24 to 27 analyses the Group's financial results in more detail and sets out other financial information, including the Directors' opinion on asset values on page 25.

Directors

In accordance with the provisions of the UK Corporate Governance Code (the Code) all Directors are offering themselves up for re-election at this year's Annual General Meeting. The Board continues to believe that each Director makes an effective and valuable contribution to the Board, demonstrating continued commitment to his or her role. The Non-executive Directors, Gerard Connell and Martin Angle, are considered to be independent in accordance with the provisions of the Code. Dinah Nichols, subject to her re-election at this year's Annual General Meeting, will have served as a Non-executive Director for more than nine years. The Board has determined that Dinah remains independent as she demonstrates independence of character and judgement in her conduct of matters with the Board. The Non-executive Directors do not have service contracts. The Chairman, Ken Harvey, also does not have a service contract but he does have a contract for services which is terminable upon 12 months' notice. The Executive Directors, David Dupont and Chris Loughlin, have service contracts which are due to expire when they reach age 60 (the unexpired term for David Dupont and Chris Loughlin is until 10 June 2014 and 20 August 2012 respectively). In respect of Colin Drummond, who has reached age 60, his contract now continues subject to 12 months' notice. The other Executive Directors' contracts are also expected to continue after they reach age 60. Formal resolutions for the above Directors' re-election will be proposed at the Annual General Meeting. The Directors' biographies are set out on pages 44 and 45.

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 57. Further details relating to the Directors and their service agreements or contracts for services are set out on pages 55 and 57 and details of the Directors' interests in shares of the Company are given on pages 58 to 60.

Directors' insurance and indemnities

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

Financial instruments

Details of the financial risk management objectives and policies of the Group and the exposure of the Group to price, credit, liquidity and cash flow risks are set out in the Business review on pages 26 and 27.

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

2012 Annual General Meeting business

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

- **renew the existing authorities to issue a limited number of shares and to purchase up to 10% of the issued share capital of the Company**
- **seek authority to make political donations under the Political Parties, Elections and Referendums Act 2000, as amended. (It is not the Group's policy to make political donations. This is a precautionary measure which is followed by many companies to ensure that there is no inadvertent breach of the law)**
- **re-elect Mr K G Harvey, Mr M D Angle, Mr G D Connell, Mr C I J H Drummond, Mr D J Dupont, Mr C Loughlin and Ms D A Nichols as Directors of the Company**
- **seek authority to continue to call general meetings other than an annual general meeting on not less than 14 clear days' notice (Pursuant to the EU Shareholder Rights Directive shareholder authority is required to continue to call meetings on at least 14 clear days' notice. Such authority would only be exercised by the Directors in exceptional circumstances and if they considered that it was in the best interests of shareholders and the Company as a whole to do so).**

pre-employment aptitude tests. Wherever possible the opportunity is taken to retrain people who become disabled during their employment in order to maintain their employment within the Group. The Group also has a Boardroom Diversity Policy and encourages gender diversity in particular. Further details are set out in the report of the Nomination Committee on page 49.

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 17, 23, 37 and 38 of the Business review.

The Group encourages share ownership amongst its employees by operating an HM Revenue & Customs approved Sharesave Scheme and Share Incentive Plan. At 31 March 2012 around one-third 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 (2010/11 £0.2 million).

Pennon Group donations

During the year donations amounting to £73,992 (2010/11 £78,678) were made. Further details are included on page 37 of the Group Sustainability report. No political donations were made (2010/11 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 2013 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 2011/12 and the amount owed to its trade creditors at 31 March 2012, was 16 days.

Purchase of own Ordinary shares

The Company has authority from shareholders to purchase up to 10% of its own Ordinary shares (as renewed at the Annual General Meeting in 2011) which was valid as at 31 March 2012 and remains currently valid. Of the 4,309,567 shares held in Treasury at 31 March 2011, 676,862 were subsequently re-issued under the Company's employee share schemes for proceeds of £1.9 million.

Major shareholdings

Details of major shareholdings notified to the Company in accordance with the FSA Disclosure and Transparency Rules 5 are set out on page 113 'Shareholder Information'.

Independent auditors

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

Appointed business

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

Annual General Meeting

The twenty-third Annual General Meeting of the Company will be held at the Sandy Park Conference Centre, Sandy Park Way, Exeter, Devon EX2 7NN on 26 July 2012 at 11.00am. Details of the resolutions are summarised above and set out in the separate Notice of Annual General Meeting which is circulated to shareholders with this Annual Report or provided by electronic communication via the Company's website pennon-group.co.uk

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

By Order of the Board

Ken Woodier
Group General Counsel & Company Secretary
18 June 2012

Governance

Chairman's introduction to governance

The Board is committed to the highest standards of corporate governance in the best interests of its shareholders and other stakeholders.

Ken Harvey
Chairman,
Pennon Group Plc

Dear shareholder

I am pleased to introduce the Corporate Governance Report for 2012 on behalf of the Board.

The Annual Report remains the principal means of reporting to our shareholders on the Board's governance policies. This Report sets out how the main and supporting principles of good corporate governance set out in the UK Corporate Governance Code (June 2010) have been applied in practice. The Code is publicly available on the Financial Reporting Council (FRC) website frcpublications.com

Role of the Board and its effectiveness

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

I firmly believe that we have good governance in place and that we operate effectively as a Board. However there is always room for improvement and each year we carry out a detailed performance evaluation of the Board and each of the Committees as well as of the Directors and the Group General Counsel & Company Secretary. Further details of the review, which was facilitated by an external governance consultancy for the first time, are set out later in this report. I remain mindful of the need to ensure that the Non-executive Directors continue to have appropriate up to date knowledge and understanding of both South West Water and Viridor as they develop and pursue new initiatives. Last year the Board had a number of visits to key sites within both South West Water and Viridor and met and discussed the then current issues with managers and employees across the Group. This year the Board has concentrated on receiving presentations from senior management on material developments in the businesses including our energy from waste plant projects; landfill gas management; energy production from landfill; and regulatory and legislative changes proposed by Ofwat and Government.

Remuneration

The Board and the Remuneration Committee remain mindful of shareholder and the Government's concerns regarding some companies' remuneration practices.

We have always pursued a remuneration policy of setting pay at a level which is just sufficient to attract and retain high calibre management and providing incentives which are fully aligned with creating shareholder value. We have reviewed our pay and benefits practice again this year and are satisfied no changes are necessary to maintain this policy.

Shareholder engagement

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

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

I also actively encourage the participation of shareholders at our Annual General Meeting and as usual at our 2012 Annual General Meeting on 26 July all our Directors aim to be present together with a number of directors and executives of South West Water and Viridor to meet with shareholders to discuss the business of the Group.

Compliance with UK Corporate Governance Code and other requirements

I am pleased to report that throughout the year the Company complied with the provisions and applied the main principles set out in the UK Corporate Governance Code with no exceptions to report.

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

Ken Harvey
Chairman
18 June 2012

Guide to the contents of the Governance report

Board of Directors

Chairman

Kenneth George Harvey CBE, BSc
Chairman
Committees
Nomination (Chairman)

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

Executive Directors

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

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

Non-executive Directors

Martin David Angle BSc Hons, FCA, MCSI
Non-executive Director
Committees
Audit, Sustainability, Nomination, Remuneration (Chairman)

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

Gerard Dominic Connell MA
Senior Independent Non-executive Director
Committees
Audit (Chairman), Sustainability, Nomination, Remuneration

Appointed on 1 October 2003. Gerard currently is also a non-executive director and chairman of the audit committee of the Defence Science and Technology Laboratory and the independent director, finance and investment, of the Nuclear Decommissioning Fund Company Limited. He was previously group finance director of Wincanton Plc. Before that he was a director of Hill Samuel and a managing director of Bankers Trust, having trained originally at Price Waterhouse. In addition he has held other corporate finance and business development positions in the City and in industry. He is also a governor of King's College School, Wimbledon.

David Jeremy Dupont MA, MBA
Group Director of Finance
Committees
Executive

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

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

Appointed on 1 August 2006. Chris was previously chief operating officer with Lloyd's Register and earlier in his career was an executive director of British Nuclear Fuels Plc and executive chairman of Magnox Electric Plc. He was also a senior diplomat in the British Embassy, Tokyo, working in both the consulting and contracting sectors. Chris started his career as a chartered engineer and subsequently held a number of senior positions with British Nuclear Fuels. Between April 2008 and March 2012 he was chairman of Water UK and currently is vice-chairman of the Cornwall Local Enterprise Partnership and a member of the audit committee of the charity, WaterAid.

Company Secretary

Dinah Alison Nichols CB, BA Hons
Non-executive Director
Committees
Audit, Sustainability (Chairman), Nomination, Remuneration

Appointed on 12 June 2003. Dinah was formerly Director General Environment at the Department for Environment, Food and Rural Affairs and previously held various senior appointments within Government, including being head of the water directorate during the period of water privatisation. She is also a Crown Estate Counsellor, a non-executive director of the Land Trust and Keep Britain Tidy and, until recently, a director of Aberdeen Smaller Companies High Investment Trust.

Kenneth David Woodier, Solicitor, CMA, DMS, CPE (Law)
Group General Counsel & Company Secretary
Committees
Executive

Appointed company secretary to the Board in March 1998. Ken was formerly the head of group legal services at Pennon Group Plc (then South West Water Plc) from February 1990. Previously he held senior legal positions with H.P. Bulmer (Holdings) Plc, Investors in Industry Plc (3i) and Severn Trent Water. He is a director of the Devon & Somerset Law Society and a member of its governance committee.

Corporate governance and internal control

The Board and its Committees

The Board

The Directors, independence and responsibilities

The Board of Directors at the end of the year comprised the Chairman, three Executive Directors and three Non-executive Directors. The Non-executive Directors were considered by the Board to be independent throughout the year. None of the relationships or circumstances set out in provision B.1.1 of the UK Corporate Governance Code (the Code) applied to them. Following this year's Annual General Meeting and subject to re-election, Dinah Nichols will have served on the Board for more than nine years since her first election. However Dinah has been determined by the Board to be independent. The Board is satisfied that she does and will continue to demonstrate independence of character and judgement in the performance of her role on the Board. All of the Non-executive Directors are considered to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations. Their biographies on pages 44 and 45 demonstrate a broad range of business and financial experience. Gerard Connell is the Senior Independent Non-executive Director. His duties include leading the annual evaluation of the performance of the Chairman by the Non-executive Directors and being available as an additional point of contact on the Board for shareholders. Gerard is also chairman of the Audit Committee and in accordance with the Code's principles relating to audit committee membership he has recent and relevant financial experience (as set out in his biography on page 44). Martin Angle is also a member of the Audit Committee and he has relevant financial experience as set out in his biography on page 44. 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 now subject to re-election each year in accordance with provision B.7.1 of the Code.

The search for an additional non-executive director is well under way. The intention is to appoint a director who is considered to be independent and who will be a member of the Remuneration, Audit, Nomination and Sustainability committees.

The Directors on the Board and their attendance at the 11 scheduled meetings of the Board during 2011/12 are shown below:

Board

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

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

How the Board operates

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

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

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

The training needs of Directors are reviewed as part of the performance evaluation process.

Performance evaluation

The Board has well developed 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 this year by an external governance consultancy, Lintstock. All participants' views were sought via an online questionnaire on a range of questions which were specifically designed by the Chairman and the Group General Counsel and Company Secretary in conjunction with Lintstock to ensure objective evaluation of performance. Responses were then summarised and evaluated by Lintstock for the Board and each Committee to consider and determine whether any changes should be made to be more effective. A meeting between the Chairman, the Group General Counsel & Company Secretary and Lintstock was then held to discuss the high level findings of the evaluation and to consider them in the context of governance developments generally. While performance was again considered to be satisfactory, there were a number of suggestions made to refine the overall effectiveness of the Board which the Board agreed should be introduced over the following months when appropriate. For example it was agreed that performance could be improved further through a number of minor changes to Board reports and discussions at the beginning of each meeting on topical issues.

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

Dealing with Directors' conflicts of interest

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

Board committees

Group policies allocate the tasks of giving detailed consideration to specified matters, to monitoring executive actions and to assessing reward, to the Board Committees as set out in the remaining sections of this Governance Report and the Directors' Remuneration Report on pages 52 and 53.

Gerard Connell, Audit Committee Chairman

The Audit Committee

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

Our activities during the year

A continuing focus this year has been reviewing the systems and controls in place in Viridor to manage its increasingly complex and regionalised businesses across the UK. It is important to ensure that Viridor continues to have appropriate processes and controls in place to manage the strong growth expected from its energy from waste plants, its developing recycling businesses and the major contracts with waste authorities. The Committee was pleased to note that plans are also being developed to deliver significant enhancements and upgrading of IT systems and that regular internal audits at local sites are demonstrating that new controls and systems put in place have been working satisfactorily.

In South West Water the emphasis has been on continuing to manage systems in place as efficiently as possible whilst ensuring that risks are being appropriately assessed and controls in place are operating satisfactorily. The Committee was pleased to note that South West Water's risk assessment and internal control processes remain robust.

We decided to review our risk review process this year bearing in mind that it is 12 years since the Group introduced detailed risk management policies and procedures in accordance with the Turnbull Recommendations. We appointed Deloitte to undertake a full review; to date we have received a valuable interim report which is to be followed up shortly by a presentation to the Committee and the Board to enable us to consider any changes which may be appropriate to existing processes.

As part of the Group's risk review process this year we have once again assessed the key areas of sensitivity to the Group and these are set out on pages 28 to 33. We have concentrated on the high level key risks to the Group and have provided an indication of how the level of risk has changed over the past year.

As reported in previous Annual Reports we continue to monitor carefully the effectiveness of our external auditors as well as their independence, bearing in mind that it is recognised there is a need to use our auditors' firm for non-audit services from time to time. We have full regard to the Auditing Practices Board's Ethical Standards and ensure that our procedures and safeguards meet these standards.

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

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

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

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

The Audit Committee continued

Set out on page 80 is the level of fees paid to the Company's auditors' firm for audit services, or audit-related services and non-audit services following the guidance proposed by the Auditing Practices Board's Ethical Standards Guidance for Auditors. It is recognised that the level of non-audit fees payable to the Company's auditors' firm in the past year was in excess of the audit fee paid. This was primarily due to fees paid to the corporate finance arm of the auditors' firm in relation to the major new PPP/PFI contract gains by Viridor. We considered carefully the reasons for the engagement of the auditors' firm in accordance with the process described above. Of paramount importance was the continuing independence of the auditors which the Committee was satisfied was maintained due to the safeguards followed by the auditors' firm as described above. We were also satisfied that it was appropriate to appoint the auditors' firm to undertake such work because of the auditors' firm's specialist knowledge and the limited number of consultants with the expertise to undertake such engagements. These PPP/PFI contracts are of vital importance to the long-term strategic development of Viridor and it is critical that Viridor should be able to benefit from the best advice available in the market. The number of PPP/PFI contract opportunities is expected to decline from 2012/13 onwards leading to a corresponding decline in corporate finance fees payable.

The Committee also acknowledged that the absolute level of non-audit fees payable to the Company's auditors is consistent with the level of non-audit fees incurred by many companies within the FTSE 100.

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

The areas of the business of the Group which received audit attention over the past year included Group treasury processes; business continuity management; information security and IT risks; Viridor site practices; credit management and debt collection; and core systems and processes.

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

- reviewing the accounting policies and reporting judgements adopted by the Group in preparing its financial statements. We were satisfied that they were appropriate to provide a fair assessment of the financial performance of the Group
- agreeing the external auditors' strategy for carrying out the audit during the past financial year
- carrying out a review of the Half Yearly Report with the external auditors
- considering a report from the external auditors on the review of the financial year-end and meeting them in the absence of management to discuss their remit and any issues arising from the audit, including management's treatment of significant judgements which the auditors had confirmed (following discussion with management) were considered to be satisfactory
- considering an internal control report from the external auditors which reviewed the co-ordination of activities with the Group's internal audit function
- keeping under review the effectiveness of the Group's internal controls, including all material financial, operational and compliance controls and risk management systems
- monitoring and reviewing the effectiveness of the Group's internal audit function and approving the annual internal audit plan
- reviewing the findings of the internal audit function and reviewing and monitoring management's responsiveness to such findings
- overseeing the relationship with the external auditors including their appointment, remuneration, re-appointment and the monitoring of their independence and objectivity particularly having regard to the supply of any non-audit services by the auditors' firm
- reviewing the level of audit and non-audit fees paid
- an updated fraud, anti-bribery and other irregularities policy and procedure to take account of the provisions of the new Bribery Act, which was subsequently approved by the Board.

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

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

Dinah Nichols, Sustainability Committee Chairman

Sustainability Committee[1]

Members	Appointment date	Attendance
Dinah Nichols (Chairman)	November 2006	5/5
Gerard Connell	November 2006	5/5
Martin Angle	December 2008	4/5
Colin Drummond	November 2006	4/5
Christopher Loughlin	November 2006	5/5

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

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

- the 2011/12 Group Sustainability Report and the associated Verifier's Report
- the South West Water and Viridor Sustainability Reports
- the Group's health and safety performance and plans
- the Verifier's recommendations for the next Sustainability Reports
- progress against the Sustainability targets for 2011/12
- Sustainability targets for 2012/13
- the annual review of Group policies
- a new community relations and investment policy
- developments and progress in carbon reduction driving sustainability within the Group supply chains.

In reporting on sustainability, the Company has sought to comply with the Association of British Insurers' Guidelines on Responsible Investment Disclosure. The Business review on pages 34 to 39 contains the Group's 2012 Annual Sustainability Report.

[1] (formerly Corporate Responsibility Committee).

Board committees' terms of reference

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

Ken Harvey, Nomination Committee Chairman

The Nomination Committee

Members	Appointment date	Attendance
Kenneth Harvey (Chairman)	March 1997	3/3
Gerard Connell	October 2003	3/3
Martin Angle	December 2008	3/3
Dinah Nichols	June 2003	3/3

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

During the year the Committee considered the annual performance evaluation results for the Committee; considered and approved the appointments of an executive director and a non-executive director to the Viridor board; reviewed equality and diversity arrangements throughout the Group; and commenced the process, with the assistance of external search consultants, for the appointment of a further Non-executive Director to the Board taking account of the recommendations of the Lord Davies Review, 'Women on Boards'.

Gender Diversity – The Board's policy

In accordance with the Lord Davies Review recommendations and the expected changes to the UK Corporate Governance Code (the Code) the Committee is pleased to report that the Board has adopted a Boardroom Diversity Policy which confirms that the Board is committed to:

- the search for Board candidates being conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the Board, including gender
- satisfying itself that plans are in place for orderly succession of appointments to the Board and to senior management to maintain an appropriate balance of skills and experience within the Group and on the Board and to ensure progressive refreshing of the Board.

In addition, within the spirit of Principle B.2 of the Code, the Board will endeavour to achieve and subsequently maintain:

- a minimum of 25% female representation on the Board by 2015 (and maintain the current 14% representation until the higher percentage is achieved)
- a minimum of 25% female representation on the Group's senior management team by 2015.

Currently the Group has 14% female representation at Board level and in a workforce of circa 4,500 some 16% are women. In senior/middle management executive positions the female representation is circa 18%.

As well as its Boardroom Diversity Policy the Group has a number of policies embracing workplace matters, including non-discrimination and equal opportunities policies.

The Committee is required by the Board to review and monitor compliance with the Boardroom Diversity Policy and report on the targets, achievement against those targets and overall compliance in the Annual Report each year.

The Remuneration Committee

Details of the Remuneration Committee and the Directors' remuneration report can be found on pages 52 to 60.

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 2011/12 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 UK Corporate Governance Code and the 'Guidance on Internal Control' (The Turnbull Guidance) which suggests means of applying the internal control part of the Code. As part of these procedures the Board has a Group Risk Management Policy (GRMP) which provides for the identification of key risks in relation to the achievement of the business objectives of the Group, monitoring of such risks and annual evaluation of the overall process, as described in more detail below. The GRMP is applied by all business units within the Group in accordance with an annual timetable.

Risk identification

A full risk and control assessment is undertaken annually by the management of each business to identify financial and non-financial risks which are then regularly updated. Each business compiles (as part of regular management reports) an enhanced and focused assessment of key risks against corporate objectives. At each meeting the Board 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.

We also have a Whistleblowing policy and we thoroughly investigate any allegations of misconduct and irregularity and consider the implications for our control environment. In the normal course of business investigations into irregularities may be ongoing as of the date of the approval of the financial statements.

All of these processes serve to ensure that a culture of effective control and risk management is embedded within the organisation and that the Group is in a position to react appropriately to new risks as they arise. Details of key risks affecting the Group are set out in the Business review on pages 28 to 33.

Internal control framework

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

This framework comprises:

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

Internal control review

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

In addition the Audit Committee regularly reviews the operation and effectiveness of the internal control framework and annually reviews the scope of work, authority and resources of the Company's internal audit function. The Committee reports and makes recommendations to the Board on such reviews. For

2011/12 and up to the date of the approval of the Annual Report and Accounts, both the Audit Committee and the Board were satisfied with the effectiveness of the GRMP and the internal control framework and their operation within the Group.

Further information on the internal control review is set out on page 47 in relation to the Audit Committee.

Going concern

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

Directors' responsibilities statements

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

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

In preparing these financial statements the Directors are required to:

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

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, article 4 of the International Accounting Standards (IAS) Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the Directors, whose names and functions are listed on pages 44 and 45, confirms that, to the best of their knowledge:

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

b) the Directors' report contained on pages 2 to 41 includes a fair review of the development and performance of the business and position of the Company and the Group, together with a description of the principal risks and uncertainties they face.

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

Corporate governance statements

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

As at 31 March 2012:

a) details of the Company's issued share capital, which consists of Ordinary shares of nominal value 40.7 pence each, are set out in note 31 to the financial statements on pages 101 to 103. All of the Company's issued shares are fully paid up, rank equally in all respects and are listed on the Official List and traded on the London Stock Exchange. The rights and obligations attaching to the Company's shares, in addition to those conferred on their holders by law, are set out in the Company's Articles of Association ('Articles'), copies of which can be obtained from Companies House in the UK or by writing to the Group Company Secretary at the Company's registered office.

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

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

c) details of significant direct or indirect holdings of securities of the Company are set out in the shareholder analysis on page 113;

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

e) the Directors have the power to make purchases of the Company's own shares in issue as set out in the Directors' report on page 41 'Purchase of own Ordinary shares'. No such purchases have been made during the year. The Directors also have the authority to allot shares up to an aggregate nominal value of (i) £48,541,689 (such amount to be reduced by any shares allotted or rights granted under (ii) below in excess of £48,541,689) or (ii) £97,083,378 by way of rights issue (such amount to be reduced by any shares allotted or rights granted from (i)) above) which were approved by shareholders at the 2011 Annual General Meeting (AGM). In addition, shareholders approved a resolution giving the Directors a limited authority to allot shares for cash other than pro rata to existing shareholders. These resolutions remain valid until the conclusion of this year's AGM. Similar resolutions will be proposed at this year's AGM. The Directors have no present intention to issue Ordinary shares other than pursuant to the Company's employee share schemes and Scrip Dividend Alternative; and

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

By Order of the Board

Ken Woodier
Group General Counsel & Company Secretary
18 June 2012

Directors' remuneration report

Dear shareholder

I am pleased to present the remuneration report for 2012 on behalf of the Board. We will be presenting this report for your approval at our Annual General Meeting in July.

This report is designed to provide you with details of:

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

We appreciate that there remains investor concern relating to executive director remuneration generally and, whilst focus has been on the financial sector primarily, it is fully recognised that there is a need for other sectors to continue to take account of this concern in reviewing and setting their remuneration policies and overall remuneration practice. This is why we asked our remuneration consultants recently to undertake a review of our incentive benefits to ensure that they continue to be aligned with creating shareholder value and only provide rewards to Directors commensurate with the achievements of the Group. I am pleased to say that our consultants confirm that this is the position. As a result we do not propose any changes to our remuneration arrangements which have been in place without amendment for the past five years.

The essential elements of our remuneration package and their purpose therefore continue to be as set out below.

Martin Angle, Remuneration Committee Chairman

The Remuneration Committee

Members	Appointment date	Attendance
Martin Angle (Chairman)	December 2008	3/4
Gerard Connell	October 2003	4/4
Dinah Nichols	June 2003	4/4

Elements of remuneration

Type of Remuneration	Description	Purpose
Fixed		
Base Salary	Annual salary set by reference to market level appropriate for role and based on individual skills, experience and performance	Rewards appropriately for the role undertaken and assists in key person retention and recruitment
Pension	Final Salary (Defined Benefit) for existing Directors/ Defined Contributions for any new appointees or cash alternative commensurate with market level pension arrangements	Assists in key person retention and recruitment
Variable		
Short-term – Annual: Annual Incentive Bonus Plan – Maximum 100% of basic salary with 50% paid in cash and 50% in shares deferred for three years	Assessed against corporate financial performance and individual personal achievements relating to a range of operational and compliance targets	Incentive for annual performance across the Group at individual and team level. The deferred element also assists in key person retention and recruitment
Long-term – three years: Performance and Co-investment Plan (PCP) – future performance over three years	Total shareholder return performance criteria – 50% linked to water and waste comparator group and 50% linked to relative FTSE 250 with an underpin relating to operational and economic performance	A long-term reward which aligns Directors' performance to shareholder value and which drives sustainable practices and assists in key person retention and recruitment.

The Committee's Terms of Reference include:

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

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

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

- Ken Woodier, Group General Counsel & Company Secretary, on remuneration and share scheme matters. He also provides legal advice and company secretarial services to the Company
- Deloitte LLP, auditing and remuneration consultants, on calculating the Company's total shareholder return compared with two comparator groups for the Company's Performance and Co-investment Plan. Deloitte also provide financial, tax and risk management review advice to the Company
- Aon Hewitt Limited, pensions and remuneration consultants, on providing advice on pension benefits. Aon Hewitt also provided actuarial and investment advice to the Company and to the Trustees of the Group's pension schemes
- Towers Watson UK Limited, remuneration consultants, on the Company's Director and senior management annual incentive benefits framework.

Remuneration policy

The Group's remuneration policy which will be applied in 2012/13, and is also currently intended to be applied in each subsequent year, continues to be to provide a remuneration package for Executive Directors which is adequate to attract, retain and motivate good quality executives and which is commensurate with the remuneration packages provided by companies of similar size and complexity. The key guiding principles of this policy are to:

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

The policy in respect of Non-executive Directors' fees is set out on page 56 in the Non-executive Directors' remuneration section.

In setting executive remuneration the Committee not only takes account of employment market conditions, but seeks to ensure that there are coherent pay and benefit structures across the Group which are consistent with the remuneration packages of the Executive Directors and senior management. From summary reports on workforce remuneration and terms and conditions of employment by the Executive Directors with regard to their respective business areas, the Committee has regard to the general levels of responsibility, qualifications and experience required throughout the Group in setting salary and other benefits of the Executive Directors and senior management. The Committee also ensures that the incentive structures do not raise environmental, social or governance (ESG) risks by inadvertently motivating irresponsible behaviour. A number of individual performance objectives specifically relate to achieving non-financial, including ESG, targets (as outlined on page 54).

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

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

(i) **Basic salary and benefits** – these are set out on page 57 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. Last year the general increase was 4.0%. When reviewing base salaries the Committee takes account of the performance of the individual Executive Directors which the Committee assesses with the advice of Ken Harvey, Chairman of the Company. Other benefits, not mentioned below, include four times salary life assurance cover; a fully expensed car or a cash alternative; and health cover.

(ii) **Performance-related bonus** – annual performance related bonuses are awarded in accordance with the Group's Annual Incentive Bonus Plan (the Bonus Plan) and are based on the achievement by the Executive Directors of overall corporate and individual objectives set by the Committee. The maximum bonus achievable under the Bonus Plan for Executive Directors for 2011/12 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 Sustainability report on pages 34 to 39 of the Business review. The Committee in setting such objectives and in determining its remuneration policy overall ensures that the relevant incentives to Directors and senior management aligns their interests with shareholders and raise no ESG risks by inadvertently motivating irresponsible behaviour.

The Bonus Plan is also operated in conjunction with the Company's Executive Share Option Scheme (ESOS) on the basis that the aggregate pre-tax value of the awards made under both the Bonus Plan and the ESOS would be the same as they would have been if the Bonus Plan had been operated alone, which was the position prior to 2009/10. This is achieved by providing for Deferred Bonus Shares awarded to be forfeited by the Directors up to the same value as that of any gain made in respect of options exercised by the Directors pursuant to the ESOS at the end of the three-year restricted period. Only the HMRC approved part of the ESOS was operated in 2009/10 which enabled options over Ordinary shares in the Company to be granted to Directors to the value of £30,000 at the then prevailing price. No further options will be granted to the Executive Directors pursuant to the Bonus Plan until the existing options either are exercised or lapse at the end of the three-year restricted period in September this year. Details of the options are set out in the table in paragraph (d) on page 60.

Set out below is a summary of the performance targets determined by the Committee for each Executive Director for 2012/13. These are similar to the targets applied for 2011/12.

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

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

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

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 2011 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 2011 will vest based on the Company's total shareholder return (TSR) performance over the Restricted 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 2010 and July 2009. TSR measures the value created for shareholders through increases in share price and the payment of dividends and was applied by the Committee because, based upon advice received from remuneration consultants, Deloitte LLP, it believes that this is an appropriate measure to align the interests of the Executive Directors with those of shareholders:

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

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

These companies are regarded as the Company's key listed comparators.

* As Northumbrian Water Group was delisted from the London Stock Exchange in October 2011 the Committee in respect of the July 2011 award at the end of the three-year Restricted Period will have discretion to include this company in the calculation of the index up to the date of delisting (or other earlier date at its discretion) and exclude the company from the date onwards or adopt an alternative approach.

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

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

FTSE 250 Index (excluding investment trusts)	Vesting
At or above the 75th percentile	50%
Above 50th percentile	15%
Straight-line vesting in between above positions	
At or below the 50th percentile	0%

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

For the PCP awards made in August 2008 the same performance measures were used as set out above except that Suez Environnement was listed part-way through the performance period on 21 July 2008 and was included In the calculation of the index value from that date onwards. The calculation of TSR performance over the three-year performance period (being 1 April 2008 to 1 April 2011) for these PCP awards was undertaken by Deloitte LLP for the Committee. The table below summarises the calculation:

Comparator group	Portion of award	Rank	Percentile rank	Final vesting level
Waste/Water index	50%	17.2% outperformance against index	–	50.0%
FTSE 250 (excluding investment trusts)	50%	103rd out of 186	44.9%	0.0%
Total vesting				50.0%

The Committee was satisfied that the 'Underpin' condition referred to above had been met and therefore approved the vesting of 50.0% of the award as calculated by Deloitte (together with shares equivalent to the value of dividends declared during the Restricted Period on such shares) with the remaining 50.0% lapsing.

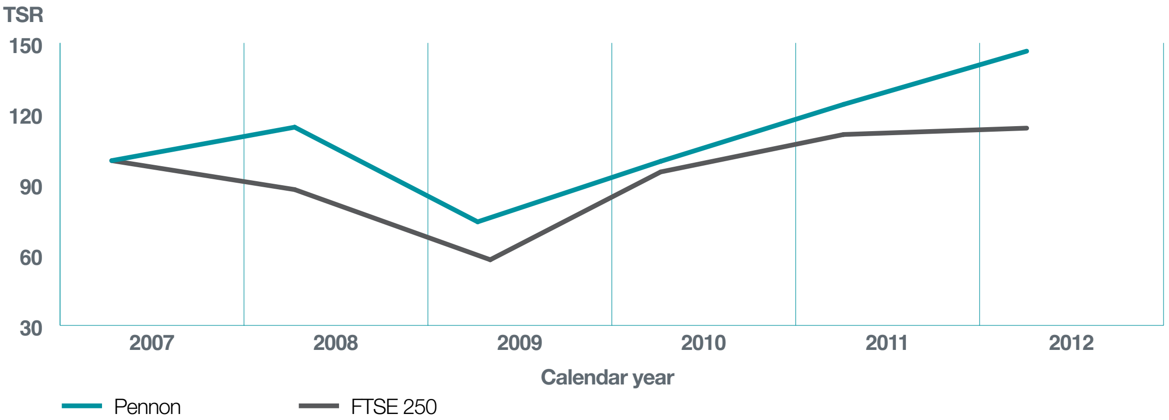
(iv) **Other share schemes** – Executive Directors are entitled to participate in the Company's Sharesave Scheme and Share Incentive Plan. Both are all-employee plans to which performance conditions do not apply.

(v) **Service contracts** – In accordance with Company policy, all Executive Directors have service contracts subject to one year's notice. David Dupont's and Chris Loughlin's service contracts are due to expire when they reach their normal retirement age of 60. However it is expected that they will be extended by agreement between each Director and the Company. Colin Drummond reached his normal retirement date on 22 February 2011 and has continued in employment with the Company in the same position as Chief Executive, Viridor, and as a Director of the Pennon Group Board. His service contract with the Company continues subject to one year's notice.

No provision is made for termination payments under the service contracts. In the event of an early termination of a Director's service contract, the Committee's policy is to ensure that any compensation payable (whether share-based or cash) reflects the Director's performance and 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

Total shareholder return (TSR)



The graph above shows the value, over the five-year period ending on 31 March 2012, of £100 invested in Pennon Group on 31 March 2007 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.

(vi) **Provision for pensions** – During the year David Dupont participated in the Pennon Group Pension Scheme and the Pennon Group Executive Pension Scheme until 3 March 2012 when he decided to take his benefits early. 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 up to an Earnings Cap which ceased to apply in the Executive Scheme from 6 April 2006.

David Dupont had been provided with additional pension benefits under an unapproved funded Supplementary Pension Scheme of the Company in order to bring his 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 statutory Earnings Cap no longer applied to pension schemes as part of the simplification of taxation of pensions legislation. The Committee accordingly decided to provide future service pension benefits above the Earnings Cap level from the Pennon Group Executive Pension Scheme to Directors who were members of that 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 David Dupont consisted of the highest basic salary in any consecutive twelve-month period of service within five years of retirement. Bonuses are not included in pensionable pay.

Colin Drummond and Chris Loughlin receive an annual payment (payable by monthly instalments) equivalent to 30% of each of their annual basic salaries in lieu of the provision of pension benefits. David Dupont from 3 March 2012 is also entitled to receive a similar benefit but, with the agreement of the Company, has had his pension accrued benefit augmented by the sum of £94,062 paid for by the Employer which will be deducted from the annual payment to be paid in lieu of pension benefit.

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.

Non-executive Directors and the Chairman

Non-executive Directors' remuneration (excluding that of the Chairman, Ken Harvey) consisting of fees only as set out below, is determined by the Board of Directors, including the Chairman, but in the absence of the other Non-executive Directors. It is usually reviewed each year to take account of market changes in Non-executive Directors' fees. In reviewing the fees, the Board takes into account market information on Non-executive Directors' fees. The fees were reviewed last year and increased by between 4.5% and 4.76%. The base Non-executive Director fee in the year was £40,000 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 members of these committees 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 reviewed last year and increased by 4.4% by the Committee.

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

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

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

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

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

Director	Date of contract	Expiry date of contract
Martin Angle	28 November 2008	30 November 2014
Gerard Connell	30 September 2003	31 July 2014
Dinah Nichols	10 June 2003	25 July 2013

The above contracts do not contain any notice periods.

The information set out below and on the remaining pages of this Remuneration Report (pages 58 to 60) has been audited by the Group's independent auditors, PricewaterhouseCoopers LLP.

Emoluments of Directors

The emoluments of individual Directors holding office during 2011/12 were:

Director	Salary/fees £000	Performance related bonus payable[1] £000	Other emoluments[2] £000	Payment in lieu of pension[3] £000	Total 2012 Year to 31 March £000	Total 2011 Year to 31 March £000
Chairman:						
Ken Harvey	240	–	23	–	263	253
Executive Directors:						
Colin Drummond	359	97	24	108	588	546
David Dupont	359	140	25	94*	618	531
Chris Loughlin	359	156	24	108	647	632
Non-executive Directors:						
Martin Angle	55	–	–	–	55	52
Gerard Connell	58	–	–	–	58	55
Dinah Nichols	55	–	–	–	55	52
Total	1,485	393	96	310	2,284	2,121

1 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 59.

2 Other emoluments are car benefit and health cover.

3 In lieu of any pension provision by the Company, Colin Drummond, David Dupont (from 3 March 2012) and Chris Loughlin received cash payments equivalent to 30% of each of their annual basic salaries. * David Dupont's cash payment of £94,062 represents in part a pre-payment as set out in '(vi) Provision for pensions' on page 56 which has augmented his pension entitlement and is included in the pension benefit figures set out below in the Executive Directors' pensions table.

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 2011/12 were:

Director	Decrease in accrued pension during 2011/12 (net of inflation) £000 a	Increase/ decrease in accrued pension during 2011/12 £000 b	Accrued pension at 31 March 2012 £000 c	Transfer value at 31 March 2012 £000 d	Transfer value at 31 March 2011 £000 e	Increase in transfer value (net of Directors' con-tributions) £000 f	Decrease in transfer value of Column a (net of Directors' con-tributions) £000 g
Colin Drummond	(3)	3	124	3,379	2,710	670	(92)
David Dupont	(19)	(11)	134	3,918	3,150	739	(573)

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

a) increase/decrease in accrued pension during 2011/12 (net of inflation)

b) increase/decrease in accrued pension during 2011/12

c) accrued pension at 31 March 2012 payable at normal retirement age

d) transfer value of the accrued pension in c) as at 31 March 2012

e) transfer value of the accrued pension at the end of the previous financial year on 31 March 2011

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

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

Colin Drummond was a pensioner member of the Pennon Group's pension schemes during the year. As such no further benefits were accrued and no employee or employer contributions were paid (other than the employer's deficit reduction contributions). The accrued pension at 31 March 2012 (column c) therefore shows the actual pension in payment at 31 March 2012. The increase in Colin's accrued pension over the year (column b) is solely as a result of indexation of his pension as set out in the schemes' rules.

The accrued pension at 31 March 2012 (column c) for David Dupont is lower than the pension amount quoted in the 31 March 2011 accounts as David decided to draw his pension from the Pennon Group's pension schemes early from 3 March 2012. On taking his benefits David made a tax payment of £287,880 which was deducted from his accrued benefit. The accrued pension figure at 31 March 2012 (column c) therefore reflects the residual pension in payment at that date.

The increase in transfer value over the year (column f) is mainly as a result of the large fall in gilt yields between 31 March 2011 and 31 March 2012.

Directors' share interests

(a) Shareholdings

The number of Ordinary shares of the Company in which Directors held beneficial interests at 31 March 2012 and 31 March 2011 were:

Director	2012 Ordinary shares (40.7p each)	2011 Ordinary shares (40.7p each)
Martin Angle	–	–
Gerard Connell	4,000	4,000
Colin Drummond	288,163	263,225
David Dupont	262,671	237,945
Ken Harvey	26,209	18,209
Chris Loughlin	97,745	58,534
Dinah Nichols	4,549	4,549

Since 31 March 2012 1,991 additional Ordinary shares (40.7p each) in the Company have been acquired by Chris Loughlin as a result of participation in the Company's Scrip Dividend Alternative and the Company's Share Incentive Plan and 212 additional Ordinary shares (40.7p each) in the Company have been acquired by David Dupont as a result of dividend reinvestment in an ISA. There have been no other changes in the beneficial interests or the non-beneficial interests of the Directors in the Ordinary shares of the Company between 1 April 2012 and 8 June 2012.

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

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

Director and date of award	Conditional awards held at 1 April 2011	Conditional awards made in year	Market price upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2012	Date of end of period for qualifying conditions to be fulfilled
Colin Drummond							
10/7/08	51,764	–	637.50p	29,118*	199	–	9/7/11
1/7/09	67,831	–	486.50p	–	–	67,831	30/6/12
2/7/10	63,186	–	546.00p	–	–	63,186	1/7/13
1/7/11	–	51,432	698.00p	–	–	51,432	1/7/14
David Dupont							
10/7/08	51,764	–	637.50p	29,118*	199	–	9/7/11
1/7/09	67,831	–	486.50p	–	–	67,831	30/6/12
2/7/10	63,186	–	546.00p	–	–	63,186	1/7/13
1/7/11	–	51,432	698.00p	–	–	51,432	1/7/14
Chris Loughlin							
10/7/08	49,411	–	637.50p	27,795*	190	–	9/7/11
1/7/09	64,748	–	486.50p	–	–	64,748	30/6/12
2/7/10	63,186	–	546.00p	–	–	63,186	1/7/13
1/7/11	–	51,432	698.00p	–	–	51,432	1/7/14

* 50.0% of the 10 July 2008 award shares vested on 10 July 2011 as explained in the section (iii) 'Long-term incentive plan' on page 54 of this report at a market price of £6.85 per share. The total number of shares that vested included additional shares equivalent in value to such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on the vested shares during the Restricted Period of three years. The balance of the award lapsed.

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

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

Director and date of award	Conditional awards held at 1 April 2011	Conditional awards made in year	Market price upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2012	Date of end of period for qualifying conditions to be fulfilled
Colin Drummond							
27/6/08	22,838	–	620.00p	22,838*	151	–	26/6/11
29/9/09*	16,730	–	473.40p	–	–	16,730	28/9/12
27/7/10	27,091	–	572.50p	–	–	27,091	26/7/13
27/7/11	–	23,079	725.00p	–	–	23,079	26/7/14
David Dupont							
27/6/08	21,145	–	620.00p	21,145*	139	–	26/6/11
29/9/09*	17,880	–	473.40p	–	–	17,880	28/9/12
27/2/10	755	–	524.50p	–	–	755	26/2/13
27/7/10	25,938	–	572.50p	–	–	25,938	26/7/13
27/7/11	–	22,365	725.00p	–	–	22,365	26/7/14
Chris Loughlin							
27/6/08	18,806	–	620.00p	18,806*	124	–	26/6/11
29/9/09*	19,562	–	473.40p	–	–	19,562	28/9/12
27/2/10	1,261	–	524.50p	–	–	1,261	26/2/13
27/7/10	25,133	–	572.50p	–	–	25,133	26/7/13
27/7/11	–	22,141	725.00p	–	–	22,141	26/7/14

* In addition to the awards made on 29 September 2009 the Directors also received options pursuant to the Company's Executive Share Option Scheme (the ESOS), details of which are set out in the table of paragraph (d) on page 60. These awards were made in conjunction with the operation of the Bonus Plan. In the event that the ESOS options are exercised by the Directors, shares from the Bonus Plan equivalent in value to the gain on the ESOS options will be forfeited. Further details of the operation of the ESOS in relation to the Bonus Plan are set out in paragraph (ii) 'Performance-related bonus' on page 53.

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

Colin Drummond £16,473; David Dupont £16,409; Chris Loughlin £16,536.

Chris Loughlin also received Ordinary shares (40.7p each) in the Company as a result of participation in the Company's Scrip Dividend Alternative and these shares are included in the figure given for the additional Ordinary shares (40.7p each) in the Company that he acquired since 31 March 2012 given on page 58.

A further conditional award of shares will be made in 2012/13 to the value of the amount of the performance-related cash bonus shown in the Emoluments of Directors table on page 57. Paragraph (ii) 'Performance-related bonus' on page 53 sets out the provisions relating to the conditional award of shares pursuant to the Bonus Plan.

(d) Executive Share Option Scheme

The following Directors have a contingent interest in the number of options in the Ordinary shares (40.7p each) of the Company pursuant to the Company's Executive Share Option Scheme shown below. Further details relating to the operation of the Scheme are set out in paragraph (ii) 'Performance-related bonus' on page 54.

Director and date of grant	Options held at 1 April 2011	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 2012	Options held at 31 March 2012	Maturity date
Colin Drummond 29/9/09	6,337	–	–	473.40p	–	711.50p	6,337	28/9/12
David Dupont 29/9/09	6,337	–	–	473.40p	–	711.50p	6,337	28/9/12
Chris Loughlin 29/9/09	6,337	–	–	473.40p	–	711.50p	6,337	28/9/12

(e) Sharesave Scheme

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

Director and date of grant	Options held at 1 April 2011	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 2012	Options held at 31 March 2012	Exercise period/ maturity date
Colin Drummond 6/7/09	2,351	–	–	386.00p	–	711.50p	2,351	1/9/12 – 28/2/13
David Dupont 3/7/07	3,136	–	–	522.00p	–	711.50p	3,136	1/9/12 – 28/2/13
Chris Loughlin 3/7/07	3,136	–	–	522.00p	–	711.50p	3,136	1/9/12 – 28/2/13

(f) Share price

The market price of the Ordinary shares (40.7p each) of the Company at 31 March 2012 was 711.50p (2011 625.00p) and the range during the year was 620.00p to 737.50p (2010/11 482.90p to 650.00p).

Basis of preparation

The Remuneration report has been prepared in accordance with the Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (the Regulations) and meets the relevant requirements of the FSA Listing Rules. In accordance with the Regulations, the following sections of the Remuneration report are subject to audit: Emoluments of Directors; Executive Directors' Pensions; and Directors' Share Interests (including long-term incentive plan and bonus plan awards and their vesting criteria and executive share options and sharesave) for which the independent auditors' opinion thereon is expressed on page 61. The other sections are not subject to audit nor are the pages referred to from within the audited sections.

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

Martin Angle
Chairman of the Remuneration Committee
18 June 2012

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 2012 which comprise Consolidated income statement, the Consolidated statement of comprehensive income, the Group and Company Balance sheets, the Group and Company Statements of changes in equity, the Group and Company Cash flow statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the 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 51, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Company's affairs as at 31 March 2012 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 42 to 43 and 46 to 51 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 26, in relation to going concern;
- the parts of the corporate governance statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

David Charles (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP Chartered Accountants and Statutory Auditors

Bristol

18 June 2012

Consolidated income statement

For the year ended 31 March 2012

	Notes	2012 £m	2011 £m
Revenue	5	**1,233.1**	1,159.2
Operating costs	6		
Manpower costs		**(155.4)**	(148.3)
Raw materials and consumables used		**(133.9)**	(121.6)
Other operating expenses		**(528.0)**	(486.7)
Depreciation and amortisation		**(147.0)**	(141.7)
Operating profit	5	**268.8**	260.9
Finance income	7	**119.3**	45.1
Finance costs	7	**(191.6)**	(121.8)
Net finance costs	7	**(72.3)**	(76.7)
Share of post-tax profit from joint ventures	19	**4.0**	4.3
Profit before tax	5	**200.5**	188.5
Taxation	8	**(28.1)**	(16.9)
Profit for the year		**172.4**	171.6
Profit attributable to equity shareholders		**172.4**	171.6
Earnings per share (pence per share)	10		
– Basic		**48.1**	48.4
– Diluted		**47.8**	48.1

The notes on pages 67 to 111 form part of these financial statements.

Financial statements
Consolidated statement of comprehensive income
For the year ended 31 March 2012

	Notes	2012 £m	2011 £m
Profit for the year		**172.4**	171.6
Other comprehensive loss			
Actuarial (losses)/gains on defined benefit pension schemes	28	**(51.7)**	2.4
Net fair value losses on cash flow hedges		**(24.7)**	(0.1)
Share of other comprehensive loss from joint ventures	19	**(5.4)**	(3.0)
Deferred tax credit/(charge) on items taken directly to or transferred from equity	8, 29	**16.0**	(3.3)
Other comprehensive loss for the year net of tax	34	**(65.8)**	(4.0)
Total comprehensive income for the year		**106.6**	167.6
Total comprehensive income attributable to equity shareholders		**106.6**	167.6

The notes on pages 67 to 111 form part of these financial statements.

Balance sheets

At 31 March 2012

	Notes	Group 2012 £m	Group 2011 (Restated note 37) £m	Company 2012 £m	Company 2011 £m
Assets					
Non-current assets					
Goodwill	14	**327.1**	300.4	**–**	–
Other intangible assets	15	**17.5**	4.4	**–**	–
Property, plant and equipment	16	**3,082.8**	2,922.7	**0.2**	0.3
Other non-current assets	18	**138.4**	116.0	**352.0**	367.7
Financial assets at fair value through profit		**–**	2.6	**–**	–
Deferred tax assets	29	**–**	–	**4.6**	4.2
Derivative financial instruments	22	**21.9**	–	**–**	–
Investments in subsidiary undertakings	19	**–**	–	**1,172.1**	1,032.0
Investments in joint ventures	19	**0.1**	1.5	**–**	–
		3,587.8	3,347.6	**1,528.9**	1,404.2
Current assets					
Inventories	20	**9.0**	7.2	**–**	–
Trade and other receivables	21	**238.4**	219.0	**91.7**	92.7
Financial assets at fair value through profit		**0.5**	0.9	**–**	–
Derivative financial instruments	22	**9.7**	6.9	**8.9**	6.6
Current tax recoverable	25	**–**	–	**2.6**	1.7
Cash and cash deposits	23	**425.3**	555.5	**158.9**	236.6
		682.9	789.5	**262.1**	337.6
Liabilities					
Current liabilities					
Borrowings	26	**(325.5)**	(99.2)	**(534.4)**	(316.1)
Derivative financial instruments	22	**(16.6)**	(5.3)	**–**	–
Trade and other payables	24	**(242.5)**	(253.5)	**(10.8)**	(11.1)
Current tax liabilities	25	**(59.7)**	(79.5)	**–**	–
Provisions	30	**(25.6)**	(16.3)	**–**	–
		(669.9)	(453.8)	**(545.2)**	(327.2)
Net current assets/(liabilities)		**13.0**	335.7	**(283.1)**	10.4
Non-current liabilities					
Borrowings	26	**(2,204.4)**	(2,390.1)	**(356.8)**	(572.9)
Other non-current liabilities	27	**(76.9)**	(30.4)	**(8.7)**	(8.7)
Financial liabilities at fair value through profit		**(16.7)**	–	**–**	–
Derivative financial instruments	22	**(32.0)**	(16.3)	**–**	–
Retirement benefit obligations	28	**(98.6)**	(85.8)	**(7.8)**	(6.8)
Deferred tax liabilities	29	**(273.8)**	(292.5)	**–**	–
Provisions	30	**(76.3)**	(88.7)	**–**	–
		(2,778.7)	(2,903.8)	**(373.3)**	(588.4)
Net assets		**822.1**	779.5	**872.5**	826.2
Shareholders' equity					
Share capital	31	**148.2**	147.0	**148.2**	147.0
Share premium account	32	**8.0**	9.2	**8.0**	9.2
Capital redemption reserve	33	**144.2**	144.2	**144.2**	144.2
Retained earnings and other reserves	34	**521.7**	479.1	**572.1**	525.8
Total shareholders' equity		**822.1**	779.5	**872.5**	826.2

The notes on pages 67 to 111 form part of these financial statements.

The financial statements on pages 62 to 111 were approved by the Board of Directors and authorised for issue on 18 June 2012 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 Number 2366640

Financial statements
Statements of changes in equity
For the year ended 31 March 2012

Group	Share capital (Note 31) £m	Share premium account (Note 32) £m	Capital redemption reserve (Note 33) £m	Retained earnings and other reserves (Note 34) £m	Total equity £m
At 1 April 2010	145.3	10.9	144.2	362.5	662.9
Profit for the year	–	–	–	171.6	171.6
Other comprehensive loss for the year	–	–	–	(4.0)	(4.0)
Total comprehensive income for the year	–	–	–	167.6	167.6
Transactions with equity shareholders					
Dividends paid	–	–	–	(79.6)	(79.6)
Adjustment for shares issued under the Scrip Dividend Alternative	1.7	(1.7)	–	22.8	22.8
Adjustment in respect of share-based payments (net of tax)	–	–	–	3.9	3.9
Transfer from hedging reserve to property, plant and equipment	–	–	–	0.3	0.3
Proceeds from treasury shares re-issued	–	–	–	1.6	1.6
Total transactions with equity shareholders	1.7	(1.7)	–	(51.0)	(51.0)
At 31 March 2011	147.0	9.2	144.2	479.1	779.5
Profit for the year	–	–	–	172.4	172.4
Other comprehensive loss for the year	–	–	–	(65.8)	(65.8)
Total comprehensive income for the year	–	–	–	106.6	106.6
Transactions with equity shareholders					
Dividends paid	–	–	–	(88.2)	(88.2)
Adjustment for shares issued under the Scrip Dividend Alternative	1.2	(1.2)	–	19.1	19.1
Adjustment in respect of share-based payments (net of tax)	–	–	–	3.5	3.5
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	–	–	–	(0.3)	(0.3)
Proceeds from treasury shares re-issued	–	–	–	1.9	1.9
Total transactions with equity shareholders	1.2	(1.2)	–	(64.0)	(64.0)
At 31 March 2012	**148.2**	**8.0**	**144.2**	**521.7**	**822.1**

Company	Share capital (Note 31) £m	Share premium account (Note 32) £m	Capital redemption reserve (Note 33) £m	Retained earnings and other reserves (Note 34) £m	Total equity £m
At 1 April 2010	145.3	10.9	144.2	487.4	787.8
Profit for the year	–	–	–	90.1	90.1
Other comprehensive income for the year	–	–	–	2.7	2.7
Total comprehensive income for the year	–	–	–	92.8	92.8
Transactions with equity shareholders					
Dividends paid	–	–	–	(79.6)	(79.6)
Adjustment for shares issued under the Scrip Dividend Alternative	1.7	(1.7)	–	22.8	22.8
Adjustment in respect of share-based payments (net of tax)	–	–	–	0.8	0.8
Proceeds from treasury shares re-issued	–	–	–	1.6	1.6
Total transactions with equity shareholders	1.7	(1.7)	–	(54.4)	(54.4)
At 31 March 2011	147.0	9.2	144.2	525.8	826.2
Profit for the year	–	–	–	116.3	116.3
Other comprehensive loss for the year	–	–	–	(3.6)	(3.6)
Total comprehensive income for the year	–	–	–	112.7	112.7
Transactions with equity shareholders					
Dividends paid	–	–	–	(88.2)	(88.2)
Adjustment for shares issued under the Scrip Dividend Alternative	1.2	(1.2)	–	19.1	19.1
Adjustment in respect of share-based payments (net of tax)	–	–	–	0.8	0.8
Proceeds from treasury shares re-issued	–	–	–	1.9	1.9
Total transactions with equity shareholders	1.2	(1.2)	–	(66.4)	(66.4)
At 31 March 2012	**148.2**	**8.0**	**144.2**	**572.1**	**872.5**

The notes on pages 67 to 111 form part of these financial statements.

Cash flow statements

For the year ended 31 March 2012

	Notes	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	35	**324.7**	376.2	**18.9**	(44.2)
Interest paid		**(74.5)**	(78.2)	**(22.7)**	(22.0)
Tax (paid)/received		**(41.4)**	(43.2)	**2.6**	(0.3)
Net cash generated/(outflow) from operating activities		**208.8**	254.8	**(1.2)**	(66.5)
Cash flows from investing activities					
Interest received		**13.2**	14.4	**23.3**	20.9
Dividends received		**–**	–	**117.5**	93.1
Acquisition of subsidiary undertakings (net of cash acquired)	37	**(29.2)**	(25.1)	**–**	–
Investments in subsidiary undertakings		**–**	–	**(140.1)**	–
Loans advanced to joint ventures		**(13.4)**	(12.5)	**–**	–
Loan repayments received from joint ventures		**3.6**	3.5	**–**	–
Purchase of property, plant and equipment		**(262.2)**	(190.3)	**–**	(0.2)
Proceeds from sale of property, plant and equipment		**4.6**	4.7	**–**	–
Net cash (used in)/received from investing activities		**(283.4)**	(205.3)	**0.7**	113.8
Cash flows from financing activities					
Proceeds from treasury shares re-issued	31	**1.9**	1.6	**1.9**	1.6
Purchase of Ordinary shares by the Pennon Employee Share Trust		**(0.3)**	–	**–**	–
Deposit of restricted funds (net)		**(0.1)**	(30.8)	**–**	–
Proceeds from new borrowing		**25.0**	187.0	**25.0**	139.9
Repayment of borrowings		**(71.0)**	(104.6)	**(35.0)**	(70.0)
Finance lease sale and lease back		**79.5**	–	**–**	–
Finance lease principal repayments		**(14.0)**	(20.5)	**–**	–
Dividends paid		**(69.1)**	(56.8)	**(69.1)**	(56.8)
Net cash (used in)/received from financing activities		**(48.1)**	(24.1)	**(77.2)**	14.7
Net (decrease)/increase in cash and cash equivalents		**(122.7)**	25.4	**(77.7)**	62.0
Cash and cash equivalents at beginning of the year	23	**414.9**	389.5	**235.2**	173.2
Cash and cash equivalents at end of the year	23	**292.2**	414.9	**157.5**	235.2

The notes on pages 67 to 111 form part of these financial statements.

Notes to the financial statements

1. General information
Pennon Group Plc is a company registered in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 64. Pennon Group's business is operated through two main subsidiaries. South West Water Limited holds the water and sewerage services appointments for Devon, Cornwall and parts of Dorset and Somerset. Viridor Limited's business is recycling, renewable energy and waste management.

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

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

The going concern basis has been adopted in preparing these financial statements as stated by the Directors on page 51.

New or revised standards or interpretations which were mandatory for the first time in the year beginning 1 April 2011 did not have a material impact on the net assets or results of the Group.

At the date of approval of these financial statements IFRS 11 Joint Arrangements and IAS 19 (Revised) Employee Benefits were in issue, but not yet effective. Other standards and interpretations in issue, but not yet effective, are not expected to have a material effect on the Group's net assets or results.

IFRS 11 is relevant to the Group, but it is not expected to have a material effect on the results or net assets, as the Group currently consolidates joint ventures on an equity basis.

The Directors anticipate that the adoption of IAS 19 'Employee benefits' revised, expected on 1 April 2013, will potentially have a material impact, dependent upon market conditions, on the financial statements of the Group. The revised standard is expected to increase net finance costs and operating costs. The extent of this impact is currently being assessed.

The preparation of financial statements in conformity with IFRS 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 subsidiaries, joint ventures and associate undertakings.

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

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

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

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

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

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

Income from electricity generated from waste management landfill gas production during the year includes an estimation of the amount to be received under Renewables Obligation Certificates.

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

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

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

2. Principal accounting policies continued

(d) Landfill tax

Landfill tax is included within both revenue and operating costs.

(e) Segmental reporting

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

(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. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash generating units or group of cash generating units, that is expected to benefit from the synergies of the combination. Each unit or group of units to which goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal reporting purposes. Goodwill is monitored at the operating segment level. Further details are contained in accounting policy (j).

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

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

(g) Other intangible assets

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

(h) Property, plant and equipment

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

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

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

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

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

ii) Landfill sites

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

iii) Landfill restoration

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

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

Other assets are included at cost less accumulated depreciation.

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

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

2. Principal accounting policies continued

(h) Property, plant and equipment continued

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

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

Asset lives and residual values are reviewed annually.

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

(i) Leased assets

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

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

(j) Impairment of non-financial assets

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

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

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

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

(k) Investment in subsidiary undertakings

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

(l) Investment in joint ventures

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

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

(m) Cash and cash deposits

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

(n) Derivatives and other financial instruments

The Group classifies its financial instruments in the following categories:

i) Loans and receivables

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

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

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

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

2. Principal accounting policies continued

(n) Derivatives and other financial instruments continued

ii) Trade receivables

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

iii) Trade payables

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

iv) Derivative financial instruments and hedging activities

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

The Group designates certain hedging derivatives as either:

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

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

The gain or loss on remeasurement is recognised 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.

Where a non-derivative transaction or series of transactions with the same counterparty has the aggregate effect in substance of a derivative instrument, the transaction or series of transactions shall be recognised as a single derivative instrument at fair value with associated movements recorded in the income statement.

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.

v) Financial assets at fair value through profit

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

(o) Taxation including deferred tax

The tax charge for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in the statement of comprehensive income or directly in equity. In this case the tax is also recognised in the statement of comprehensive income or directly in equity.

Current tax is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date. Management periodically evaluates tax items subject to interpretation and establishes full provisions on individual tax items where in the judgement of management the position is uncertain.

Deferred tax is provided in full on temporary differences between the carrying amount of assets and liabilities in the financial statements and the tax base, except if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be realised. Deferred tax is determined using the tax rates enacted or substantively enacted at the balance sheet date, and expected to apply when the deferred tax liability is settled or the deferred tax asset is realised.

2. Principal accounting policies continued

(p) Provisions

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

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

i) Landfill restoration costs

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

ii) Environmental control and aftercare costs

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

iii) Restructuring costs

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

(q) Share capital and treasury shares

Ordinary shares are classified as equity.

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

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

(r) Dividend distributions

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

(s) Employee benefits

i) Retirement benefit obligations

The Group operates defined benefit and defined contribution pension schemes.

Defined benefit pension schemes

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

The expected return on scheme assets and the increase during the year in the present value of scheme liabilities are shown in notional interest within finance income and cost.

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

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

Defined contribution scheme

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

ii) Share-based payment

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

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

(t) Pre-contract and development costs

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

2. Principal accounting policies continued

(u) Fair values

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

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

(v) Service concession arrangements

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

(w) Transfers of assets from customers

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

The fair value of assets on transfer from customers is determined using a cost valuation approach allowing for depreciation.

(x) Foreign exchange

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

3. Financial risk management

(a) Financial risk factors

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

The principal financial risks faced by the Group relate to interest rate and credit counterparty 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, optimise the use of surplus funds and manage overall interest rate performance. 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 56% of Group net borrowings were at fixed rates (including 50% of South West Water's borrowings fixed for the period to March 2015) and 18% 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 notes 22 and 26.

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

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

For 2012 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 £1.3 million (2011 £1.1 million).

For 2012 if RPI on index-linked borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year would have decreased/increased by £1.8 million (2011 £1.8 million).

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

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 sufficient available funds for operations and planned expansions equivalent to at least one year's forecast requirements at all times. Details of undrawn committed facilities and short-term facilities are provided in note 26.

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

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

3. Financial risk management continued
(a) Financial risk factors continued
ii) Liquidity risk continued
Contractual undiscounted cash flows, including interest payments, 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 2012					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	284.8	96.1	274.8	1,371.4	2,027.1
Interest payments on borrowings	28.4	18.2	40.8	642.3	729.7
Finance lease liabilities including interest	63.8	60.8	232.2	2,214.3	2,571.1
Derivative financial liabilities					
Derivative contracts – net payments	15.9	14.0	15.7	–	45.6
31 March 2011					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	74.5	266.6	314.8	1,093.7	1,749.6
Interest payments on borrowings	35.4	35.2	65.4	569.3	705.3
Finance lease liabilities including interest	47.9	57.0	215.0	2,239.2	2,559.1
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	8.1	4.9	(1.9)	7.9	19.0
Company					
31 March 2012					
Non-derivative financial liabilities					
Borrowings	253.2	75.0	181.6	100.0	609.8
Interest payments on borrowings	18.2	7.6	9.5	15.0	50.3
31 March 2011					
Non-derivative financial liabilities					
Borrowings	34.9	245.1	228.5	99.7	608.2
Interest payments on borrowings	19.2	17.5	10.7	12.0	59.4

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

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

3. Financial risk management continued

(b) Capital risk management

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

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

The Group monitors capital on the basis of the gearing ratio. This ratio is calculated as net borrowings divided by total capital. Net borrowings are analysed in note 36 and calculated as total borrowings less cash and cash deposits. Total capital is calculated as total shareholders' equity plus net borrowings.

The gearing ratios at the balance sheet date were:

	2012 £m	2011 £m
Net borrowings (note 36)	**2,104.6**	1,933.8
Total shareholders' equity	**822.1**	779.5
Total capital	**2,926.7**	2,713.3
Gearing ratio	**71.9%**	71.3%

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%.

	2012 £m	2011 £m
Regulatory Capital Value	**2,826.7**	2,703.5
Net borrowings	**1,584.9**	1,542.8
Net borrowings/Regulatory Capital Value	**56.1%**	57.1%

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

(c) Determination of fair values

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

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

The majority of the Group's financial instruments are valued using level 2 measures as analysed in note 22.

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, principally environmental provisions, 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.

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 2012 the Group's environmental and landfill restoration provisions were £92.7 million (note 30).

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

Retirement benefit obligations

The Group operates defined benefit pension schemes for which actuarial valuations are carried out as determined by the trustees at intervals of not more than three years. The last valuation of the main scheme was at 31 March 2010.

The pension cost and liabilities under IAS 19 are assessed in accordance with Directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2009 actuarial tables with an allowance for future longevity improvement. The principal assumptions used to measure schemes' liabilities, sensitivities to changes in those assumptions and future funding obligations are set out in note 28 of the financial statements.

Cash-generating units

For the purposes of assessing impairment of goodwill, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The waste management segment is considered to be a single cash-generating unit as it is an integrated business. The principal assumptions used to assess impairment are set out in note 14 of the financial statements.

Taxation

The Group corporation tax provision of £59.7 million reflects management's judgement of the amount of tax payable for fiscal years with open tax computations where liabilities remain to be agreed with HM Revenue & Customs. Management periodically evaluates items detailed in tax returns where the tax treatment is subject to interpretation. The Group establishes provisions on a full basis for individual tax items where, in the judgement of management, the tax position is uncertain.

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 to reflect external market conditions according to the type of service provided.

Site development costs

The development of waste management facilities for 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 are expensed.

Landfill costs

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

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

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

4. Critical accounting judgements and estimates continued

Carrying value of property, plant and equipment

The carrying value of property, plant and equipment as at 31 March 2012 was £3,082.8 million and the Group's accounting policy is set out in note 2. In the year ended 31 March 2012 additions totalled £257.4 million and the depreciation charge was £147.5 million. Estimated useful economic lives of property, plant and equipment are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of capital investment to the Group, variations between actual and estimated useful lives could impact operating results both positively and negatively. Asset lives and residual values are reviewed annually and historically changes to remaining estimates of useful lives have not been material.

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 revenue being adjusted in the period in which the revision of the estimates is determined.

Viridor estimates income from certain contractual revenue streams based on tonnages, cost and historic data which are dependent on agreement with the customer after the delivery of the service. Actual results could differ from these estimates which would result in revenue being adjusted in the period in which the revision of the estimate is determined.

Provision for doubtful debts

At the 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 2012 the Group's current trade receivables were £188.4 million, against which £67.0 million had been provided for impairment.

Impairment of intangible assets

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

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

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

	2012 £m	2011 £m
Revenue		
Water and sewerage	**474.0**	448.8
Waste management	**761.1**	712.0
Other	**9.8**	9.5
Less intra-segment trading*	**(11.8)**	(11.1)
	1,233.1	1,159.2
Segment result		
Operating profit before depreciation and amortisation (EBITDA)		
Water and sewerage	**305.2**	286.8
Waste management	**110.3**	116.5
Other	**0.3**	(0.7)
	415.8	402.6
Operating profit		
Water and sewerage	**204.7**	189.8
Waste management	**63.7**	71.6
Other	**0.4**	(0.5)
	268.8	260.9
Profit before tax		
Water and sewerage	**141.5**	128.9
Waste management	**57.6**	62.9
Other	**1.4**	(3.3)
	200.5	188.5

* 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.

5. Operating segments continued

	Water and sewerage £m	Waste management £m	Other £m	Eliminations £m	Group £m
Balance sheet					
31 March 2012					
Assets (excluding investments in joint ventures)	**2,938.2**	**1,209.5**	**912.2**	**(789.3)**	**4,270.6**
Investments in joint ventures	**–**	**0.1**	**–**	**–**	**0.1**
Total assets	**2,938.2**	**1,209.6**	**912.2**	**(789.3)**	**4,270.7**
Liabilities	**(2,159.6)**	**(826.0)**	**(1,252.3)**	**789.3**	**(3,448.6)**
Net assets/(liabilities)	**778.6**	**383.6**	**(340.1)**	**–**	**822.1**
31 March 2011 (Restated note 37)					
Assets (excluding investments in joint ventures)	2,845.5	1,076.6	1,002.8	(789.3)	4,135.6
Investments in joint ventures	–	1.5	–	–	1.5
Total assets	2,845.5	1,078.1	1,002.8	(789.3)	4,137.1
Liabilities	(2,036.1)	(811.4)	(1,299.4)	789.3	(3,357.6)
Net assets/(liabilities)	809.4	266.7	(296.6)	–	779.5

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

	Notes	Water and sewerage £m	Waste management £m	Other £m	Group £m
Other information					
31 March 2012					
Amortisation of other intangible assets	15	**–**	**1.4**	**–**	**1.4**
Capital expenditure (including acquisitions)		**130.8**	**155.8**	**–**	**286.6**
Depreciation		**100.5**	**45.2**	**(0.1)**	**145.6**
Finance income	7	**59.3**	**23.2**	**36.8**	**119.3**
Finance costs	7	**122.5**	**33.2**	**35.9**	**191.6**
31 March 2011					
Amortisation of other intangible assets	15	–	0.7	–	0.7
Capital expenditure (including acquisitions)		125.1	98.8	0.2	224.1
Depreciation		97.0	44.2	(0.2)	141.0
Finance income	7	22.6	21.4	1.1	45.1
Finance costs	7	83.5	34.3	4.0	121.8

Geographic analysis of revenue based on location of customers

	2012 £m	2011 £m
Revenue		
United Kingdom	**1,162.4**	1,091.8
Rest of European Union	**13.3**	11.1
China	**51.0**	49.5
Rest of World	**6.4**	6.8
	1,233.1	1,159.2

The Group's country of domicile is the United Kingdom and is the country in which it generates the majority of its revenue. The Group's non-current assets are all located in the United Kingdom.

6. Operating costs

	Notes	2012 £m	2011 £m
Manpower costs	12	**155.4**	148.3
Raw materials and consumables		**133.9**	121.6
Other operating expenses include:			
Profit on disposal of property, plant and equipment		**(2.8)**	(2.3)
Operating lease rentals payable:			
– Plant and machinery		**6.6**	7.4
– Property		**8.0**	6.1
Research and development expenditure		**0.2**	0.2
Trade receivables impairment	21	**9.2**	8.4
Depreciation of property, plant and equipment:			
– Owned assets		**110.5**	106.4
– Under finance leases		**35.1**	34.6
Amortisation of other intangible assets	15	**1.4**	0.7

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

	2012 £000	2011 £000
Fees payable to the Company's auditors for the statutory audit of the Group	**446**	400
Other services pursuant to legislation:		
Regulatory reporting	**30**	30
Interim review	**30**	30
Other audit services	**16**	47
	76	107
Total fees for statutory audit and audit related services	**522**	507
Tax services	**242**	150
Corporate finance transactions	**707**	988
Other services	**97**	170
	1,046	1,308
Total fees	**1,568**	1,815
Fees payable to the Company's auditors in respect of Pennon Group pension schemes:		
Audit	**26**	26

Fees payable to the Company's auditors for the statutory audit of the Group include fees payable for the statutory audit of the Company of £48,000 (2011 £47,000) and fees payable for the audit of the Company's subsidiaries of £398,000 (2011 £353,000).

Expenses reimbursed to the auditors in relation to the audit of the Group were £37,000 (2011 £35,000).

Corporate finance services in 2012 related to corporate finance advice on a number of EfW and PPP projects.

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

A description of the work of the Audit Committee is set out in its report on pages 47 and 48 which includes an explanation of how the auditor's objectivity and independence are safeguarded when non-audit services are provided by the auditors' firm.

7. Net finance costs

	Notes	2012 Finance cost £m	2012 Finance income £m	2012 Total £m	2011 Finance cost £m	2011 Finance income £m	2011 Total £m
Cost of servicing debt							
Bank borrowing and overdrafts		**(50.0)**	**–**	**(50.0)**	(55.5)	–	(55.5)
Interest element of finance lease rentals		**(38.8)**	**–**	**(38.8)**	(30.6)	–	(30.6)
Other finance costs		**(5.5)**	**–**	**(5.5)**	(3.9)	–	(3.9)
Interest receivable		**–**	**6.2**	**6.2**	–	6.1	6.1
Interest receivable on shareholder loans to joint ventures		**–**	**7.5**	**7.5**	–	6.7	6.7
		(94.3)	**13.7**	**(80.6)**	(90.0)	12.8	(77.2)
Other finance income							
Investment income received		**–**	**67.3**	**67.3**	–	–	–
Fair value losses on derivative financial instruments providing commercial hedges		**(63.9)**	**–**	**(63.9)**	–	–	–
		(63.9)	**67.3**	**3.4**	–	–	–
Notional interest							
Interest receivable on service concession arrangements		**–**	**3.3**	**3.3**	–	2.9	2.9
Retirement benefit obligations	28	**(29.1)**	**32.7**	**3.6**	(27.8)	29.4	1.6
Unwinding of discounts in provisions		**(4.3)**	**–**	**(4.3)**	(4.0)	–	(4.0)
		(33.4)	**36.0**	**2.6**	(31.8)	32.3	0.5
Net gains on non-designated derivative financial instruments		**–**	**2.3**	**2.3**	–	–	–
		(191.6)	**119.3**	**(72.3)**	(121.8)	45.1	(76.7)

Other finance income represents enhanced yields from investment income received on short-term deposits held partially offset by fair value losses on derivative financial instruments which provided commercial hedges against these short-term structured deposits. These transactions commenced and matured during the year.

8. Taxation

	Notes	2012 £m	2011 £m
Analysis of charge in year			
UK corporation tax		**30.9**	38.6
Deferred tax – other		**23.6**	3.4
Deferred tax arising on change of rate of corporation tax		**(26.4)**	(25.1)
Total deferred tax	29	**(2.8)**	(21.7)
Tax charge for year		**28.1**	16.9

UK corporation tax is calculated at 26% (2011 28%) of the estimated assessable profit for the year.

The deferred tax credit for the year is due to a non-recurring credit of £26.4 million (2011 £25.1 million) arising from a 2% reduction in the rate of corporation tax.

The tax for the year differs from the theoretical amount which would arise using the standard rate of corporation tax in the UK (26%) from:

	2012 £m	2011 £m
Profit before tax	**200.5**	188.5
Profit before tax multiplied by the standard rate of UK corporation tax of 26% (2011 28%)	**52.1**	52.8
Effects of:		
Expenses not deductible for tax purposes	**3.5**	1.7
Other	**(0.6)**	(1.1)
Change in rate of corporation tax	**(26.4)**	(25.1)
Adjustments to tax charge in respect of prior years	**(0.5)**	(11.4)
Tax charge for year	**28.1**	16.9

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

The average applicable tax rate for the year was 14% (2011 9%).

In addition to the amount debited to the income statement, a deferred tax credit relating to actuarial gains on defined benefit pension schemes of £10.2 million (2011 charge of £2.9 million) and a deferred tax credit relating to losses on cash flow hedges of £5.8 million (2011 charge of £0.4 million) have been credited directly to equity. A deferred tax charge relating to share-based payments of £0.1 million (2011 credit of £0.5 million) has been recognised directly to equity.

9. Profit of parent company

	2012 £m	2011 £m
Profit attributable to equity shareholders dealt with in the accounts of the parent company	**116.3**	90.1

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

10. Earnings per share
Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of Ordinary shares outstanding during the year, excluding those held in the employee share trust (note 34), which are treated as cancelled.

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

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

	2012	2011
Number of shares (millions)		
For basic earnings per share	**358.7**	354.6
Effect of dilutive potential Ordinary shares from share options	**2.2**	2.0
For diluted earnings per share	**360.9**	356.6

Basic and diluted earnings per share
Earnings per share before deferred tax are presented as the Directors believe that this measure provides a more useful comparison on business trends and performance since deferred tax reflects distortive effects of changes in corporation tax rates and the level of long-term capital investment. Earnings per share have been calculated:

	2012			2011		
	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	**172.4**	**48.1**	**47.8**	171.6	48.4	48.1
Deferred tax credit	**(2.8)**	**(0.8)**	**(0.8)**	(21.7)	(6.1)	(6.1)
Earnings per share before deferred tax	**169.6**	**47.3**	**47.0**	149.9	42.3	42.0

11. Dividends

	2012 £m	2011 £m
Amounts recognised as distributions to equity holders in the year:		
Interim dividend paid for the year ended 31 March 2011: 7.50p (2010 6.95p) per share	**26.8**	24.5
Final dividend paid for the year ended 31 March 2011: 17.15p (2010 15.60p) per share	**61.4**	55.1
	88.2	79.6
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2012: 8.22p (2011 7.50p) per share	**29.6**	26.8
Proposed final dividend for the year ended 31 March 2012: 18.30p (2011 17.15p) per share	**66.3**	61.4
	95.9	88.2

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

The proposed interim dividend for 2012 was paid on 3 April 2012 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting.

12. Employment costs

	2012 £m	2011 £m
Wages and salaries	**130.9**	122.7
Social security costs	**12.6**	11.4
Pension costs	**16.6**	20.5
Share-based payments	**3.6**	3.4
Total employment costs	**163.7**	158.0
Charged:		
Manpower costs	**155.4**	148.3
Capital schemes	**8.3**	9.7
Total employment costs	**163.7**	158.0

Details of Directors' emoluments are set out in note 13. There are no personnel, other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Group.

	2012	2011
Employees (average number)		
The average monthly number of employees (including Executive Directors) was:		
Water and sewerage	**1,335**	1,196
Waste management	**3,148**	3,012
Other	**46**	44
Group totals	**4,529**	4,252

The total number of employees at 31 March 2012 was 4,592 (2011 4,354).

13. Directors' emoluments

	2012 £000	2011 £000
Executive Directors:		
Salary	**1,077**	1,035
Performance-related bonus paid or payable	**393**	490
Share-based payments	**1,094**	984
Other emoluments	**73**	70
Payment in lieu of pension provision	**310**	114
Non-executive Directors	**431**	412
	3,378	3,105

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

The aggregate gains on vesting of Directors' share-based awards amounted to a total of £1,002,000 (2011 £677,000).

Total gains made by Directors on the exercise of share options were nil (2011 nil).

Total emoluments include £1,570,000 (2011 £1,418,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2012 there were no Directors accruing retirement benefits under defined benefit pension schemes (2011 one).

No pension contributions were payable to defined contribution schemes but three Directors received payments in lieu of pension provision (2011 two).

More detailed information concerning Directors' emoluments (including pensions and the highest paid Director) and share interests is shown in the Directors' remuneration report on pages 52 to 60.

14. Goodwill

	(Restated note 37) £m
Cost:	
At 1 April 2010	257.4
Recognised on acquisition of subsidiaries	43.0
At 31 March 2011	300.4
Recognised on acquisition of subsidiaries (note 37)	26.7
At 31 March 2012	327.1
Carrying amount:	
At 31 March 2011	300.4
At 31 March 2012	**327.1**

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.

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 fair value less costs to sell calculations. The fair value of the CGU has been estimated using an earnings multiple informed by recent market data from purchases of similar business.

15. Other intangible assets

	Customer contracts £m	Patents £m	Total £m
Acquired intangible assets			
Cost:			
At 1 April 2010	12.5	0.2	12.7
At 31 March 2011	12.5	0.2	12.7
Recognised on acquisition of subsidiaries (note 37)	14.5	–	14.5
At 31 March 2012	27.0	0.2	27.2
Accumulated amortisation:			
At 1 April 2010	7.6	–	7.6
Charge for year	0.7	–	0.7
At 31 March 2011	8.3	–	8.3
Charge for year	1.3	0.1	1.4
At 31 March 2012	9.6	0.1	9.7
Carrying amount:			
At 31 March 2011	4.2	0.2	4.4
At 31 March 2012	**17.4**	**0.1**	**17.5**

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 six years.

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

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

16. Property, plant and equipment

	Land and buildings (Restated note 37) £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers (Restated note 37) £m	Landfill restoration £m	Construction in progress £m	Total (Restated note 37) £m
Group							
Cost:							
At 1 April 2010	418.2	1,419.1	606.4	1,322.4	48.7	103.2	3,918.0
Arising on acquisitions	7.7	–	–	9.6	–	–	17.3
Additions	15.5	17.8	0.3	29.2	–	136.2	199.0
Assets adopted at fair value	–	12.4	0.6	1.7	–	–	14.7
Other (note 30)	–	–	–	–	4.7	–	4.7
Grants and contributions	–	(1.2)	–	–	–	–	(1.2)
Disposals	(1.2)	(1.8)	(4.4)	(59.3)	–	–	(66.7)
Transfers/reclassifications	0.9	21.6	11.3	66.3	–	(92.9)	7.2
At 31 March 2011	441.1	1,467.9	614.2	1,369.9	53.4	146.5	4,093.0
Arising on acquisitions (note 37)	0.2	–	–	0.7	–	–	0.9
Additions	17.0	14.9	1.7	19.0	–	204.8	257.4
Assets adopted at fair value	–	46.7	–	–	–	–	46.7
Other (note 30)	–	–	–	–	1.6	–	1.6
Grants and contributions	–	(1.6)	–	–	–	–	(1.6)
Disposals	–	(0.9)	(0.1)	(11.6)	–	–	(12.6)
Transfers/reclassifications	(18.0)	14.0	5.2	90.1	–	(86.9)	4.4
At 31 March 2012	**440.3**	**1,541.0**	**621.0**	**1,468.1**	**55.0**	**264.4**	**4,389.8**
Accumulated depreciation:							
At April 2010	172.5	93.2	163.8	647.8	15.0	–	1,092.3
Charge for year	16.3	21.5	10.8	90.9	2.8	–	142.3
Disposals	–	(1.8)	(4.4)	(58.1)	–	–	(64.3)
At 31 March 2011	188.8	112.9	170.2	680.6	17.8	–	1,170.3
Charge for year	16.6	22.2	10.9	95.8	2.0	–	147.5
Disposals	–	(0.9)	(0.1)	(9.8)	–	–	(10.8)
Transfers/reclassifications	(15.1)	–	–	15.1	–	–	–
At 31 March 2012	190.3	134.2	181.0	781.7	19.8	–	1,307.0
Net book value:							
At 1 April 2010	245.7	1,325.9	442.6	674.6	33.7	103.2	2,825.7
At 31 March 2011	252.3	1,355.0	444.0	689.3	35.6	146.5	2,922.7
At 31 March 2012	**250.0**	**1,406.8**	**440.0**	**686.4**	**35.2**	**264.4**	**3,082.8**

Of the total depreciation charge of £147.5 million (2011 £142.3 million), £1.4 million (2011 £1.3 million) has been charged to capital projects, £0.5 million (2011 nil) has been offset by deferred income and £145.6 million (2011 £141.0 million) has been charged against profits.

Asset lives and residual values are reviewed annually.

Asset transfers/reclassifications include assets transferred from other non-current assets of £4.4 million (2011 £7.2 million).

During the year borrowing costs of £3.0 million (2011 £1.1 million) have been capitalised on qualifying assets.

16. Property, plant and equipment continued

Assets held under finance leases included above were:

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Landfill restoration £m	Construction in progress £m	Total £m
Cost:							
At 31 March 2011	–	357.0	465.0	312.3	–	0.5	1,134.8
At 31 March 2012	–	357.0	465.2	379.9	–	0.3	1,202.4
Accumulated depreciation:							
At 31 March 2011	–	26.0	89.2	175.9	–	–	291.1
At 31 March 2012	–	31.3	97.0	189.0	–	–	317.3
Net book amount:							
At 31 March 2011	–	331.0	375.8	136.4	–	0.5	843.7
At 31 March 2012	**–**	**325.7**	**368.2**	**190.9**	**–**	**0.3**	**885.1**

	Fixed and mobile plant, vehicles and computers £m
Company	
Cost:	
At 1 April 2010	0.4
Additions	0.2
Disposals	(0.2)
At 31 March 2011	0.4
At 31 March 2012	0.4
Accumulated depreciation:	
At 1 April 2010	0.2
Charge for year	0.1
Disposals	(0.2)
At 31 March 2011	0.1
Charge for year	0.1
At 31 March 2012	0.2
Net book value:	
At 1 April 2010	0.2
At 31 March 2011	0.3
At 31 March 2012	**0.2**

Asset lives and residual values are reviewed annually.

17. Financial instruments by category

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

	Notes	Fair value: Derivatives used for fair value hedging £m	Fair value: Derivatives used for cash flow hedging £m	Fair value: Derivatives deemed held for trading £m	Amortised cost: Loans and receivables £m	Amortised cost: Trade receivables and trade payables (Restated note 37) £m	Total (Restated note 37) £m
Group							
31 March 2012							
Financial assets							
Trade receivables	21	–	–	–	–	121.4	121.4
Derivative financial instruments	22	22.7	6.6	2.3	–	–	31.6
Cash and cash deposits	23	–	–	–	425.3	–	425.3
Total		22.7	6.6	2.3	425.3	121.4	578.3
Financial liabilities							
Borrowings	26	–	–	–	(2,529.9)	–	(2,529.9)
Derivative financial instruments	22	(6.5)	(42.1)	–	–	–	(48.6)
Trade payables	24	–	–	–	–	(87.2)	(87.2)
Total		(6.5)	(42.1)	–	(2,529.9)	(87.2)	(2,665.7)
31 March 2011							
Financial assets							
Trade receivables	21	–	–	–	–	136.9	136.9
Derivative financial instruments	22	–	6.9	–	–	–	6.9
Cash and cash deposits	23	–	–	–	555.5	–	555.5
Total		–	6.9	–	555.5	136.9	699.3
Financial liabilities							
Borrowings	26	–	–	–	(2,489.3)	–	(2,489.3)
Derivative financial instruments	22	(3.5)	(18.1)	–	–	–	(21.6)
Trade payables	24	–	–	–	–	(87.3)	(87.3)
Total		(3.5)	(18.1)	–	(2,489.3)	(87.3)	(2,598.2)
Company							
31 March 2012							
Financial assets							
Derivative financial instruments	22	–	6.6	2.3	–	–	8.9
Cash and cash deposits	23	–	–	–	158.9	–	158.9
Total		–	6.6	2.3	158.9	–	167.8
Financial liabilities							
Borrowings	26	–	–	–	(891.2)	–	(891.2)
Trade payables	24	–	–	–	–	(0.1)	(0.1)
Total		–	–	–	(891.2)	(0.1)	(891.3)
31 March 2011							
Financial assets							
Derivative financial instruments	22	–	6.6	–	–	–	6.6
Cash and cash deposits	23	–	–	–	236.6	–	236.6
Total		–	6.6	–	236.6	–	243.2
Financial liabilities							
Borrowings	26	–	–	–	(889.0)	–	(889.0)
Trade payables	24	–	–	–	–	(0.1)	(0.1)
Total		–	–	–	(889.0)	(0.1)	(889.1)

18. Other non-current assets

Non-current receivables

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Amounts owed by subsidiary undertakings	–	–	350.9	366.8
Amounts owed by related parties (note 42)	69.0	56.6	–	–
Other receivables	69.4	59.4	1.1	0.9
	138.4	116.0	352.0	367.7

Non-current receivables were due:

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Between 1 and 2 years	15.5	20.0	89.2	90.6
Between 2 and 5 years	15.9	5.9	262.8	277.1
Over 5 years	107.0	90.1	–	–
	138.4	116.0	352.0	367.7

The fair values of non-current receivables were:

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Amounts owed by subsidiary undertakings	–	–	354.7	372.8
Amounts owed by related parties	147.7	126.7	–	–
Other receivables	69.4	59.4	1.1	1.0
	217.1	186.1	355.8	373.8

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% (2011 2.5%).

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

The effective interest rate on amounts owed by related parties was 14.0% (2011 14.0%).

Other receivables include site development and pre-contract costs of £9.6 million (2011 £17.6 million).

19. Investments

Subsidiary undertakings

	£m
Company	
At 1 April 2010	1,032.0
At 31 March 2011	1,032.0
Additions	140.1
At 31 March 2012	**1,172.1**

Joint ventures

	Shares £m
Group	
At 1 April 2010	0.2
Share of post-tax profit	4.3
Share of other comprehensive loss	(3.0)
At 31 March 2011	1.5
Share of post-tax profit	4.0
Share of other comprehensive loss	(5.4)
At 31 March 2012	**0.1**

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

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

	Assets		Liabilities		Income		Other comprehensive income
	Non-current £m	Current £m	Non-current £m	Current £m	Revenue £m	Profit £m	£m
2012							
Lakeside Energy from Waste Holdings Limited	**78.2**	**13.7**	**(89.9)**	**(2.0)**	**23.2**	**3.7**	**(5.1)**
Viridor Laing (Greater Manchester) Holdings Limited	**171.3**	**15.9**	**(168.3)**	**(18.9)**	**46.8**	**0.3**	**(0.3)**
2011							
Lakeside Energy from Waste Holdings Limited	82.0	9.5	(87.8)	(2.2)	21.6	3.6	(2.3)
Viridor Laing (Greater Manchester) Holdings Limited	181.5	10.4	(146.1)	(45.8)	61.7	0.7	(0.7)

20. Inventories

	Group		Company	
	2012 £m	2011 (Restated note 37) £m	2012 £m	2011 £m
Raw materials and consumables	**9.0**	7.2	**–**	–

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21. Trade and other receivables – current

	Group		Company	
	2012 £m	2011 (Restated note 37) £m	2012 £m	2011 £m
Trade receivables	**188.4**	195.1	**–**	–
Less: provision for impairment of receivables	**(67.0)**	(58.2)	**–**	–
Net trade receivables	**121.4**	136.9	**–**	–
Amounts owed by related parties (note 42)	**12.2**	8.8	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**90.8**	91.7
Other receivables	**13.0**	8.5	**0.7**	0.8
Prepayments and accrued income	**91.8**	64.8	**0.2**	0.2
	238.4	219.0	**91.7**	92.7

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

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

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

	2012 £m	2011 £m
Group		
Past due 1 – 30 days	**37.3**	36.1
Past due 31 – 120 days	**13.0**	11.9
More than 120 days	**97.4**	84.5

The aged trade receivables above are taken directly from aged sales ledger records before deduction of credit balances and other adjustments.

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:

	2012 £m	2011 £m
At 1 April	**58.2**	50.6
Provision for receivables impairment	**9.2**	8.4
Receivables written-off during the year as uncollectable	**(7.1)**	(8.3)
Cumulative amounts previously excluded from debt	**6.7**	7.3
Arising on acquisitions	**–**	0.2
At 31 March	**67.0**	58.2

22. Derivative financial instruments

	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
Derivatives used for cash flow hedging				
Current assets	**6.6**	6.9	**6.6**	6.6
Current liabilities	**(15.3)**	(4.4)	**–**	–
Non-current liabilities	**(26.8)**	(13.7)	**–**	–
Derivatives used for fair value hedging				
Non-current assets	**21.9**	–	**–**	–
Current assets	**0.8**	–	**–**	–
Current liabilities	**(1.3)**	(0.9)	**–**	–
Non-current liabilities	**(5.2)**	(2.6)	**–**	–
Derivative deemed held for trading				
Current assets	**2.3**	–	**2.3**	–

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

The ineffective portion recognised in the income statement arising from cash flow hedges was nil (2011 nil).

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50% of Group net borrowings are at fixed rate. At 31 March 2012, 56% of Group net borrowings were at fixed rate (2011 53%).

At 31 March 2012 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £855.0 million and a weighted average maturity of 4.0 years (2011 £605.0 million, with 4.0 years). The weighted average interest rate of the swaps for their nominal amount was 3.2% (2011 3.2%).

At 31 March 2012 the Company had cross-currency interest rate swaps to swap from floating to fixed rate and hedge financial liabilities, relating to a borrowing of 70 million Australian dollars, with a weighted average maturity of 1.0 years (2011 70 million Australian dollars, with 2.0 years). The weighted average interest rate of the swaps was 3.7% (2011 3.7%).

The derivative deemed held for trading does not qualify for hedge accounting under IAS 39, but is designed to improve the Group's overall interest rate performance. This derivative arises from of a combination of non-derivative instruments entered into during the year that when combined result in a derivative instrument. Included in the derivative instrument is a £200 million floating interest rate-linked loan from Peninsula MB Limited to the Company and a fixed rate £200 million obligation due to the Company from Peninsula MB Limited. This derivative has an expected life of 15 years. The £2.3 million fair value movement in the derivative has been recognised in the income statement.

Valuation hierarchy

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

Level 2 inputs	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
Assets				
Derivatives used for cash flow hedging	**6.6**	6.9	**6.6**	6.6
Derivatives used for fair value hedging	**22.7**	–	**–**	–
Total assets	**29.3**	6.9	**6.6**	6.6
Liabilities				
Derivatives used for cash flow hedging	**42.1**	18.1	**–**	–
Derivatives used for fair value hedging	**6.5**	3.5	**–**	–
Total liabilities	**48.6**	21.6	**–**	–

The amounts above are the fair value of financial instruments using level 2 – inputs that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The fair values of these swaps are based on the market value of equivalent instruments at the balance sheet date.

Level 3 inputs	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
Assets				
Derivative deemed held for trading	**2.3**	–	**2.3**	–

The amount above is the fair value of financial instruments using level 3 – inputs for asset or liability that are not based on observable market data (that is, unobservable market data).

23. Cash and cash deposits

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash at bank and in hand	**18.3**	15.9	**58.4**	39.3
Short-term bank deposits	**67.1**	121.8	**47.1**	95.8
Other deposits	**339.9**	417.8	**53.4**	101.5
Total cash and cash deposits (note 36)	**425.3**	555.5	**158.9**	236.6

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

Group other deposits have an average maturity of 115 days.

Group other deposits include restricted funds of £108.4 million (2011 £80.2 million) to settle long-term lease liabilities (note 26) and £14.2 million (2011 £40.0 million) relating to letters of credit.

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash and cash deposits as above	**425.3**	555.5	**158.9**	236.6
Bank overdrafts (note 26)	**(10.5)**	(18.1)	**–**	–
	414.8	537.4	**158.9**	236.6
Less: deposits with a maturity of three months or more (restricted funds)	**(122.6)**	(122.5)	**(1.4)**	(1.4)
	292.2	414.9	**157.5**	235.2

24. Trade and other payables – current

	Group		Company	
	2012 £m	2011 (Restated note 37) £m	2012 £m	2011 £m
Trade payables	**87.2**	87.3	**0.1**	0.1
Amounts owed to subsidiary undertakings	**–**	–	**5.7**	6.4
Amounts owed to joint venture (note 42)	**7.0**	8.5	**–**	–
Other tax and social security	**41.2**	53.0	**0.3**	0.3
Accruals and other payables	**107.1**	104.7	**4.7**	4.3
	242.5	253.5	**10.8**	11.1

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

Included in accruals and other payables are amounts provided by the Group in relation to claims received which are considered by the Directors and the management of the Group to be the best estimate of the amounts that might be finally settled.

25. Current tax liabilities/(recoverable)

	Group		Company	
	2012 £m	2011 (Restated note 37) £m	2012 £m	2011 £m
UK corporation tax	**59.7**	79.5	**(2.6)**	(1.7)

26. Borrowings

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Current				
Bank overdrafts	10.5	18.1	–	–
Short-term loans	253.2	35.3	253.2	34.9
European Investment Bank	21.1	21.1	–	–
Amounts owed to subsidiary undertakings	–	–	281.2	281.2
	284.8	74.5	534.4	316.1
Obligations under finance leases	40.7	24.7	–	–
Total current borrowings (note 36)	325.5	99.2	534.4	316.1
Non-current				
Bank and other loans	139.3	372.6	139.3	358.0
Private placement	99.9	99.9	99.9	99.9
Bond 2040	132.3	132.1	–	–
RPI index-linked bond	240.3	228.8	–	–
Convertible bond	117.6	115.0	117.6	115.0
European Investment Bank	231.5	252.5	–	–
	960.9	1,200.9	356.8	572.9
Obligations under finance leases	1,243.5	1,189.2	–	–
Total non-current borrowings (note 36)	2,204.4	2,390.1	356.8	572.9
Total borrowings	2,529.9	2,489.3	891.2	889.0

The Company issued £125 million 4.625% convertible bonds in August 2009. The bonds mature five years from the issue date at their nominal value of £125 million or can be converted into shares, at the holders' option, at the maturity date at the conversion price of 597.81 pence per Ordinary share. The value of the equity conversion component was determined to be £10 million has been recognised in shareholders' equity in retained earnings.

The Company issued a £100 million private placement in July 2007 maturing in 2022. Interest is payable at a floating rate based on the performance of an interest rate-linked index. The interest rate payable in the year was 3.2% (2011 4.3%).

South West Water Finance Plc issued a £150 million Bond in July 2010 maturing in 2040 with a cash coupon of 5.875%.

South West Water Finance Plc issued a £200 million RPI index-linked bond in July 2008 maturing in 2057 with a cash coupon of 1.99%.

The fair values of non-current borrowings were:

	2012		2011	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Group				
Bank and other loans	139.3	139.3	372.6	372.6
Private placement	99.9	92.3	99.9	82.7
Bond 2040	132.3	157.5	132.1	147.0
RPI index-linked bond	240.3	159.5	228.8	182.4
Convertible bond	117.6	161.7	115.0	161.8
European Investment Bank	231.5	205.8	252.5	219.5
	960.9	916.1	1,200.9	1,166.0
Obligations under finance leases	1,243.5	1,088.1	1,189.2	962.7
	2,204.4	2,004.2	2,390.1	2,128.7
Company				
Bank and other loans	139.3	139.3	358.0	358.0
Private placement	99.9	92.3	99.9	82.7
Convertible bond	117.6	161.7	115.0	161.8
	356.8	393.3	572.9	602.5

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

26. Borrowings continued

The maturity of non-current borrowings was:

	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
Between 1 and 2 years	**130.3**	291.8	**74.6**	243.9
Between 2 and 5 years	**432.9**	418.7	**182.3**	229.1
Over 5 years	**1,641.2**	1,679.6	**99.9**	99.9
	2,204.4	2,390.1	**356.8**	572.9

The weighted average maturity of non-current borrowings was 23 years (2011 24 years).

Finance lease liabilities – minimum lease payments:

	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
Within 1 year	**61.7**	47.9	**–**	–
Between 2 and 5 years	**292.9**	272.0	**–**	–
Over 5 years	**2,216.5**	2,239.2	**–**	–
	2,571.1	2,559.1	**–**	–
Less: future finance charges	**(1,286.9)**	(1,345.2)	**–**	–
	1,284.2	1,213.9	**–**	–

Finance lease liabilities – present value of minimum lease payments:

	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
Within 1 year	**61.7**	47.9	**–**	–
Between 2 and 5 years	**264.1**	245.5	**–**	–
Over 5 years	**1,022.2**	1,010.4	**–**	–
	1,348.0	1,303.8	**–**	–

Included above are accrued finance charges arising on obligations under finance leases totalling £135.5 million (2011 £130.8 million), of which £12.6 million (2011 £6.4 million) is repayable within one year.

Within obligations under finance leases, South West Water Limited has utilised finance lease facilities of £180.0 million for certain water and sewerage business property, plant and equipment which are secured by bank letters of credit issued by United Kingdom financial institutions. These letters of credit, covering the full period of the finance leases, are renewable between the financial institutions and South West Water Limited at five-yearly intervals, the next being March 2016.

During 2007 the period for repayment of these leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £41.9 million at 31 March 2012 (2011 £32.4 million) are being held to settle the lease liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

During 2010 the period for repayment of certain existing leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £66.5 million at 31 March 2012 (2011 £47.8 million) are being held to settle the lease liability at the end of the lease term, subject to rights to release by negotiation with the lessor.

Undrawn committed borrowing facilities at the balance sheet date:

	Group 2012 £m	Group 2011 £m	Company 2012 £m	Company 2011 £m
Floating rate:				
Expiring within 1 year	**247.5**	50.0	**127.5**	–
Expiring after 1 year	**411.0**	160.0	**141.0**	90.0
	658.5	210.0	**268.5**	90.0

In addition the Group has, at 31 March 2012, undrawn uncommitted short-term bank facilities of £50.0 million (2011 £50.0 million) available to the Company or South West Water Limited.

27. Other non-current liabilities

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Amounts owed to subsidiary undertakings	**–**	–	**8.7**	8.7
Other payables	**76.9**	30.4	**–**	–
	76.9	30.4	**8.7**	8.7

Other payables include deferred income resulting from the adoption at fair value of assets transferred from customers.

28. Retirement benefit obligations

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

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

Defined contribution schemes

Pension costs for defined contribution schemes were £2.7 million (2011 £2.8 million).

Defined benefit schemes

Assumptions

The principal actuarial assumptions at 31 March were:

	2012 %	2011 %
Expected return on scheme assets	**6.3**	7.3
Rate of increase in pensionable pay	**3.5**	3.9
Rate of increase for current and future pensions	**3.3**	3.4
Rate used to discount schemes' liabilities	**4.7**	5.5
Inflation	**3.3**	3.4

Mortality

Assumptions regarding future mortality experience are set based on actuarial advice in accordance with published statistics and experience. The mortality assumption uses a scheme-specific calculation based on CMI 2009 actuarial tables with an allowance for future longevity improvement.

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

	2012	2011
Male	**24.9**	24.9
Female	**27.0**	26.9

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

	2012	2011
Male	**25.8**	25.7
Female	**28.2**	28.2

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

	Change in assumption	Impact on schemes' liabilities
Rate of increase in pensionable pay	+/– 0.5%	+/– 1.3%
Rate of increase in current and future pensions	+/– 0.5%	+/– 6.0%
Rate used to discount schemes' liabilities	+/– 0.5%	+/– 8.5%
Inflation	+/– 0.5%	+/– 7.6%
Life expectancy	+/– 1 year	+/– 3.4%

28. Retirement benefit obligations continued

The amounts recognised in the income statement were:

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Current service cost	**(12.9)**	(15.0)	**(0.8)**	(1.0)
Past service cost	**(1.0)**	(2.7)	**–**	–
Total included in employment costs	**(13.9)**	(17.7)	**(0.8)**	(1.0)
Expected return on pension schemes' assets	**32.7**	29.4	**2.2**	2.7
Interest cost on retirement benefit obligations	**(29.1)**	(27.8)	**(2.1)**	(2.7)
Total included within net finance costs	**3.6**	1.6	**0.1**	–
Total charge	**(10.3)**	(16.1)	**(0.7)**	(1.0)

The actual return on schemes' assets was a profit of £32.1 million (2011 £34.7 million).

The amounts recognised in the statement of comprehensive income were:

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Actuarial (losses)/gains recognised in the year	**(51.7)**	2.4	**(3.9)**	3.3

The amounts recognised in the balance sheet were:

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Fair value of schemes' assets	**517.2**	454.2	**35.4**	30.7
Present value of defined benefit obligations	**(615.8)**	(540.0)	**(43.2)**	(37.5)
Net liability recognised in the balance sheet	**(98.6)**	(85.8)	**(7.8)**	(6.8)

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

	2012			2011		
	Expected return %	Value £m	Fund %	Expected return %	Value £m	Fund %
Equities	**8.1**	**269.9**	**52**	8.5	262.0	58
Property	**7.8**	**35.4**	**7**	8.2	18.6	4
Bonds	**3.7**	**168.8**	**33**	4.8	133.4	29
Other	**4.0**	**43.1**	**8**	4.4	40.2	9
		517.2	**100**		454.2	100

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

28. Retirement benefit obligations continued

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

	2012 £m	2011 £m
Equities	**17.8**	17.6
Property	**2.7**	1.3
Bonds	**11.8**	9.0
Other	**3.1**	2.8
	35.4	30.7

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

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

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

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

Movements in the net liability were:

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
At 1 April	**(85.8)**	(107.9)	**(6.8)**	(11.7)
Income statement	**(10.3)**	(16.1)	**(0.7)**	(1.0)
Statement of comprehensive income	**(51.7)**	2.4	**(4.0)**	3.3
Employer contributions	**49.2**	35.8	**3.7**	2.6
At 31 March	**(98.6)**	(85.8)	**(7.8)**	(6.8)

Movements in the fair value of schemes' assets were:

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
At 1 April	**454.2**	402.4	**30.7**	37.3
Expected return on schemes' assets	**32.7**	29.4	**2.2**	2.7
Actuarial (losses)/gains	**(0.7)**	5.3	**0.2**	(10.4)
Members' contributions	**1.2**	1.0	**–**	–
Benefits paid	**(19.4)**	(19.7)	**(1.4)**	(1.5)
Employer contributions	**49.2**	35.8	**3.7**	2.6
At 31 March	**517.2**	454.2	**35.4**	30.7

28. Retirement benefit obligations continued

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

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
At 1 April	**(540.0)**	(510.3)	**(37.5)**	(49.0)
Service cost	**(13.9)**	(17.7)	**(0.8)**	(1.0)
Interest cost	**(29.1)**	(27.8)	**(2.1)**	(2.7)
Actuarial (losses)/gains	**(51.0)**	(2.9)	**(4.2)**	13.7
Members' contributions	**(1.2)**	(1.0)	**–**	–
Benefits paid	**19.4**	19.7	**1.4**	1.5
At 31 March	**(615.8)**	(540.0)	**(43.2)**	(37.5)

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:

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Group					
Fair value of schemes' assets	**517.2**	454.2	402.4	276.4	331.5
Present value of defined benefit obligations	**(615.8)**	(540.0)	(510.3)	(342.4)	(357.8)
Net liability recognised	**(98.6)**	(85.8)	(107.9)	(66.0)	(26.3)
Experience (losses)/gains on schemes' assets					
Amount (£m)	**(0.6)**	5.3	65.7	(101.6)	(44.7)
Percentage of schemes' assets	**(0.1)%**	1.2%	16.3%	(36.7)%	(13.5)%
Experience (losses)/gains defined benefit obligations					
Amount (£m)	**(0.4)**	0.8	2.3	34.8	49.8
Percentage of defined benefit obligations	**(1.0)%**	0.1%	0.4%	10.2%	13.9%

The cumulative actuarial losses recognised in the Group statement of comprehensive income at 31 March 2012 were £157.5 million (2011 £105.8 million).

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Company					
Fair value of schemes' assets	**35.4**	30.7	37.3	29.6	33.9
Present value of defined benefit obligations	**(43.2)**	(37.5)	(49.0)	(36.9)	(36.8)
Net liability recognised	**(7.8)**	(6.8)	(11.7)	(7.3)	(2.9)
Experience gains/(losses) on schemes' assets					
Amount (£m)	**0.2**	(10.4)	6.3	(9.6)	4.0
Percentage of schemes' assets	**0.5%**	(33.9)%	16.9%	(32.4)%	11.8%
Experience (losses)/gains on defined benefit obligations					
Amount (£m)	**(0.4)**	14.0	0.4	1.6	(5.3)
Percentage of defined benefit obligations	**(1.0)%**	37.3%	0.8%	4.3%	(14.4)%

The cumulative actuarial losses recognised in the Company statement of comprehensive income at 31 March 2012 were £11.1 million (2011 £7.2 million).

The last triennial actuarial valuation of the principal defined benefit scheme was at 1 April 2011. The Group has made deficit recovery contributions of £35 million during the year (2011 £21 million). The Group monitors funding levels on an annual basis and expects to pay total contributions of £15 million during the year ended 31 March 2013.

29. Deferred tax

Deferred tax is provided in full on temporary differences under the liability method using a tax rate of 24% (2011 26%).

Movements on deferred tax were:

	Group		Company	
	2012 £m	2011 (Restated note 37) £m	2012 £m	2011 £m
Liabilities/(assets) at 1 April	**292.5**	312.2	**(4.2)**	(5.0)
(Credited)/charged to the income statement	**(2.8)**	(21.7)	**0.5**	(0.2)
(Credited)/charged to equity	**(15.9)**	2.8	**(0.9)**	1.0
Arising on acquisitions	**–**	(0.8)	**–**	–
Liabilities/(assets) at 31 March	**273.8**	292.5	**(4.6)**	(4.2)

Deferred tax assets have been recognised in respect of all temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

The majority of the Group's deferred tax liability is expected to be recovered over more than one year.

The majority of the Company's deferred tax asset is expected to be recovered over more than one year.

All deferred tax assets and liabilities within the same jurisdiction are offset.

The deferred tax balance has been reduced by a credit of £22.8 million to recognise the changes in the rate of corporation tax enacted on 19 July 2011 and 26 March 2012 to reduce the rate from 1 April 2012 from 26% to 24%. This credit includes a credit of £26.4 million recognised in the income statement and a debit of £3.6 million recognised in the statement of comprehensive income. If the published Government proposals to reduce the rate of corporation tax by a further 1% for each financial year until 2014/15 had been enacted at the balance sheet date, the total impact would have been a further reduction of circa £23 million.

The movements in deferred tax assets and liabilities were:

Group

Deferred tax liabilities

	Accelerated tax depreciation			
	Owned assets (Restated note 37) £m	Leased assets £m	Other (Restated note 37) £m	Total (Restated note 37) £m
At 1 April 2010	323.7	17.0	22.3	363.0
Credited to the income statement	(18.2)	(0.6)	(2.9)	(21.7)
Arising on acquisitions	0.1	–	1.0	1.1
At 31 March 2011	305.6	16.4	20.4	342.4
Credited to the income statement	(11.7)	(0.6)	(2.9)	(15.2)
At 31 March 2012	**293.9**	**15.8**	**17.5**	**327.2**

Deferred tax assets

	Provisions (Restated note 37) £m	Retirement benefit obligations £m	Other (Restated note 37) £m	Total (Restated note 37) £m
At 1 April 2010	(8.3)	(30.2)	(12.3)	(50.8)
(Credited)/charged to the income statement	(0.2)	5.1	(4.9)	–
Charged/(credited) to equity	–	2.9	(0.1)	2.8
Arising on acquisitions	(1.5)	–	(0.4)	(1.9)
At 31 March 2011	(10.0)	(22.2)	(17.7)	(49.9)
Charged to the income statement	2.1	8.8	1.5	12.4
Credited to equity	–	(10.2)	(5.7)	(15.9)
At 31 March 2012	**(7.9)**	**(23.6)**	**(21.9)**	**(53.4)**
Net deferred tax liability:				
At 31 March 2011				292.5
At 31 March 2012				**273.8**

29. Deferred tax continued

Company

Deferred tax assets

	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2010	(3.2)	(1.8)	(5.0)
Charged/(credited) to the income statement	0.4	(0.6)	(0.2)
Charged to equity	1.0	–	1.0
At 31 March 2011	(1.8)	(2.4)	(4.2)
Charged/(credited) to the income statement	0.8	(0.3)	0.5
Credited to equity	(0.8)	(0.1)	(0.9)
At 31 March 2012	**(1.8)**	**(2.8)**	**(4.6)**

Deferred tax credited/(charged) to equity during the year was:

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Actuarial losses/(gains) on defined benefit schemes	**10.2**	(2.9)	**0.8**	(1.0)
Net fair value losses/(gains) on cash flow hedges	**5.8**	(0.4)	**0.1**	(0.1)
Deferred tax on other comprehensive loss	**16.0**	(3.3)	**0.9**	(1.1)
Share-based payments (note 34)	**(0.1)**	0.5	**–**	0.1
	15.9	(2.8)	**0.9**	(1.0)

30. Provisions

	Environmental and landfill restoration (Restated note 37) £m	Restructuring £m	Other provisions £m	Total (Restated note 37) £m
Group				
At 1 April 2011	102.1	2.7	0.2	105.0
Charged to the income statement	3.2	2.5	–	5.7
Transferred	–	–	5.3	5.3
Arising on acquisition	0.1	–	–	0.1
Landfill restoration	1.6	–	–	1.6
Utilised during year	(14.3)	(1.5)	–	(15.8)
At 31 March 2012	**92.7**	**3.7**	**5.5**	**101.9**

The amount charged to the income statement includes £3.7 million (2011 £4.0 million) charged to finance costs as the unwinding of discounts in provisions.

The addition to landfill restoration provision of £1.6 million recognised in the year has been matched with an addition to property, plant and equipment.

Provisions totalling £5.3 million (2011 nil) have been transferred from other payables.

The analysis of provisions between current and non-current is:

	2012 £m	2011 (Restated note 37) £m
Current	**25.6**	16.3
Non-current	**76.3**	88.7
	101.9	105.0

Environmental and landfill restoration provisions are expected to be substantially utilised throughout the operational life of a site and for landfill sites within 30 years of closure. The provisions have been established assuming current waste management technology based upon estimated costs at future prices which have been discounted to present value.

The restructuring provision related principally to severance costs and will be utilised within one year.

31. Share capital

	2012 £m	2011 £m
Group and Company		
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
Group and Company			
At 1 April 2010 Ordinary shares of 40.7p each	5,092,574	352,058,253	145.3
Shares issued under the Scrip Dividend Alternative	–	4,129,038	1.7
Shares re-issued under the Company's Performance and Co-investment Plan	(328,240)	328,240	–
For consideration of £1.6 million, shares re-issued under the Company's Sharesave Scheme	(454,767)	454,767	–
At 31 March 2011 Ordinary shares of 40.7p each	4,309,567	356,970,298	147.0
Shares issued under the Scrip Dividend Alternative	–	2,941,306	1.2
Shares re-issued under the Company's Performance and Co-investment Plan	(246,793)	246,793	–
For consideration of £0.3 million, shares re-issued to the Pennon Employee Share Trust	(44,667)	44,667	–
For consideration of £1.6 million, shares re-issued under the Company's Sharesave Scheme	(385,402)	385,402	–
At 31 March 2012 Ordinary shares of 40.7p each	**3,632,705**	**360,588,466**	**148.2**

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	
			2012	2011
6 July 2004	200p	2007 – 2011	**–**	70
5 July 2005	270p	2008 – 2012	**30**	33
4 July 2006	358p	2009 – 2013	**39**	160
3 July 2007	522p	2010 – 2014	**88**	101
8 July 2008	517p	2011 – 2015	**79**	275
6 July 2009	386p	2012 – 2016	**1,184**	1,242
28 June 2010	431p	2013 – 2017	**608**	683
29 June 2011	536p	2014 – 2018	**580**	–
			2,608	2,564

31. Share capital continued

i) Sharesave Scheme continued

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

	2012		2011	
	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	**2,564**	**409**	2,472	396
Granted	**593**	**536**	699	431
Forfeited	**(123)**	**438**	(119)	429
Exercised	**(385)**	**405**	(455)	361
Expired	**(41)**	**439**	(33)	450
At 31 March	**2,608**	**437**	2,564	409

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 656p (2011 478p). The options outstanding at 31 March 2012 had a weighted average exercise price of 437p (2011 409p) and a weighted average remaining contractual life of 3.0 years (2011 2.4 years).

The aggregate fair value of Sharesave options granted during the year was £0.9 million (2011 £0.8 million), determined using the Black-Scholes valuation model. The significant inputs into the valuation model at the date of issue of the options were:

	2012	2011
Weighted average share price	**670p**	539p
Weighted average exercise price	**536p**	431p
Expected volatility	**27.4%**	29.0%
Expected life	**3.9 years**	4.1 years
Risk-free rate	**1.4%**	1.4%
Expected dividend yield	**4.3%**	4.5%

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

31. Share capital continued

ii) Performance and Co-investment Plan

Executive Directors and senior management receive a conditional award of Ordinary shares in the Company and are also required to hold a substantial personal shareholding in the Company. The eventual number of shares, if any, which vest is dependent upon the achievement of conditions of the plan over the restricted period, being not less than three years.

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

	2012		2011	
	Number of Ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of Ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**1,559**	**550**	1,465	554
Granted	**454**	**698**	530	546
Vested	**(247)**	**637**	(328)	557
Lapsed	**(359)**	**586**	(108)	557
At 31 March	**1,407**	**573**	1,559	550

The awards outstanding at 31 March 2012 had a weighted exercise price of 573p (2011 550p) and a weighted average remaining contractual life of 1.3 years (2011 1.3 years).

The aggregate fair value of awards granted during the year was £2.0 million (2011 £2.1 million) determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2012	2011
Weighted average share price	**698p**	546p
Expected volatility	**27.4%**	29.0%
Risk-free rate	**1.4%**	1.4%

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

iii) Annual Incentive Bonus Plan – Deferred Shares

Awards under the plan to Executive Directors and senior management involve the release of Ordinary shares in the Company to participants. There is no performance condition since vesting is conditional upon continuous service with the Group for a period of three years from the award. The number and weighted average price of shares in the Annual Incentive Bonus Plan are:

	2012		2011	
	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	**459**	**557**	291	547
Granted	**175**	**725**	175	572
Vested	**(202)**	**608**	(7)	529
Lapsed	**(5)**	**522**	–	–
At 31 March	**427**	**602**	459	557

The awards outstanding at 31 March 2012 had a weighted average exercise price of 602p (2011 557p) and a weighted average remaining contractual life of 1.5 years (2011 1.5 years). The Company's share price at the date of the awards ranged from 473p to 725p.

The aggregate fair value of awards granted during the year was £1.2 million (2011 £1.0 million), determined from market value. No option pricing methodology is applied since dividends declared on the shares are receivable by the participants in the scheme.

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

32. Share premium account

	£m
Group and Company	
At 1 April 2010	10.9
Adjustment for shares issued under the Scrip Dividend Alternative	(1.7)
At 31 March 2011	9.2
Adjustment for shares issued under the Scrip Dividend Alternative	(1.2)
At 31 March 2012	**8.0**

33. Capital redemption reserve

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

	£m
Group and Company	
At 1 April 2010	144.2
At 31 March 2011	144.2
At 31 March 2012	**144.2**

34. Retained earnings and other reserves

	Own shares £m	Hedging reserve £m	Retained earnings £m	Total £m
Group				
At 1 April 2010	(2.2)	(12.9)	377.6	362.5
Profit for the year	–	–	171.6	171.6
Other comprehensive loss for the year	–	(0.4)	(3.6)	(4.0)
Dividends paid relating to 2010	–	–	(79.6)	(79.6)
Adjustment for shares issued under the Scrip Dividend Alternative	–	–	22.8	22.8
Credit to equity in respect of share-based payments	–	–	3.4	3.4
Transfer from hedging reserve to property, plant and equipment	–	0.3	–	0.3
Deferred tax in respect of share-based payments	–	–	0.5	0.5
Proceeds from treasury shares re-issued	–	–	1.6	1.6
At 31 March 2011	(2.2)	(13.0)	494.3	479.1
Profit for the year	–	–	172.4	172.4
Other comprehensive loss for the year	–	(18.7)	(47.1)	(65.8)
Dividends paid relating to 2011	–	–	(88.2)	(88.2)
Adjustment for shares issued under the Scrip Dividend Alternative	–	–	19.1	19.1
Credit to equity in respect of share-based payments	–	–	3.6	3.6
Deferred tax in respect of share-based payments	–	–	(0.1)	(0.1)
Charge in respect of share options vesting	0.7	–	(0.7)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(0.3)	–	–	(0.3)
Proceeds from treasury shares re-issued	–	–	1.9	1.9
At 31 March 2012	**(1.8)**	**(31.7)**	**555.2**	**521.7**

The own shares reserve represents the cost of Ordinary shares in Pennon Group Plc issued to or purchased in the market and held by the Pennon Employee Share Trust to satisfy awards under the Group's Annual Incentive Bonus Plan.

The market value of the 433,000 Ordinary shares (2011 589,000 Ordinary shares) held by the trust at 31 March 2012 was £3.1 million (2011 £3.7 million).

34. Retained earnings and other reserves continued

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 2010	(0.3)	487.7	487.4
Profit for the year	–	90.1	90.1
Other comprehensive income for the year	0.3	2.4	2.7
Dividends paid relating to 2010	–	(79.6)	(79.6)
Adjustment for shares issued under the Scrip Dividend Alternative	–	22.8	22.8
Credit to equity in respect of share-based payments	–	0.7	0.7
Deferred tax in respect of share-based payments	–	0.1	0.1
Proceeds from treasury shares re-issued	–	1.6	1.6
At 31 March 2011	–	525.8	525.8
Profit for the year	–	116.3	116.3
Other comprehensive loss for the year	(0.3)	(3.3)	(3.6)
Dividends paid relating to 2011	–	(88.2)	(88.2)
Adjustment for shares issued under the Scrip Dividend Alternative	–	19.1	19.1
Credit to equity in respect of share-based payments	–	0.8	0.8
Proceeds from treasury shares re-issued	–	1.9	1.9
At 31 March 2012	**(0.3)**	**572.4**	**572.1**

35. Cash flow from operating activities

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

Cash generated from operations

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Continuing operations				
Profit for the year	**172.4**	171.6	**116.3**	90.1
Adjustments for:				
Share-based payments	**3.6**	3.4	**0.8**	0.7
Profit on disposal of property, plant and equipment	**(2.8)**	(2.3)	**–**	–
Depreciation charge	**145.6**	141.0	**0.1**	0.1
Amortisation of intangible assets	**1.4**	0.7	**–**	–
Share of post-tax profit from joint ventures	**(4.0)**	(4.3)	**–**	–
Finance income	**(119.3)**	(45.1)	**(59.7)**	(23.6)
Finance costs	**191.6**	121.8	**60.6**	26.6
Dividends receivable	**–**	–	**(117.5)**	(93.1)
Taxation charge/(credit)	**28.1**	16.9	**2.1**	(0.4)
Changes in working capital (excluding the effect of acquisition of subsidiaries):				
Increase in inventories	**(1.7)**	(0.6)	**–**	–
(Increase)/decrease in trade and other receivables	**(27.3)**	(25.5)	**25.0**	(37.4)
(Decrease)/increase in trade and other payables	**(13.2)**	30.3	**(5.7)**	(5.8)
Decrease in retirement benefit obligations from contributions	**(35.3)**	(18.1)	**(3.1)**	(1.4)
Decrease in provisions	**(14.4)**	(13.6)	**–**	–
Cash generated/(outflow) from operations	**324.7**	376.2	**18.9**	(44.2)

36. Net borrowings

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Cash and cash deposits	**425.3**	555.5	**158.9**	236.6
Borrowings – current				
Bank overdrafts	**(10.5)**	(18.1)	**–**	–
Other current borrowings	**(274.3)**	(56.4)	**(253.2)**	(34.9)
Finance lease obligations	**(40.7)**	(24.7)	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**(281.2)**	(281.2)
Total current borrowings	**(325.5)**	(99.2)	**(534.4)**	(316.1)
Borrowings – non-current				
Bank and other loans	**(729.4)**	(948.4)	**(356.8)**	(572.9)
Other non-current borrowings	**(231.5)**	(252.5)	**–**	–
Finance lease obligations	**(1,243.5)**	(1,189.2)	**–**	–
Total non-current borrowings	**(2,204.4)**	(2,390.1)	**(356.8)**	(572.9)
Total net borrowings	**(2,104.6)**	(1,933.8)	**(732.3)**	(652.4)

37. Acquisitions

On 6 June 2011 the entire issued share capital of Storm Recycling Limited (renamed Viridor (Winsford) Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £1.7 million. The acquisition has been accounted for using the acquisition method. Provisional goodwill of £1.8 million has been capitalised.

On 17 November 2011 the entire issued share capital of JWS Churngold Limited (renamed Viridor (Lancashire) Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £14.3 million. The acquisition has been accounted for using the acquisition method. Provisional goodwill of nil has been capitalised.

On 29 November 2011 the entire issued share capital of Community Waste Holding Limited (renamed Viridor (Community Recycling MKH) Limited) was purchased by Viridor Waste Management Limited for a consideration of £18.5 million. Community Waste Recycling Limited (renamed Viridor (Community Recycling MK) Limited) is a wholly owned subsidiary of Viridor (Community Recycling MKH) Limited. The acquisition has been accounted for using the acquisition method. Provisional goodwill of £16.7 million has been capitalised.

On 31 October 2011 Viridor Waste Management Limited acquired Veolia's trade waste collection interests in Cornwall and North Devon for £0.6 million. On 1 January 2012 Viridor Waste Management Limited acquired Veolia's industrial and commercial collection interests in Devon and Somerset for £7.6 million. The acquisition of these trades has been accounted for using the acquisition method. Provisional goodwill of £8.2 million has been capitalised.

The residual excesses over the net assets acquired in each business combination has been recognised as goodwill. The provisional goodwill from each business combination is attributed to the profitability of the acquired business.

37. Acquisitions continued

Fair values on acquisition	Storm Recycling £m	JWS Churngold £m	Community Recycling £m	Veolia Trade £m	Total £m
Intangible assets	–	14.5	–	–	14.5
Property, plant and equipment	0.1	–	0.8	–	0.9
Inventories	–	–	0.1	–	0.1
Receivables	0.5	1.0	1.8	–	3.3
Cash and cash deposits	0.2	0.5	3.6	–	4.3
Payables	(0.7)	(1.5)	(3.8)	–	(6.0)
Taxation – current	(0.1)	(0.2)	(0.6)	–	(0.9)
Leases	–	–	(0.1)	–	(0.1)
Provisions	(0.1)	–	–	–	(0.1)
Net (liabilities)/assets acquired	(0.1)	14.3	1.8	–	16.0
Goodwill	1.8	–	16.7	8.2	26.7
Total consideration	1.7	14.3	18.5	8.2	42.7
Satisfied by:					
Cash	1.7	14.3	9.3	8.2	33.5
Unsecured loan notes	–	–	8.3	–	8.3
Deferred consideration	–	–	0.9	–	0.9
Net cash outflow arising on acquisition					
Cash consideration	1.7	14.3	9.3	8.2	33.5
Cash and cash deposits acquired	(0.2)	(0.5)	(3.6)	–	(4.3)
	1.5	13.8	5.7	8.2	29.2
Revenue for the period since acquisition to 31 March 2012	0.8	2.1	1.9	1.1	5.9
Profit/(loss) before tax for the period since acquisition to 31 March 2012	0.1	0.6	(0.9)	–	(0.2)
Directly attributable costs included in other operating expenses	–	0.2	0.8	0.5	1.5

If all the acquisitions had occurred on 1 April 2011 Group revenues for the year would have been £1,248.9 million and profit before tax for the year would have been £202.7 million. These amounts have been calculated after applying the Group's accounting policies and adjusting the results to reflect the provisional fair value adjustments.

Restatements

At 31 March 2011 the accounting for the following acquisitions was provisional:

- Oakley Waste Management Limited (renamed Viridor Waste (Corby) Limited) and Basecall Limited, acquired from Reconomy (Acquisitions) Limited
- Pearsons Group Holdings Limited
- Adapt Recycling Limited (renamed Viridor Waste (Adapt) Limited)
- Swinnerton Environmental Limited (renamed Viridor Waste (Bury) Limited)
- Martock Waste Paper Company Limited (renamed Viridor (Martock) Limited).

Completion of the accounting for the acquisitions has resulted in an increase to goodwill of £8.0 million, a decrease in property, plant and equipment of £4.8 million, a decrease in inventories of £0.2 million, a decrease in trade and other receivables of £1.6 million, a decrease in trade and other payables of £5.4 million, an increase in current tax payable of £0.1 million, a decrease in deferred tax of £1.3 million and an increase of £8.0 million in provisions.

38. Principal subsidiary, joint venture and associate undertakings at 31 March 2012

	Country of incorporation, registration and principal operations
Water and sewerage	
South West Water Limited*	England
South West Water Finance Plc	England
Source Contact Management Limited	England
Source Collections Limited	England
Waste management	
Viridor Limited*	England
Viridor Waste Limited	England
Viridor Waste Exeter Limited	England
Viridor Waste Suffolk Limited	England
Viridor Waste (West Sussex) Limited	England
Viridor Waste Management Limited	England
Viridor EnviroScot Limited	Scotland
Pearsons Group Holdings Limited	England
Viridor Waste (Thetford) Limited	England
Viridor Resource Management Limited	England
Viridor Waste Kent Limited	England
Viridor (Martock) Limited	England
Viridor Oxfordshire Limited	England
Handside Limited	England
Viridor EfW (Runcorn) Limited	England
Viridor Waste (Landfill Restoration) Limited	England
Viridor Waste (Somerset) Limited	England
Viridor Waste (Thames) Limited	England
Viridor Waste (Greater Manchester) Limited	England
Viridor Parkwood Holdings Limited	British Virgin Islands†
Viridor Polymer Recycling Limited	England
Viridor (Community Recycling MKH) Limited	England
Viridor (Community Recycling MK) Limited	England
Viridor (Winsford) Limited	England
Viridor Trident Park Limited	England
Viridor (Glasgow) Limited	England
Viridor (Lancashire) Limited	England
Viridor (Cheshire) 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.

38. Principal subsidiary, joint venture and associate undertakings at 31 March 2012 continued

Joint ventures and associate

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

	Share capital in issue	Percentage held	Principal activity
Lakeside Energy from Waste Holdings Limited	1,000,000 A Ordinary shares	–	
	1,000,000 B Ordinary shares	100%	
Lakeside Energy from Waste Limited			Waste management
Shares in Lakeside Energy from Waste Holdings Limited are held by Viridor Waste Management Limited.			
Viridor Laing (Greater Manchester) Holdings Limited	2 Ordinary shares	50%	
Viridor Laing (Greater Manchester) Limited			Waste management
Shares in Viridor Laing (Greater Manchester) Holdings Limited are held by Viridor Waste Management Limited.			
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.			

39. Operating lease commitments

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
The future aggregate minimum lease payments under non-cancellable operating leases are:				
Within 1 year	**8.8**	8.7	**–**	–
Between 2 and 5 years	**26.1**	23.1	**–**	–
Over 5 years	**75.5**	82.3	**–**	–
	110.4	114.1	**–**	–

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

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

40. Contingent liabilities

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	**–**	–	**359.9**	371.8
Contractors' claims on capital schemes	**–**	0.3	**–**	–
Performance bonds	**117.4**	107.8	**117.4**	107.8
Other	**6.9**	6.9	**6.9**	6.9
	124.3	115.0	**484.2**	486.5

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

Viridor Waste Management Limited has given a commitment to supply 160,000 tonnes of waste per annum (or pay market price based compensation) to the energy from waste plant of the joint venture in Lakeside Energy from Waste Holdings Limited. The Directors consider that the committed waste volume will be available in the ordinary course of business.

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

41. Capital commitments

	Group		Company	
	2012 £m	2011 £m	2012 £m	2011 £m
Contracted but not provided	**545.8**	218.3	**–**	–

42. Related party transactions

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

	2012 £m	2011 £m
Sales of goods and services		
Viridor Laing (Greater Manchester) Limited	**80.4**	82.0
Purchase of goods and services		
Lakeside Energy from Waste Limited	**10.7**	9.4

Year-end balances

	2012 £m	2011 £m
Receivables due from related parties		
Viridor Laing (Greater Manchester) Limited (loan balance)	**40.3**	32.0
Lakeside Energy from Waste Limited (loan balance)	**10.0**	13.6
INEOS Runcorn (TPS) Limited (loan balance)	**22.3**	11.0
	72.6	56.6
Viridor Laing (Greater Manchester) Limited (trading balance)	**7.6**	8.8
Lakeside Energy from Waste Limited (trading balance)	**1.0**	–
	8.6	8.8
Payables due to related parties		
Viridor Laing (Greater Manchester) Limited (trading balance)	**7.0**	7.0
Lakeside Energy for Waste Limited (trading balance)	**–**	1.5

The £72.6 million (2011 £56.6 million) receivable relates to loans to related parties included within receivables and due for repayment in instalments between 2012 and 2033. Interest is charged at an average of 14.0% (2011 14.0%).

The £7.0 million payable relates to consortium relief due to Viridor Laing (Greater Manchester) Limited.

Company

The following transactions with subsidiary undertakings occurred in the year:

	2012 £m	2011 £m
Sales of goods and services (management fees)	**8.4**	7.8
Purchase of goods and services (support services)	**0.5**	0.5
Interest receivable (loans)	**19.6**	18.9
Dividends received	**117.5**	93.1

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.

42. Related party transactions continued

Year-end balances

	2012 £m	2011 £m
Receivables due from subsidiary undertakings		
Loans	**439.8**	457.4
Trading balances	**1.9**	1.1

Interest on £204.3 million of the loans has been charged at a fixed rate of 4.5% and on £29.6 million at a fixed rate of 6.0% (2011 £104.8 million, 5% and £120.5 million, 6.0%).

Interest on the balance of the loans is charged at 12 month LIBOR +1.5%. The loans are due for repayment in instalments over the period 2013 to 2017. During the year there were no further provisions (2011 nil) in respect of loans to subsidiaries not expected to be repaid.

	2012 £m	2011 £m
Payables due to subsidiary undertakings		
Loans	**281.2**	281.2
Trading balances	**14.4**	15.1

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

Financial statements
Five-year financial summary

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Income statement					
Revenue	**1,233.1**	1,159.2	1,068.9	958.2	879.4
Operating profit	**268.8**	260.9	266.3	250.8	237.7
Net finance costs	**(72.3)**	(76.7)	(81.6)	(92.2)	(85.6)
Share of profit in joint ventures	**4.0**	4.3	1.1	0.8	0.2
Profit before tax	**200.5**	188.5	185.8	159.4	152.3
Taxation	**(28.1)**	(16.9)	(44.3)	(69.6)	(16.4)
Profit for the year	**172.4**	171.6	141.5	89.8	135.9
Dividends proposed	**95.9**	88.2	79.6	73.4	69.1
Earnings per share (basic):					
From continuing operations					
Earnings per share	**48.1p**	48.4p	40.4p	25.8p	38.9p
Deferred tax	**(0.8)p**	(6.1)p	0.4p	11.1p	(2.6)p
Earnings per share before deferred tax	**47.3p**	42.3p	40.8p	36.9p	36.3p
Declared dividends per share	**26.52p**	24.65p	22.55p	21.00p	19.81p

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Capital expenditure					
Acquisitions	**29.2**	25.1	9.3	3.4	89.0
Property, plant and equipment	**257.4**	199.0	192.2	231.8	207.7
Balance sheet					
Non-current assets	**3,587.8**	3,347.6	3,189.4	3,036.3	2,931.0
Net current assets	**13.0**	335.7	162.1	40.5	199.7
Non-current liabilities	**(2,778.7)**	(2,903.8)	(2,688.6)	(2,476.2)	(2,485.2)
Net assets	**822.1**	779.5	662.9	600.6	645.5
Number of employees (average for year)					
Water and sewerage business	**1,335**	1,196	1,191	1,227	1,276
Waste management	**3,148**	3,012	2,853	2,154	2,059
Other businesses	**46**	44	43	41	42
	4,529	4,252	4,087	3,422	3,377

Shareholder information

Financial calendar

Financial year-end	31 March
Twenty-third Annual General Meeting	26 July 2012
Ex-dividend date for 2012 Final dividend	8 August 2012*
Record date for 2012 Final dividend	10 August 2012*
2012 Final dividend payable	5 October 2012*
2012/13 Half yearly financial report announcement	November 2012
2013 Interim dividend payable	April 2013
2013 Preliminary results announcement	May 2013
Twenty-fourth Annual General Meeting	July 2013
2013 Final dividend payable	October 2013

* These dates are subject to obtaining shareholder approval at the 2012 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2012.

Scrip Dividend Alternative

8 August 2012	Ordinary shares quoted ex dividend
10 August 2012	Record date for final dividend
24 August 2012	Posting of Scrip dividend offer
17 September 2012	Final date for receipt of Forms of Election/Mandate
4 October 2012	Posting of dividend cheques and share certificates
5 October 2012	Final dividend payment date
5 October 2012	First day of dealing in the new Ordinary shares

Shareholder analysis at 31 March 2012

Range of shares held	Number of shareholders	Percentage of total shareholders	Percentage of Ordinary shares
1-100	2,451	10.71	0.02
101-1,000	9,468	41.35	1.37
1,001-5,000	9,389	41.01	5.51
5,001-50,000	1,222	5.34	3.77
50,001-100,000	101	0.44	2.02
100,001-HIGHEST	264	1.15	87.31
	22,895	**100.00**	**100.00**
Individuals	19,622	85.70	8.15
Companies	217	0.95	2.13
Trust companies (pension funds etc)	12	0.05	0.02
Banks and nominees	3,044	13.30	89.70
	22,895	**100.00**	**100.00**

Major shareholdings

The net position on 31 March 2012 of investors who have notified interests in the issued share capital of the Company pursuant to the Financial Services Authority's Disclosure and Transparency Rules is as follows:

Ameriprise Financial Inc	9.79%
Pictet Asset Management SA	7.10%
Prudential Plc group of companies	5.54%
AXA SA and its Group Companies	5.52%
Invesco Ltd	4.77%
Legal & General Group Plc	3.73%

No changes to the above interests in the issued share capital of the Company have been disclosed to the Company between 31 March 2012 and 16 June 2012 (being a date not more than one month prior to the date of the Company's Notice of Annual General Meeting).

Shareholder information
continued

Shareholder services

Registrar

All enquiries concerning shareholdings including notification of change of address, loss of a share certificate or dividend payments should be made to the Company's registrar. The Company's registrar, Capita Registrars, can be contacted as follows:

Capita Registrars
Pennon Group Share Register
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU

Telephone: 0871 664 9234 (calls cost 10p per minute plus network extras) Lines are open 8.30am-5.30pm Monday-Friday.

Overseas telephone: +44 800 141 2951

Email: pennon@capitaregistrars.com

Share dealing service

The telephone share dealing service offered by Stocktrade enables shareholders to buy and sell shares in the Company on a low-cost basis and to make regular investments in the Company. Telephone Stocktrade on 0845 601 0995 and quote: LOW CO107. Commission is 0.5% (subject to a minimum charge of £17.50) to £10,000, then 0.2% thereafter.

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 2012 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2012, full details of the Scrip Dividend Alternative, including how to join, will be sent out to shareholders on 24 August 2012. The full timetable for offering the Scrip Dividend Alternative is given on page 113.

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.

By registering to receive your shareholder communications electronically, you will also automatically receive your Dividend Tax Vouchers electronically.

Electronic Proxy voting

Shareholders also have the opportunity to register the appointment of a proxy for any general meeting of the Company once notice of the meeting has been given and may do so via 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 financial reports.

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.

Further shareholder information may be found at pennon-group.co.uk

Share fraud warning

Share fraud includes scams where investors are called out of the blue and offered shares that often turn out to be worthless or non-existent, or are offered an inflated price for shares that they own. These calls come from fraudsters operating in 'boiler rooms' that are mostly based abroad; often they imply a connection to the company concerned and they can be very persistent and extremely persuasive. Whilst high profits are promised, those who buy or sell shares in this way usually lose their money. The Financial Services Authority (FSA) has found most share fraud victims are experienced investors who lose an average of £20,000, with around £200 million lost in the UK each year.

Protect yourself

If you are offered unsolicited investment advice, discounted shares, a premium price for shares you own, or free company or research reports, you should take these steps before handing over any money:

1. Get the name of the person and organisation contacting you.
2. Check the FSA Register at **fsa.gov.uk/fsaregister** to ensure that they are authorised.
3. Use the details on the FSA Register to contact the firm.
4. Call the FSA Consumer Helpline on **0845 606 1234** if there are no contact details on the FSA Register or you are told that the Register is out of date.
5. If the calls persist, hang up.
6. **REMEMBER: if it sounds too good to be true, it probably is!**

If you use an unauthorised firm to buy or sell shares or other investments, you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme (FSCS) if things go wrong.

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

Report a scam

If you are approached about a share scam you should tell the FSA using the share fraud reporting form at **fsa.gov.uk/scams**, where you can find out about the latest investment scams. You can also call the Consumer Helpline on **0845 606 1234.**

If you have already paid money to share fraudsters you should contact Action Fraud on 0300 123 2040.

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