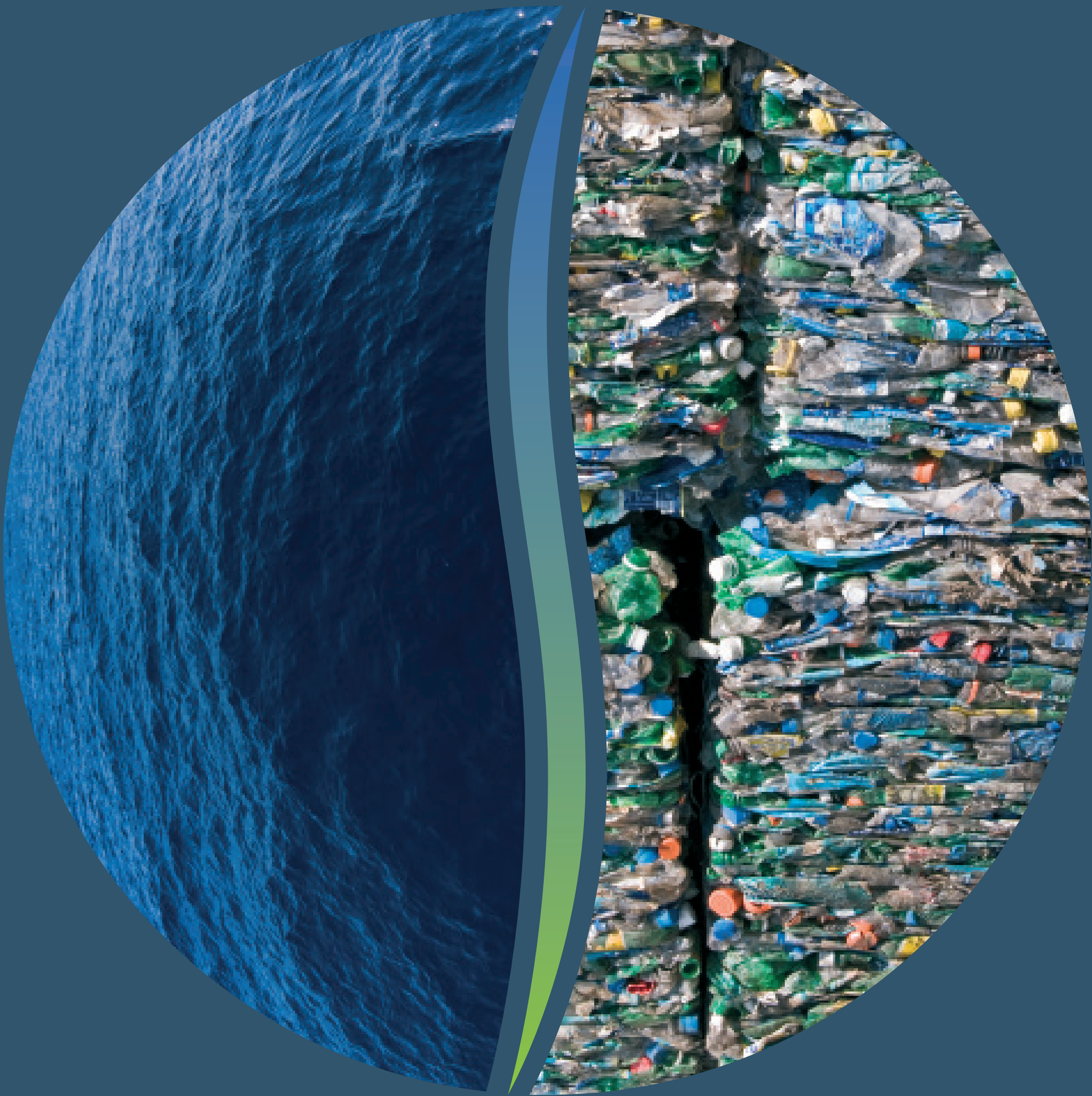


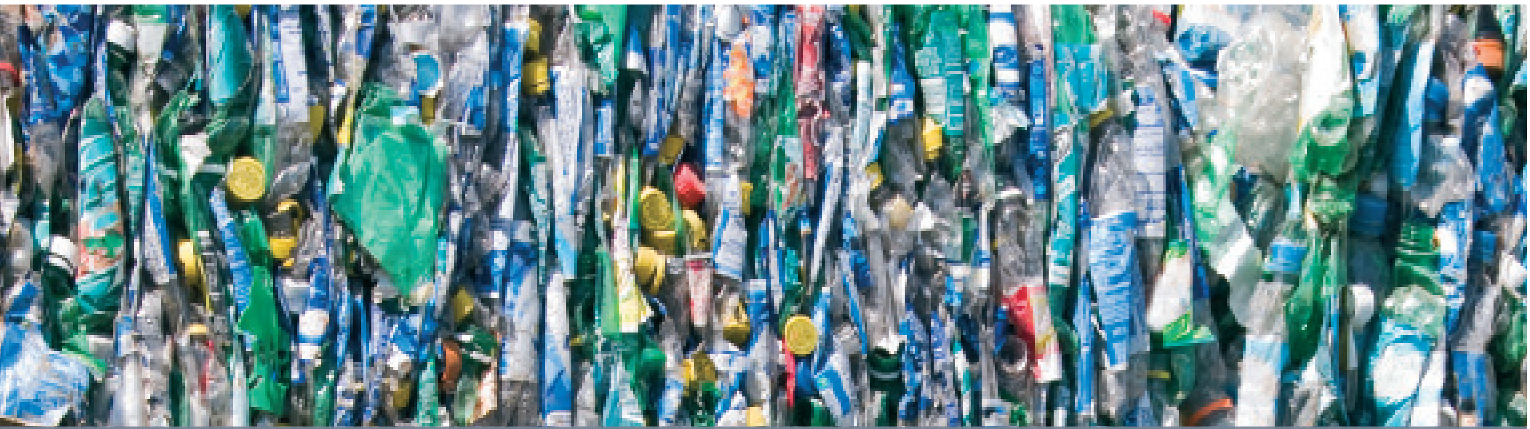
PENNON
GROUP PLC

Annual Report and Accounts 2013

Contents

PENNON GROUP PLC

To view our online report visit:
www.pennonannualreport.co.uk/2013



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 £4.7 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.

“”

As one of the largest environmental and resource management groups in the UK, Pennon’s business is all about sustainability.

Group highlights

Pennon Group

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

Financial highlights

Revenue
£1,201.1m
-2.6%

Profit before tax*
£198.2m
-1.1%

Assets
£4.7bn

Dividend
+7.3%

*Before exceptional net charges. Statutory basis £21.8 million.

South West Water

The water and sewerage services provider in Devon, Cornwall and parts of Dorset and Somerset – delivering strong operational and financial performance.

Financial highlights

Revenue
£498.6m
+5.2%

Profit before tax*
£152.1m
+7.5%

*Before exceptional net income. Statutory basis £164.6 million.

Viridor

One of the leading UK recycling, renewable energy and waste management businesses – achieving further significant progress in its long-term contract and energy from waste activities.

Financial highlights

Revenue
£703.8m
-7.5%

Profit before tax*
£36.5m
-36.6%

*Before exceptional charges. Statutory basis loss £152.4 million.

Highlights of the year

- **In a challenging year, delivered profit before tax (before exceptional items) only marginally below the previous year**
- **Group capital expenditure up 61% to £439 million**
- **£300 million hybrid capital issue provides substantial additional funding and strengthens balance sheet**
- **Group businesses well positioned for the future.**

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.

Strategy in action

- Committed to an annual dividend increase of 4% above inflation up to 2014/15
- Continued focus on our two environmental utility infrastructure businesses undertaking sustainable activities which make a positive impact on communities and the environment
- £439 million invested in key infrastructure supporting the development of the UK economy
- Group well funded with efficient long-term financing.

Highlights of the year

- **Ongoing outperformance of efficiency targets**
- **Strong operational performance despite extreme weather events**
- **88% improvement in Service Incentive Mechanism (SIM) score since the opening K5 position**
- **£60 million reinvested to enhance protection for bathing waters, private sewers and help customers in most need.**

Strategy

At the core of South West Water's strategy is the company's commitment to delivering the services its customers depend on in the most cost-effective and sustainable way.

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, rigorously controlling costs underpinned by efficient funding.

Highlights of the year

- **Strong progress in long-term Public Private Partnership (PPP)/ energy from waste (EfW) strategy**
- **Significant current headwinds in recycling and ongoing trend decline in landfill - aggressive action to reduce costs**
- **Exceptional charges - total £150 million net of tax**
- **Four more key long-term PPP/EfW contract developments.**

Strategy

Viridor's strategy is to transform waste, adding value through recycling and renewable energy generation.

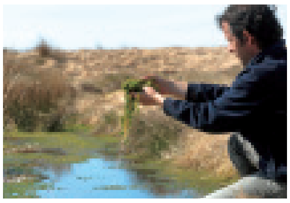
Strategy in action

- Substantial further progress during 2012/13 in the development and roll-out of Viridor's PPP/EfW pipeline
- Capital expenditure of £292 million on Viridor growth projects, mainly EfW
- Recyclate traded increased by 5.6% to 1.9 million tonnes.

Key performance indicators*

1

2



3

4

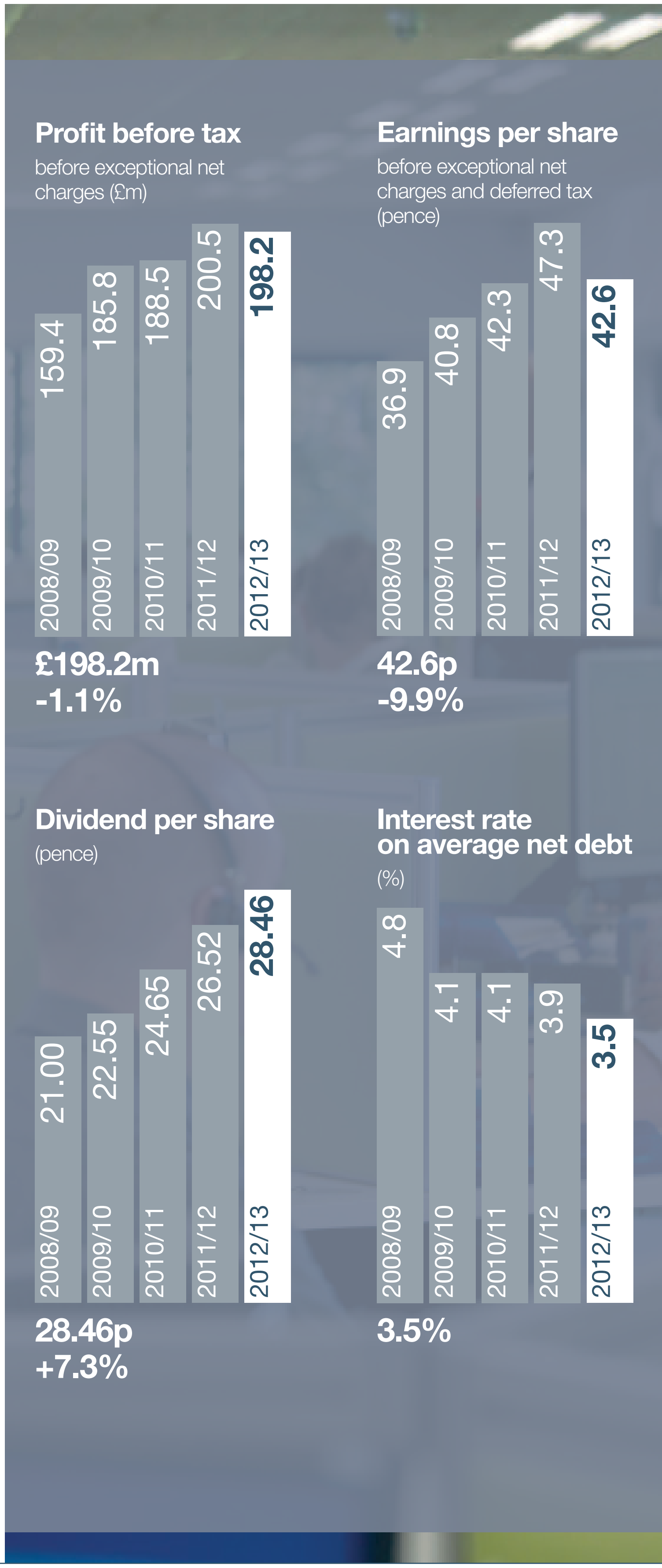
5

6

1 Energy from waste (EfW) facility, Lakeside, near Slough
2 Viridor customer waste collection
3 'Upstream Thinking' catchment management project
4 Tunnel under Roadford Dam, Devon
5 Viridor graduate management scheme employee, Hannah Kirkpatrick
6 Laboratory, Countess Wear waste water treatment works, Exeter

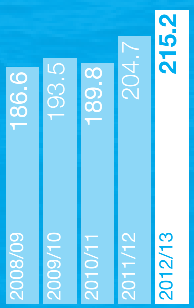
* These are key performance indicators we use to measure the performance of our businesses as described in our business model on page 11.

Pennon Group



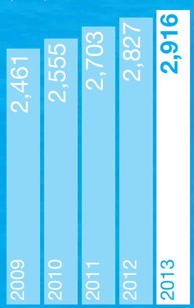
South West Water

Operating profit (£m)



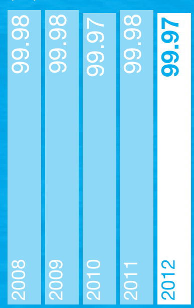
£215.2m +5.1%

Regulatory capital value as at 31 March (£m)



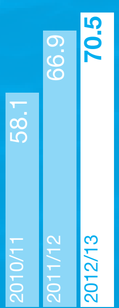
£2,916m +3.1%

Drinking water quality Mean Zonal compliance (%)



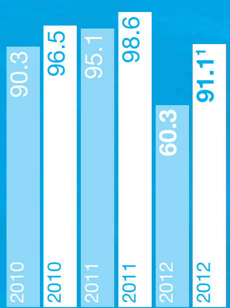
99.97%

Service Incentive Mechanism (SIM)



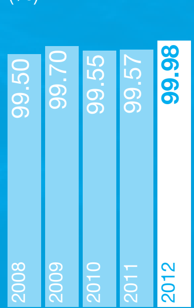
70.5% +5.3%

Bathing water compliance (%)



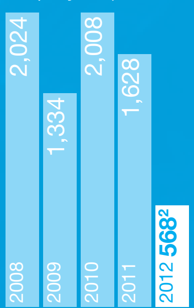
■ **EU Mandatory Standard**
■ **Guideline Standard**

Population Equivalent Sanitary Compliance (%)



99.98%

RIDDOR incidence rate (per 100,000 employees)

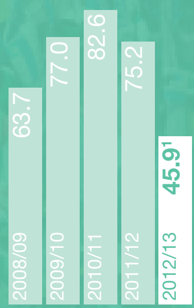


Actual no. 7

[1] Change in reporting standard for 2012 bathing season (UK rather than EU criteria).
[2] Change in RIDDOR reporting criteria (see page 53 for details).

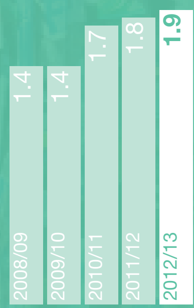
Viridor

Operating profit plus joint ventures (£m)



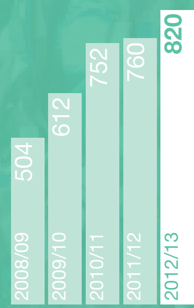
£45.9m –39.0%

Recyclate traded (million tonnes)



1.9m tonnes +5.6%

Total renewable energy generation (GWh)

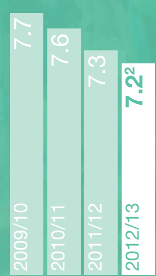


820GWh +7.9%

Renewable energy generation capacity as at 31 March (MW)

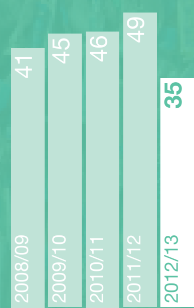
137MW

Total waste inputs (million tonnes)



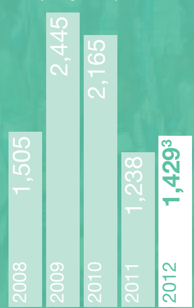
7.2m tonnes

Share of profit from recovering value in waste (%)



35%

RIDDOR incidence rate (per 100,000 employees)



Actual no. 45

[1] Before exceptional charges.
[2] Previous years restated, excluding waste not treated at Viridor facilities.
[3] Change in RIDDOR reporting criteria (see page 53 for details).

Chairman's statement

> In a challenging year for both South West Water and Viridor, the Group has achieved a profit before tax* only marginally below the previous year.

Dear shareholder

Business performance
Group revenue was down by 2.6% to £1,201 million and profit before tax* decreased by 1.1% to £198 million. We continue to maintain substantial cash resources and facilities and we ended the year with a record level of £1.15 billion.

Despite the extreme weather events of 2012/13 impacting on aspects of its operations South West Water performed well, achieving further advances in operating efficiency and customer service. It is on target to outperform the K5 (2010-2015) regulatory contract. The company has front-end loaded delivery of the operating cost efficiencies required by Ofwat and is now sharing the benefit of its K5 outperformance to date with customers by reinvesting around £60 million in further improvements to services.

Viridor experienced a mixed year. Trading was significantly down on last year, with declines in recycling and landfill outweighing the continued growth in joint ventures. The company has responded aggressively to these near-term challenges which have necessitated site rationalisations, headcount reductions and exceptional charges in relation to asset impairments and provisions.

On the positive side, Viridor has continued to make very strong progress on its growing Public Private Partnership (PPP) and energy from waste (EfW) pipeline with major new contracts having been signed and key planning permissions obtained. These and similar projects are expected to drive Viridor's long-term profit growth.

Dividend
The Board is committed to its policy to grow dividends for shareholders by 4% above inflation per annum up to the end of 2014/15. This reflects our continued 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 19.70p, which represents a 7.7% increase on last year's final dividend. This will result in a total dividend for the year of 28.46p, an increase of 7.3% (reflecting inflation of 3.3%) on the total dividend for 2011/12. We will again be offering a Scrip Dividend Alternative to shareholders in respect of the final dividend for which the timetable is given on page 144.

Sustainability and governance
The Sustainability Committee of the Board continues to oversee our performance in maintaining a responsible approach to environmental, social and governance (ESG) matters. The business review and the sustainability report set out more fully our commitment to ESG and our notable achievements during the year which include carbon reduction, enhancements to water security, water catchment management and resource security and efficiency.

In addition Viridor was ranked 'Bronze' in the Business in the Community (BitC) annual Corporate Responsibility Index, a major achievement given that it was the company's first year in the Index. It was also the first company in its sector to achieve ISO 50001 (Energy Management System) accreditation.

South West Water won both an inaugural Institute of Chartered Accountants in England and Wales (ICAEW) Finance for the Future Award (large business category) and the Environmental Award at the Utility Industry Achievement Awards for its flagship programme of work to improve raw water quality and natural water storage, 'Upstream Thinking'.

* Before exceptional net charges.

The Group's governance arrangements continue to be reviewed annually to ensure we develop and improve our governance structures and practices taking account of market developments and new best practice guidance. The corporate governance report on pages 60-71 sets out the developments in the year which include continued improvement of processes and controls, including IT systems, to meet the increasingly complex needs of our businesses.

Health and safety
We continue to strive towards achieving our goal of zero accidents across the Group. We are pleased to see a significant reduction in the number of reportable accidents in South West Water, although we are disappointed that 2012 saw an increase for Viridor. The company is redoubling its efforts to drive down the number of accidents. Health and safety initiatives during the year have included prioritising employee engagement and training alongside the Group's ongoing focus on fundamental risk assessment systems and safety management procedures.

Board succession
As I mentioned in last year's Annual Report, after 10 years as a Non-executive Director of the Company, Dinah Nichols will be retiring from the Board at the Annual General Meeting (AGM). I thank Dinah for her considerable contribution to the Board over the years including her chairmanship of the Sustainability Committee which has managed very successfully an increasingly complex ESG agenda. Gill Rider joined us as a Non-executive Director on 1 September 2012 and we plan to appoint a further Non-executive Director in due course who will succeed Gerard Connell when he retires at the 2014 AGM, after some 10 years as a Non-executive Director.

After 20 years as Chief Executive of Viridor, Colin Drummond has announced his retirement from both that position and as an Executive Director of the Board. I am pleased that he has agreed to take up the position of non-executive Chairman of Viridor once his successor has been appointed. This is expected to be by the end of September 2013. I thank Colin for the tremendous contribution he has made to the success of Viridor and Pennon over the last 20 years.

Diversity
Following on from introducing last year a Boardroom Equality & Diversity Policy, which incorporated the recommendations of the Davies Review 'Women on Boards', the Board has continued to promote equality and diversity across the Group. We have had during most of the year 25% female representation on the Board but we recognise that this will not be maintained, at least for a period, whilst the Board transition referred to above takes place. We will still endeavour to achieve a minimum of 25% female representation on the Board by 2015 and a minimum of 25% female representation in our senior management.

Our customers
Vitally important for both our businesses is the provision of the highest possible levels of service to our customers, which is reflected in our Group strategy.

During the year South West Water has further developed its affordability toolkit for customers who are struggling to pay their water bills and has a new social tariff for 2013/14 which is aimed at its most hard-pressed customers. The company has also established new partnerships with Age UK to target support for older customers and with housing associations to engage with low income customers.

Viridor continues to assist its customers in identifying the most robust and cost-effective waste treatment options in a changing market as landfill diversion increases. It also helps customers to identify the carbon saving benefits of recycling, recovery and good waste and resource management, with its carbon reporting tool which is scheduled to be updated further this summer.

Our employees
We know that the skills, commitment and hard work of our employees continue to be key to the success of our Group. We are focused on rewarding, recognising and developing our employees through a number of initiatives and strategies, details of which are given in the business review. I would like personally 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 in what has been a challenging year.

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

South West Water continues to focus on efficient service delivery, improvements in service to customers and the satisfaction of its regulatory and legislative obligations. As a consequence it is well on track to outperform the K5 regulatory contract. The company is preparing for the next regulatory review (PR14) and is well positioned for the Government's legislative changes.

Viridor faces near-term headwinds in recycling and the ongoing trend decline in landfill. The company continues to focus on quality in recycling and delivery of its PPP/EfW pipeline which is expected to drive the company's long-term profit growth.

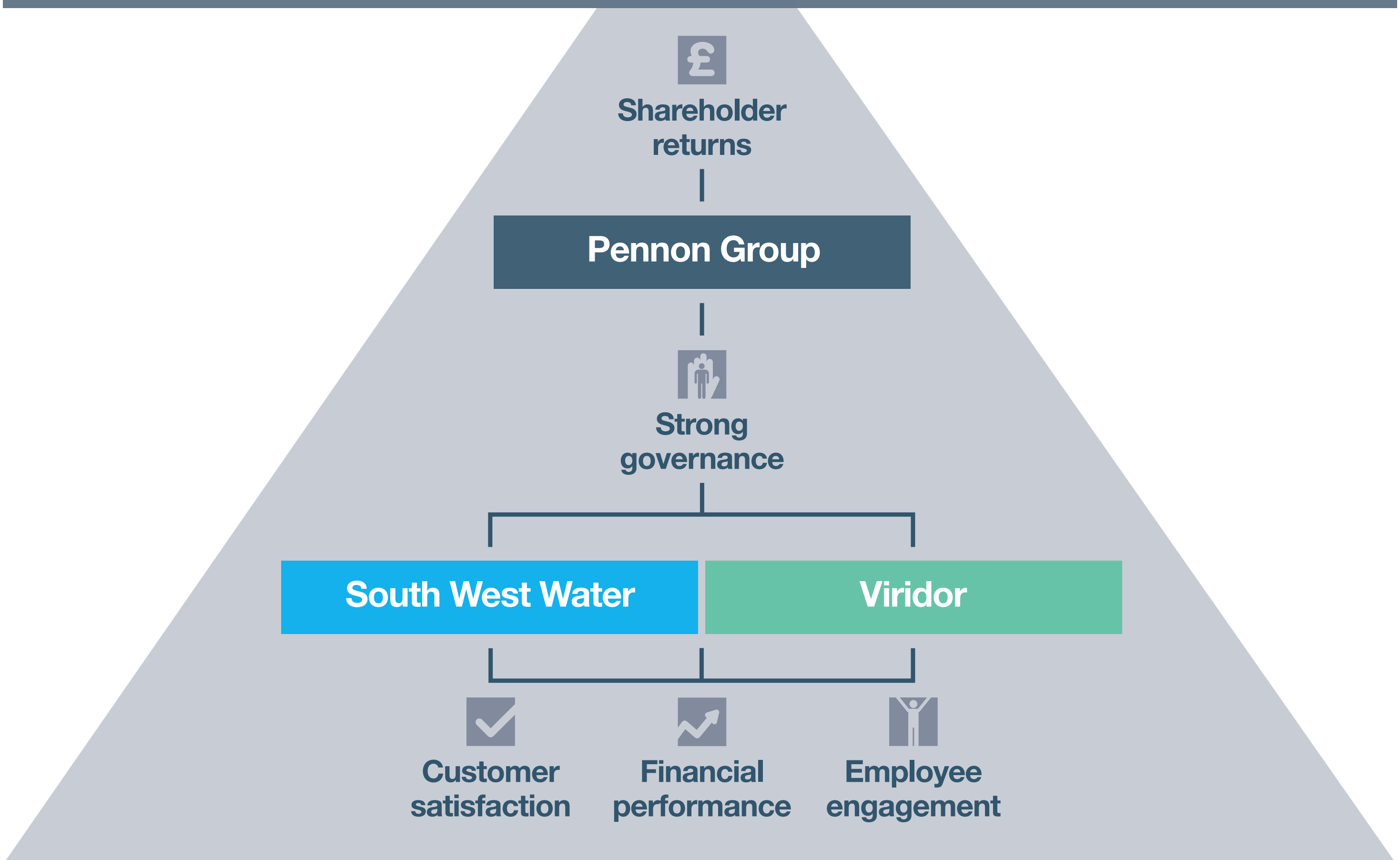
Notwithstanding the current challenges, I remain confident about the future success of our business. The Group has strong liquidity and funding and is well positioned for future growth in the best interests of our shareholders and other stakeholders.

Ken Harvey
Chairman
Pennon Group Plc
25 June 2013

Our business model

How we generate and preserve value

Pennon's business model is driven by its strategy of promoting the success of the Group for the benefit of shareholders, customers and other stakeholders through its 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.

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

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

Viridor's business model is based on growing and adding value by maximising sale of high quality recyclate, growing its EfW and PPP operations and exploiting the huge potential inherent in waste-based renewable energy generation.

How we manage our businesses to create value

Customer satisfaction

Both South West Water and Viridor are fully committed to meeting the needs of their customers. This is key to the success of each business.

How we respond to our customers' needs and assess customer satisfaction is set out on pages 19, 20, 21, 24 and 28 of the business review.

Financial performance

Our Group has set challenging financial targets against which performance is measured through a range of key performance indicators (KPIs). These KPIs include profit before tax (before exceptional items), earnings per share (before exceptional items and deferred tax), dividend per share and the interest rate on average net debt.

Our focus in setting such targets is to achieve sustainable performance over the short and long-term.

Our financial performance is set out in more detail on pages 30-35.

Shareholder returns

We are committed to delivering sustainable shareholder returns. An example of this is our policy to grow the Group dividend by 4% above inflation per annum up to 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. To address this we take a responsible and transparent approach to environmental, social and governance (ESG) matters.

Our sustainable practices not only benefit communities, but enable our businesses to be more successful.

More information on our sustainability activities are set out on pages 48-57.

Employee engagement

We know 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 employee well-being, retention, efficiency and productivity.

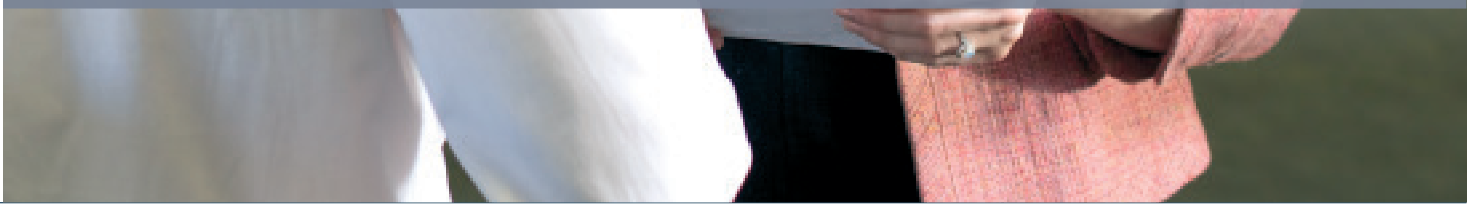
More information on the initiatives we have introduced to improve employee engagement in each of our businesses is set out on pages 15, 20, 28, 54 and 59.

How we operate and manage risks

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.

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 70 and our principal risks and uncertainties and how we mitigate them are set out on pages 36-47.



Strategic Q&A

Delivering on our strategy

2012/13 was a challenging 12 months for Pennon. Group Director of Finance David Dupont, South West Water Chief Executive Chris Loughlin and Viridor Chief Executive Colin Drummond discuss performance and outline their strategic approach to the main challenges they face.

> The Group policy is to grow the dividend by 4% above RPI up to the end of 2014/15.
>
> **David Dupont, Group Director of Finance**
> Pennon Group

What were the highlights of the year and how do they reflect Group strategy?
David Dupont
South West Water continued to perform strongly both operationally and financially towards achieving its target for the K5 period, which is in line with its strategy. While Viridor's results were impacted by the significant reduction in recyclate prices, reflecting world economic conditions, it has made substantial progress in pursuing strategic development of its energy from waste (EfW)/Public Private Partnership (PPP) pipeline.

To support this investment, the Group raised a record amount of new funding during the year – £782 million in total – including a £300 million hybrid capital instrument which strengthens the Group's balance sheet as well as providing additional funding. The Group ended the year with a record level of cash and facilities totalling £1.15 billion.

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 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 Price Determination and projected growth from Viridor's long-term contracts and EfW 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 £1.15 billion (including £143 million restricted cash) with £782 million of new/renewed facilities secured during the year. The construction phase of Viridor's committed EfW plants is now substantially funded and we are continuing to talk to a wide range of finance providers 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
Through our ongoing investment in our assets and networks we continued to deliver outstanding drinking water quality, meet our leakage target and reduce the average length of water supply interruptions per customer.

On the waste water side of the business a targeted programme of investment at 96 sites meant we achieved our best ever compliance rates for waste water treatment. Also, whilst there was an increase in Category 3 or 'minor' incidents, improvements in our monitoring systems and response times helped us to successfully avoid any Category 1 or 'serious' pollution incidents and we also saw a reduction in the number of Category 2 or 'significant' incidents.

Our PUROS* project, which uses remote technologies to manage processes and operational staff from a central hub, continues to help us improve our efficiency. Meanwhile our investment in renewable energy is also bearing fruit with the amount of energy generated through renewable sources – most notably our hydro turbines – reaching its highest ever level.

2012 started with environmental drought conditions, but for most of the year the South West experienced extreme wet weather. How did this impact on South West Water's operations and how were they managed?
CL
Thanks to the use of pumped storage during the prior winter, investment in the supply system in 2011 and careful resource management, South West Water was able to avoid any water restrictions for the 16th consecutive year. This was despite the environmental drought that was declared in April 2012 by the Environment Agency.

In stark contrast April 2012 through to March 2013 has been classified as a 'one in one hundred years' wet weather event. This had various implications for our operations including increased energy usage due to the need for more waste water pumping activity and an increase in the number of sewer flooding incidents.

* Phased Utilisation of Remote Operating Systems.

David Dupont, Group Director of Finance, Pennon Group

Spillway at Roadford Reservoir, Devon

Chris Loughlin, Chief Executive, South West Water

In the case of the latter South West Water worked alongside partner agencies, including councils and emergency services, to minimise any disruption caused. In the long term it is our intention to invest in a holistic approach to the management of waste water and flooding. This will include traditional engineering-based solutions alongside cost effective steps to manage excess surface water or rain water through innovation in areas such as sustainable urban drainage and ecosystem management.

The wet weather also highlighted the importance of investment in resilience, such as flood defences. In 2011 we installed flood protection measures at Pynes Water Treatment Works which serves Exeter. This proved invaluable during the deluge in the run-up to Christmas 2012 which saw the closure of the adjacent railway mainline.

Why has South West Water decided to embark on a £60 million reinvestment programme to fund further improvements to services for customers? What will it involve and where will the company get the money from to fund this investment?
CL
We want to share the benefits of our good financial performance with our customers by investing more where it is most needed. Investing now in our network and treatment works to protect bathing water quality, will help minimise the risk of these vital beaches losing their status, which would have a serious knock-on effect on one of the region's main industries – tourism.

So the aim of our reinvestment programme is to protect bathing water quality at key tourist beaches, maintain nearly six thousand kilometres of former private sewers and help customers in the most need. This investment initially will be funded from the efficiency savings that South West Water has made in the current regulatory period, having no impact on the average household bill, which is reduced in 2013/14 following the implementation in April of the Government's £50 reduction on household bills.

How are you preparing for the price review which takes effect from 2015? What do you expect to be the key investment drivers for the five-year period from 2015-2020?
CL
Extensive customer and stakeholder research and a range of on and offline engagement activity has been carried out as part of South West Water's 'WaterFuture' campaign in order to find out their priorities for the future. This helped inform our 25-year WaterFuture outlook which was published in December 2012 to outline our long-term aims and some of the steps we plan on taking during the next K period (2015-2020).

The main investment drivers for that period arise from further improvements to and protection of bathing waters; the revised Water Framework Directive legislation; the adaptation to and mitigation of extreme weather and climate change; the need to maintain our asset base; and the supply and demand pressures from the population growth forecast for our region.

Consultation is ongoing and our business plan is being developed further in time for submission to Ofwat in December 2013.

We are also targeting a holistic approach to the prevention of pollution and sewer flooding.

How is South West Water responding to the points raised by Jonson Cox, the new Chairman of Ofwat, in his lecture 'Observations on the regulation of the water sector'?
CL
Mr Cox's particular focus was on corporate governance and transparency in respect of companies in the private sector. South West Water is one of only a few listed water companies and, as such is already subject to disclosure on corporate governance through, and in close operation with, the Pennon Group Board. To further promote good governance and transparency, South West Water has established its own audit committee of the South West Water Board and is reviewing in detail the points raised by Mr Cox in his lecture to ascertain whether the company needs to undertake any further actions to address the issues raised.

> South West Water was able to avoid any water restrictions for the 16th consecutive year.
>
> **Chris Loughlin, Chief Executive**
> South West Water

Strategic Q&A
Continued

Colin Drummond, Chief Executive, Viridor

Trident Park EfW, Cardiff, under construction

You have indicated that the long-term growth from Viridor's EfW/PPP pipeline is expected to start to flow in from 2014/15. What do you expect for 2013/14 given the ongoing trend decline in profits from landfill and the current uncertainties in recycling?

Colin Drummond

Trading conditions for Viridor between October to December 2012 were particularly tough and results for the second half of 2012/13 were down on the first half. Whilst recyclate prices have recovered somewhat from the lows of October to December we remain cautious about any further substantial increase.

We believe we have faced up to the situation head on and undertaken the necessary actions to ensure that we are well placed to manage future challenges to the business going forward. Our 2013/14 results will progressively show the benefit of the cost reductions we have implemented in recycling, whilst our landfill gas power generation business will benefit in the second half from the transfer of more of our historic Non Fossil Fuel Obligation (NFFO) contracts to higher priced Renewables Obligation (RO) contracts.

> Viridor's EfW/PPP pipeline is expected to drive the company's long-term profit growth.
>
> **Colin Drummond, Chief Executive**
> Viridor

There were significant exceptional charges in respect of Viridor in 2012/13. Does this imply that there is a change in strategy or that the previous strategy was wrong?

CD

No. The exceptional charges primarily flow from our strategy and also reflect our speedy response to greater than expected weakness in UK and world economic conditions. Our strategy recognises that landfill is a declining business; this is the basis for our growth in recycling, where we are now the UK leading operator of materials recycling facilities (MRFs), and in EfW projects, where our pipeline of projects is expected to make us a UK market leader with over 15% market share by 2020.

As a result we have recognised a non cash impairment to reflect declining landfill volumes and the fact that some of our landfills will not now be filled to the degree previously envisaged – indeed on three of them (Ardley, Beddington and Dunbar) we plan to build EfW facilities. We have also increased our landfill provisions to reflect both the revised final landforms now projected and the latest Environment Agency guidance. In addition, though we had expected a decline in commodity prices, the actual fall was much more severe than we (and perhaps many others) had expected. This has necessitated closure of certain uneconomic MRFs, redundancies and non cash asset impairment in our recycling business.

Viridor has made significant progress in growing its pipeline of energy from waste projects. Do you see a danger of over-capacity in the UK?

CD

We have carefully evaluated projected demand and competing capacity for each of our planned EfW facilities and are confident that we will fill them profitably. With landfill tax set to reach £80 per tonne in April 2014, large scale EfW facilities of the type we are building will be the low cost way of disposing of residual waste. They will also be the UK's lowest cost source of base-load distributed renewable energy which will assist in addressing the UK's increasing energy shortage.

In total we estimate that, on the basis of government policies and trends in recycling, there will be a need for around 20 million tonnes of EfW capacity in the UK by 2020. When we review current competing projects and take account of planning barriers, financing difficulties and the lack of further large base-load municipal contracts, we calculate that there will be a capacity shortfall of up to 25%. Of the 2.5 million tonnes capacity we are committed to operating by 2020, more than half (1.3 million tonnes) is already backed by long-term municipal contracts.

Do you see risks in delivering the large energy from waste pipeline?
CD
We have an enviable pipeline of EfW/PPP contracts. The main challenge is delivery. Our policy is to have well protected and carefully constructed, fixed-price contracts with established contractors providing proven technology. We recognise that as our pipeline increases so does the absolute level of risk and we have grown our organisation accordingly, including the appointment in 2012/13 of a Capital Projects and Engineering Director (previously a director in the nuclear industry). The main risk we see is delay on the part of our contractors, against which we have contractual protection which we will call upon if we have to.

Are you sorry to be retiring as Chief Executive and why now?
CD
I am sorry to be retiring but now is the right time for me and for the company. Over the past few years Viridor has won the major EfW/PPP contracts and achieved the associated planning permissions which are expected to grow its EBITDA by £100 million over the next four years. At the same time we have been implementing a management succession plan to manage the retirement of a number of highly skilled and long serving directors; Viridor now has a new team of five experienced executive directors in addition to myself, alongside three non-executive directors with significant relevant skills. I am two years beyond my normal retirement date and therefore my retirement is now appropriate. However, I am delighted and privileged to be able to continue to contribute to Viridor in the different role of chairman of the Viridor Board.

What have been the major changes in Viridor over the past 20 years?
CD
Viridor has been transformed from a local South West waste collection and landfill company to one of the UK's leading recycling, renewable energy and waste management companies. During the first ten years we established and capitalised on our position as a leading player in the landfill market in key regions of the UK. From 2002, whilst landfill remained a very profitable business, we were able to achieve significant further profit growth from the sale of renewable energy generated from the gas produced by our landfills, growing our associated generation capacity from 28MW to a current 107MW. In 2005, with projected steep rises in landfill tax, we recognised the commercial opportunity represented by the UK's move towards greater recycling and gradually established ourselves as the UK's leading operator of MRFs.

More recently we have focused on providing an alternative to landfill for final disposal of residual waste which cannot be recycled; this is the basis of our investment programme which will see Viridor become one of the largest operators of EfW facilities in the UK and a major supplier of renewable energy with a total capacity of over 300MW.

We have become a more sustainable business in environmental, social and economic terms, embedding the care and enhancement of the environment and community benefit into our business.

This is illustrated by our obtaining ISO 9001, ISO 14001 and OHSAS 18001 accreditations and in 2012/13 achieving ISO 50001 energy management accreditation and being ranked 'Bronze' in the Business in the Community (BitC) annual Corporate Responsibility Index.

We have created jobs, increasing from around 200 employees to over 3,000 (in addition to the substantial numbers employed by our contractors and subcontractors in our £1.5 billion capital investment programme), though we have had to implement some painful redundancies over the past year.

Our health and safety performance has generally improved but more is still to be done to achieve our goal of zero accidents. We have made significant progress in employee development with our extensive apprenticeships, a very successful graduate programme and most recently the Viridor in-house degree (inconceivable in the waste industry a few years ago). However, together with the rest of our sector, we lag behind in gender diversity with few women employed at senior levels in the company and none on the Viridor Board. We have plans in place to address this.


EfW/Combined Heat and Power (CHP) facility, Runcorn, under construction

South West Water
Focused on operational excellence

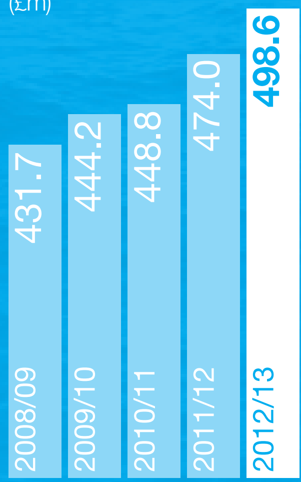
Operational highlights

- 16 consecutive years without water restrictions
- Leakage control on target
- Excellent drinking water quality
- Improved customer service
- Best ever waste water treatment performance
- Highest ever renewable energy output

Notable achievements

- £60 million of reinvestment announced
- New Customer Relationship Management System rolled out
- Expansion of services for business customers
- Winner of the ICAEW Finance for the Future Award (large business category) and the Environmental Award at the Utility Industry Achievements Awards
- Extensive customer and stakeholder engagement ahead of 2014 Price Review (WaterFuture)
- Pioneered advanced drinking water treatment technology

Revenue
(£m)



£498.6m
+5.2%

Profit before tax*
(£m)

£152.1m
+7.5%

* Before exceptional net income.

Where we operate

- Reservoir
- Key Water Mains

1.68m
Resident population

29
Drinking water treatment works

641
Waste water treatment works

15,200km
Water mains

15,600km
Sewers

Strategy and performance

South West Water remains committed to its Pure Water, Pure Service and Pure Environment vision. The company strives to achieve the highest standards possible in every sphere of its activity, delivering efficiency through innovation, meeting the needs of those it serves and meeting its responsibilities to the environment, while keeping its costs as low as possible.

Pure Water

Providing a reliable supply of safe, clean drinking water.

Performance
Top quality drinking water and leakage control and a 16th consecutive year without drinking water restrictions.

Pure Service

Delivering responsive and cost-effective services that meet customers' needs.

Performance
Improved customer satisfaction, expansion of business services under 'Source for Business' and metering over 75% of domestic customers. Robustness of asset base illustrated in the maintenance of 'stable serviceability'.

Pure Environment

Protecting the world around us through sustainable actions and initiatives.

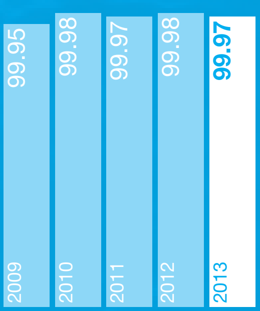
Performance
Best ever waste water treatment compliance rates*, renewable energy generation at a record high, zero major pollution incidents and a reduction in serious pollution incidents.

Financial

Making resilient business decisions while outperforming the regulatory contract.

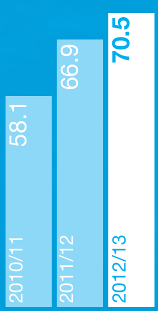
Performance
Efficiency targets exceeded. Operating profit increased and rigorous cost control achieved. Capital programme efficiencies remain on track.

Drinking water quality
Mean Zonal Compliance
(%)



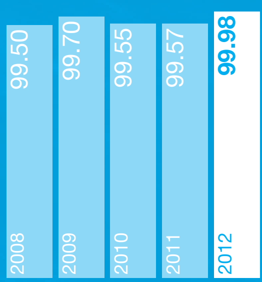
99.97%

Service Incentive Mechanism
(SIM)



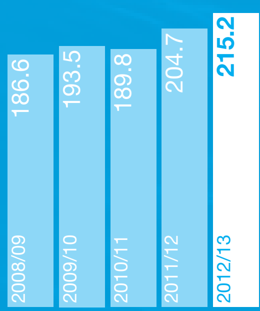
70.5%
+5.3%

Population Equivalent Sanitary Compliance
(%)



99.98%

Operating profit
(£m)



£215.2m
+5.1%

* Population Equivalent Sanitary Compliance 2012/13: 99.98% (2011/12: 99.57%).
Numeric Compliance 2012/13: 97.1% (2011/12: 92.1%).

To view our online annual report:
www.pennonannualreport.co.uk/2013

Business review

Business performance

Against a backdrop of extreme weather events ranging from environmental drought to flooding, South West Water continued to deliver solid operational performance and strong financial results in the year while raising its standards of customer service.

Increased revenue and rigorous cost control were underpinned by the continued delivery of efficiencies resulting in operating profit increasing by £10.5 million to £215.2 million. An overall reduction in demand of almost 3% and the effect of customers switching to a metered tariff was offset by tariff increases and new connections with revenue rising by 5.2% to £498.6 million. Profit before tax (excluding exceptional net income) increased by 7.5% to £152.1 million.

The company has front-end loaded delivery of the required 2.8% per annum average cost efficiencies with an average 4.1% per annum delivered in the first three years of this K period (2010-2015). The K5 efficiencies to date total £18.6 million with £3.5 million of that total delivered in the year through a combination of the following:

- improved operational ways of working from the integration of customer services management and asset improvements through the PUROS* programme
- energy procurement and usage – energy efficiency schemes alongside additional power generation through renewable sources
- rationalising administration and support services
- right-sourcing and innovative contracting – continued tendering to achieve the 'right price'.

Capital expenditure for the year was £116.5 million compared with £130.8 million in 2011/12.

Major investments were made in the improvement of waste water treatment works in order to achieve compliance, sewer rehabilitation, and clean water network improvements targeting reliability, water quality and security of supply. The private sewer adoption in October 2011 – which increased South West Water's sewer network by 50% – also necessitated £6.7 million of additional expenditure.

South West Water's main investment focus continues to be on the maintenance of existing assets alongside improvements necessary to:

- enhance high standards of water and sewerage services that meet customer expectations
- increase the resilience of the infrastructure
- deliver environmental improvements
- meet emerging legislative and regulatory obligations
- enhance sustainability of water resources.

* Phased Utilisation of Remote Operating Systems

In previous K periods South West Water has historically shared the benefits of financial outperformance with customers through reinvestment of efficiencies and accelerating capital expenditure. The company's strong operational and financial outperformance in K5 to date will enable it to reinvest around £60 million on improving services to customers through:

- upgrading assets in key bathing waters by accelerating capital investment
- maintaining and enhancing sewers that were adopted as part of the private sewer transfer in October 2011
- tackling customer affordability through debt initiatives.

"South West Water continued its upward trend of customer service improvement as measured by Ofwat's Service Incentive Mechanism."

Chris Loughlin, Chief Executive
South West Water

UV treatment at Waste Water Treatment Works, Brokenbury

Construction of storm storage tank at Lostwithiel, Cornwall

Operational performance

Pure Water

Drinking water quality
In 2012 South West Water once again achieved a near perfect standard (99.97%) for the quality of its drinking water as measured by the Drinking Water Inspectorate's Mean Zonal Compliance (MZC) measure. This success can be attributed to the company's ongoing investment in the maintenance and improvement of both drinking water treatment processes and the mains network. South West Water is also committed to addressing any taste, odour or discolouration issues – in 2012/13 this included pioneering steps taken to utilise advanced oxidisation processes at Drift Water Treatment Works in West Cornwall, a first in the UK.

Water resources
Despite some of the driest conditions in decades (a state of 'environmental drought' was declared in mid April 2012 by the Environment Agency), South West Water was able to continue delivering unrestricted supplies to its customers for the 16th consecutive year.

Reservoir levels remained healthy throughout the dry period as a result of pumped storage during winter 2011/12, investment in the supply system in 2011 and careful resource management.

The extreme wet weather that followed from April 2012 to early 2013 resulted in reservoir storage levels subsequently reaching near full capacity. South West Water is therefore confident that no water restrictions will need to be put in place during 2013/14.

Leakage control
South West Water's performance in minimising leakage remained on target. The company expanded its pressure management activity to reduce the risk of failures in the network, increased its use of remote technologies to improve the efficiency of its leak detection teams and took steps to improve the analysis of flow data in order that potential problems could be identified more quickly.

Upstream Thinking: sustainable water management
South West Water's flagship programme to improve raw water quality and natural water storage in the landscape continued in the year. The 'Upstream Thinking' initiatives, which target a reduction in water treatment costs, include the restoration of wetland areas on the region's moors and schemes to reduce the impact of farming and industrial activity on specific catchment areas. The actions delivered by the programme in K5 to date include:

- over 300 hectares of land restored
- working with farmers across the catchments, supporting investment at 161 farms
- 17 studies/investigations completed on further catchment areas to inform future investments at 2014 Periodic Review.

The project has won several awards since its inception. In 2012 these included an inaugural Institute of Chartered Accountants in England and Wales (ICAEW) 'Finance for the Future' Award (large business category) and the 'Environmental Award' at the Utility Industry Achievement Awards.

Pure Service

Customer satisfaction
South West Water continued its upward trend of customer service improvement as measured by Ofwat's Service Incentive Mechanism (SIM) with a 5% increase on the previous year (2011/12: 66.9, 2012/13: 70.5). SIM takes into account a range of customer service aspects including the number of written complaints received and the results of customer satisfaction surveys. This year's score represents an 88% improvement since the start of K5.

The number of written complaints has halved during K5 and the number of escalated complaints has been reduced by 84%. The results reflect both improvements made at an operational level and steps taken to improve customers' experience – in July 2012 South West Water introduced a new Customer Management System to enhance customer satisfaction.

Metering
During the year South West Water installed over 12,800 meters, taking the total percentage of domestic customers who are metered to over 75%.

As part of its metering strategy South West Water began a programme of SMART metering in 2012/13. These transmit real-time information about water usage, thereby improving the accuracy and efficiency of the billing system while also giving customers a better understanding of how much water they are using.

The £50 Government Payment
First announced in autumn 2011 and implemented for 2013/14 charges, the £50 Government Payment – an annual bill reduction of £50 for all eligible household customers – is a recognition of the historic 'unfairness' to customers associated with the bill impact of South West Water's environmental clean-up over the past two decades in a region that has one third of the UK's beaches but only around 3% of its resident population.

The announcement was welcomed by customers, regional media and MPs, many of whom had actively campaigned, alongside South West Water, for Government action on this issue.

Business customers
South West Water continued to expand its relationships with commercial and other non-domestic customers (e.g. local councils, hospitals and other public bodies). Against the backdrop of difficult economic circumstances, the advice and assistance provided by South West Water available through its 'Source for Business' initiative has been well received by the region's business community.

The Source for Business services include dedicated contact routes to business customer specialists; bill validation; a named account manager for larger organisations; project management; laboratory and analytical services; water and process efficiency advice; and advice on capital solutions.

Business review
Continued

Pure Environment

Waste water treatment
In 2012 South West Water's long-standing endeavours to raise the standard of the waste water it returns to the environment were reflected in its best ever compliance score of 99.98% for the percentage of population served by waste water treatment works meeting the required criteria (Population Equivalent Sanitary Compliance).

Another Ofwat measure that looks at a much wider range of compliance parameters is Numeric Compliance of waste water treatment works (which gives equal weighting to small and large treatment works).

South West Water performed similarly well against this compliance measure, achieving a record high of 97.1%.

This improvement in performance can be attributed to a programme of targeted investment in waste water treatment processes at 98 of the company's operational sites over the past 18 months.

Bathing waters
Despite the extreme wet weather and its associated run-off and floodings, 133 out of 146 bathing waters (91%) achieved the European mandatory or 'good' standard and 88 bathing waters (60%) achieved the guideline or 'excellent' standard for the 2012 bathing season. South West Water is committed to delivering sustainable environmental improvements to the region's bathing waters. In 2012/13 investments in this area included storm tanks, filtration improvements and cleaning process enhancements.

"In 2012 South West Water's long-standing endeavours to raise the standard of the waste water it returns to the environment were reflected in its best ever compliance score."

Chris Loughlin, Chief Executive
South West Water

Pollution
The impact of flooding and extreme wet weather contributed to an increase in the total number of pollution incidents compared with the previous year. However, while there was a rise in the number of Ofwat minor (Category 3) incidents, South West Water saw a significant reduction in the number of significant (Category 2) incidents compared with the previous calendar year (2012: 4, 2011: 15).

It is South West Water's aim to ensure that no harmful pollution incidents occur. It therefore continues to invest in the maintenance and improvements necessary to reduce the risk of pollution.

Flooding
In a year of abnormally wet weather, river flows and groundwater levels both reached exceptionally high levels, increasing the likelihood of flooding for many homes and businesses.

The number of internal sewer flooding incidents (an incident in which sewage enters a property) totalled 266. Inevitably a high proportion of these incidents were caused by the sewerage system becoming overwhelmed by the sheer volume of rain water.

Renewable energy
In 2012/13 excellent progress was made towards increasing renewable energy generation, with more power from renewable sources generated than ever before. In total, 19.3GWh was harnessed from a combination of solar, wind, hydro and combined heat and power (CHP) from waste.

The extreme wet weather, while serving to increase energy demand, was highly advantageous for South West Water's hydro power sites. The company continues to invest in renewable technology.

People

Once again the dedication, professionalism and support of all South West Water's employees has been vital in achieving a successful outcome in a challenging year. The company expresses its gratitude to every employee for their contribution to the business during the year.

South West Water developed a new 'People Strategy', focused on attracting, retaining and developing its workforce. The company's aim is to be the 'Employer of Choice' in the South West and it provides employees with the opportunity to develop their careers through a number of schemes. These include supplementary training through its Management Academy, customer service skills training, NVQ programmes and a development programme for the senior management group.

Eight new apprentices were recruited through South West Water's apprenticeship programme, developed in partnership with South Devon College.

The company also made headway with improving its health and safety record, achieving its lowest ever RIDDOR incidence rate (Reporting of Injuries, Diseases, and Dangerous Occurrences) of 568 per 100,000 employees for 2012 compared with 1,628 for 2011*.

Key relationships

Regulators and others
South West Water actively engages with a wide range of environmental and regulatory stakeholders. It takes steps to ensure that communication is handled in the most appropriate way and that the information the company provides is high quality and consistent. It uses a range of commercial channels including traditional and online platforms to communicate with its stakeholders.

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

* Change in RIDDOR reporting criteria (see page 53 for details).

South West Water apprentice, Joe Farrant

Meldon Reservoir, Devon

WaterFuture customer panel
As part of the 2014 Periodic Review process, following guidance from Ofwat, South West Water has 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 the company's business plan adequately reflects an understanding of customers' priorities and that its planned activities are socially, economically and environmentally sustainable.

Procurement and suppliers
South West Water's procurement strategy is focused on partnering and strategic alliances with 60 key suppliers who account for the large majority of expenditure. The company includes all aspects of sustainability in its procurement processes and this is a central theme of its procurement strategy for its supply chains and support of the regional economy. With the start of the K5 regulatory period the company introduced an innovative 'mixed economy' model to source its capital programme. This means using a significant number of smaller local contractors to provide specialised services as well as developing long-term relationships with larger 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

South West Water is well placed to continue delivering improvements in operational efficiency and customer service for the remainder of the K5 period.

The company is currently preparing for the 2014 Price Review which will determine the investment programme and associated charges for 2015-2020.

In December 2012 the company published its 25-year outlook statement which was designed to provide context to the steps it plans to take in 2015-2020. Published online and widely distributed to customers and stakeholder groups, it was published in two formats – 'What's in the Pipeline 2015-2040' (a consumer-orientated overview) and 'WaterFuture: Our Vision 2015-2040' (an extended version for audiences requiring more specific detail).

An independently-chaired 'WaterFuture' Customer Challenge Panel' is also being consulted on South West Water's 25-year outlook statement. The Panel comprises consumer representatives and customer and community stakeholders. Its role is to ensure that the company's final business plan reflects a sound understanding of customer and stakeholder opinion and that the proposals for the 2015-2020 period are economically, socially and environmentally sustainable.

The 25-year outlook statement reflects the results of the research to date on customer and stakeholder priorities. It also explores key investment drivers for the 2015-2020 period. These include:

- responding to changes in legislation, including improvements to protect key bathing waters in the region and meeting the required standards of the Water Framework Directive
- the importance of ensuring assets and networks can cope with extreme weather and climate change
- the need to maintain and replace assets, where necessary, to prevent fault or failure
- the need for a holistic approach to the prevention of pollution and sewer flooding
- future supply and demand needs.

South West Water's 2015-2020 business plan will be submitted to Ofwat in December 2013.
For further information visit:
www.southwestwater.co.uk/waterfuture

Viridor

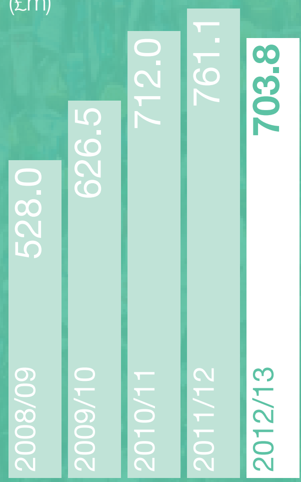
Investing in renewable energy and resource efficiency

Operational highlights

- Strong progress in long-term Public Private Partnership (PPP)/energy from waste (EfW) strategy
- Significant headwinds in recycling and ongoing trend decline in landfill affecting 2012/13 results
- Aggressive action to reduce costs
- Exceptional charges of:
  – £99 million asset impairment (primarily landfill) and onerous contracts
  – £90 million increased landfill provisions
  These totalled £150 million net of tax

Revenue

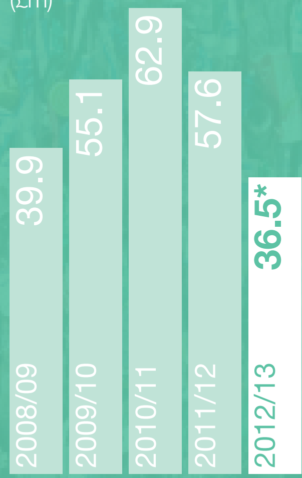
(£m)



£703.8m
-7.5%

Profit before tax

(£m)



£36.5m
-36.6%

* Before exceptional charges.

Notable achievements

- Financial close achieved for Glasgow Design, Build, Finance & Operate (DBFO) project and planning permission gained for associated Recycling and Renewable Energy Centre – construction commenced
- Financial close achieved for South London Waste Partnership PPP and planning permission gained for associated Beddington EfW
- Planning approval and financial close achieved for Peterborough PPP – construction to start imminently
- Dunbar EfW planning enhanced to cover all of Scotland
- Preferred bidder status achieved for South East Wales, residual waste PPP (Prosiect Gwyrdd) – associated Trident Park EfW construction underway

Where we operate

327
Operating facilities

7.2
Million tonnes of material handled

27
Materials recycling facilities

34
Landfill gas power plants

3 operational/6 under construction
Energy from waste (EfW) plants

Strategy and performance

Viridor is at the forefront of transforming waste. The company aims to impress its customers by showing them how it can put waste into action, transforming it into high quality recyclate, raw materials and energy. It will do this by empowering all Viridor people to be safe, professional and enterprising within a business always striving to be environmentally, economically and socially sustainable.

Viridor's strategy is focused on transforming waste

The company is building its business through a combination of securing long-term contracts, driving quality (and hence price realisation) in recycling and growing capacity in waste-derived renewable energy.

Long-term profit growth is expected to be driven by its PPP contracts and EfW projects.

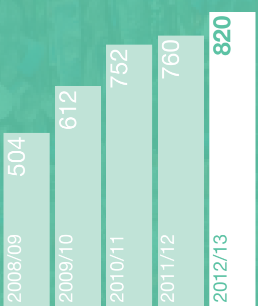
Performance – contracts and energy from waste
Major progress in long-term PPP/EfW projects including:

- Glasgow City 25-year Residual Waste Treatment Services DBFO, Peterborough and South London PPP contracts secured and Preferred Bidder for 'Prosiect Gwyrdd' (South East Wales) PPP
- Runcorn Phases 1 and 2, Ardley, Exeter, Trident Park (Cardiff) and Glasgow EfWs and Walpole Anaerobic Digestion (AD) facility – all under construction
- Lakeside EfW performing above expectations.

Performance – recycling

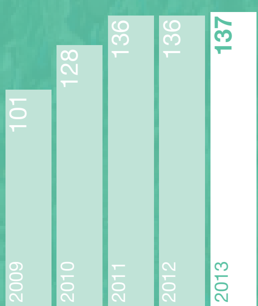
- Significant current headwinds in recycling prices
- Aggressive action to reduce costs
- Focus on quality and adding value.

Total renewable energy generation
(GWh)



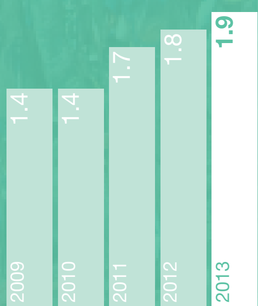
820GWh
+7.9%

Renewable energy generation capacity
as at 31 March (MW)



137MW
+0.7%

Recyclate traded
(million tonnes)



1.9m tonnes
+5.6%

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www.pennonannualreport.co.uk/2013

Business review

Strategy and UK context

European and UK waste and resource management strategies and policies are focused on the principles of resource efficiency, maximising recycling and recovery, and landfill diversion. EU member countries have increasingly tough targets for the diversion of biodegradable municipal waste from landfill sites. This will be achieved in the UK by continued increases in local authority and commercial and industrial recycling rates and by energy recovery from residual waste. The latter is predominantly a form of biomass and is a significant form of renewable energy. Waste already accounts for approaching 2% of total UK electricity production (through landfill gas power generation and energy from waste facilities).

The UK Government's main mechanism for diverting both municipal and commercial and industrial wastes from landfill and incentivising recycling and energy recovery, remains Landfill Tax. The Government has confirmed the continuation of the increase in landfill tax of £8 a year, rising to a total of £80 per tonne from 1 April 2014. This increase will further enhance the long-term economics of recycling and energy recovery and is supported by a range of other policy and legislative measures.

Within the wider sustainability agenda, many businesses and other organisations are also looking to improve their environmental and business performance through increased recycling and resource efficiency.

All of these elements underline the key service objectives and long-term trends in the UK resource and waste management sector and the clear customer demand that Viridor has been anticipating, upon which it has proactively strengthened its business strategy and services.

Viridor's clearly stated strategy within this context is to add value by transforming waste through recycling and waste-based renewable energy generation. Viridor has substantially increased its recycling business over the past five years to a total of around two million tonnes per annum. The next phase of its strategy involves substantial growth in EfW capacity. Viridor is targeting over 15% market share by 2020 with a network of strategic facilities in operation, under construction or planned. At present there is about six million tonnes of EfW capacity in the UK and it is estimated that 20 million tonnes of capacity will be required by 2020 to meet the Government's landfill diversion targets. There is likely to be significant under capacity in the UK by 2020 compared with projected demand. Viridor believes that up to 6% of UK electricity could come from waste sources by 2020.

"Viridor believes that up to 6% of UK electricity could come from waste sources by 2020."

Colin Drummond, Chief Executive
Viridor

EfW facility, Exeter, under construction

Viridor Polymers recycling facility, Skelmersdale

Business performance

Revenue was down 7.5% to £704 million.

Before exceptional charges Viridor's earnings before interest, tax, depreciation and amortisation (EBITDA) for the year decreased by £32.4 million (29.4%) to £77.9 million. PBIT fell £32.9 million to £30.8 million. PBIT plus joint ventures decreased by £29.3 million (39.0%) to £45.9 million as the increased contribution from joint ventures was more than offset by the decline in landfill and recycling. Profit before tax and exceptional charges decreased £21.1 million to £36.5 million, including the benefit of reduced interest from intra group funding.

From 2007/08 until the first half of 2011/12, the fast growth in profits from recycling had more than offset the decline in annual landfill profits. As noted previously, however, recyclate prices have fallen back sharply from the peak reached in the first half of 2011/12 reflecting world economic conditions including weakness in the Eurozone economies and uncertainty about the speed of growth in China.

Viridor responded swiftly with an aggressive restructuring programme particularly in its recycling business and in 2012/13 closed/mothballed six of its facilities and made 152 redundancies. This and other items generated savings of about £13 million across all recycling operations which were enough to offset about 35% of the price decline. In tandem with the significant downturn in recycling profits UK landfill volumes continue to decline, in line with the ongoing trend, as a result of Government policy and a weak UK economy. Recycling revenues per tonne have recovered a little from their lows of October to December 2012; however they remain significantly below the first half of 2011/12 levels.

On the positive side Viridor has continued to make very strong progress on its strategic expansion into the energy from waste (EfW) and Public Private Partnership (PPP) market. EfW will represent the low-cost solution for disposing of residual waste (which is currently landfilled) when landfill tax reaches £80 per tonne in April 2014.

It will also be one of the UK's lowest cost and most effective sources of base-load, distributed renewable energy at a time when the UK is facing an increasing energy shortage and projected long-term energy price rises. During the year major new contracts were signed for South London, Glasgow and Peterborough and Viridor was appointed as preferred bidder for the South East Wales PPP. Six EfW projects are currently under construction and a new Capital Projects and Engineering Director has been appointed to lead the delivery of the programme.

Capital expenditure for the year, including construction spend on service concession arrangements, was £323 million (2011/12: £143 million) of which £292 million was for Viridor growth projects (largely EfW) with the balance being maintenance of existing assets.

PPP and EfW projects already enhance the bottom line and committed projects are expected to contribute more than £100 million to Viridor's EBITDA within four years.

Despite the continuing challenging UK and global economic conditions, Viridor remains convinced that embracing the sustainability agenda is an effective driver for long-term growth. The company is confident that its strategy will continue to drive long-term growth and produce value for Viridor and its stakeholders. Recycling will be key to Viridor's profits in the next couple of years, with long-term growth expected to be driven by a growing PPP contract and EfW pipeline.

Exceptional charges

As a result of the continued weakness in recyclate prices and the continuing reduction in landfill volumes Viridor has reviewed the carrying values of some of its assets. The company has also re-assessed the expected costs of landfill provisions.

In response to landfill trends and its own EfW development programme (including EfW plants at its Ardley, Beddington and Dunbar landfills), Viridor reviewed its long-term site lives. Post 2020 it expects to have a network of three strategically located landfills. Of the current 61.5 million cubic metres (m^3) of landfill void, it is expected that around 39 million m^3 (including Ardley, Beddington and Dunbar) will no longer be filled.

An exceptional charge of £99 million has been recognised to write-down the carrying values of property, plant and equipment, primarily in landfill, but also reflecting the company's expectations on recyclate prices and the impact of onerous contracts. This charge has no cash impact.

The company has also reviewed its landfill aftercare and restoration provisioning costs to reflect revised final land forms and has made a re-assessment of the aftercare period (increased from 30 to 60 years) based upon independent external advice. This resulted in an increase in provisions of £90 million, which has no immediate cash impact.

The exceptional charges above totalled £150 million net of tax.


Ardley EfW, Oxfordshire, under construction

Business review
Continued

Investment
Investments in the future capabilities and strength of Viridor's business included capital expenditure of £323 million, of which £292 million was for growth projects (largely EfW). This investment is part of the ongoing £1.5 billion programme committed to delivering essential infrastructure which will make a substantial contribution to energy and resource security in the UK.

Viridor continued to invest in targeted acquisitions in 2012/13 and purchased two companies, JWT Holdings Limited and Pulp Friction Limited, for a combined value of around £15.0 million. These acquisitions will add value and support the company's recycling and EfW strategies.

Recycling
The recycling market in the UK is reaching maturity and is affected by world commodity prices. Difficult trading conditions are resulting in a competitive shake-out taking place and Viridor is well positioned to benefit from this.

During the year recycling volumes traded increased by 5.6% to 1.9 million tonnes (71,000 tonnes of the increase from acquisitions). The average recycling revenue of £99 per tonne from gate fees and recyclate sales in 2012/13 was significantly down on last year's figure of £118 per tonne which benefited particularly from last year's strong first half. Recyclate revenues per tonne appear to have stabilised, having recovered a little from their lows of October to December 2012, but remain significantly below first half 2011/12 levels.

The outcome of a recent judicial review confirms DEFRA's interpretation of EU recycling regulatory requirements, supporting commingled collection and centralised processing at materials recycling facilities (MRFs) where most practicable and where there are the appropriate quality controls. This is in line with the predominant Viridor service model. Viridor now has the largest MRF capacity in the UK.

Contracts and collection
Profits were stable across the 16 municipal contracts (the more significant ones include Lancashire, Glasgow, Lakeside, Manchester, Somerset, West Sussex and Bedfordshire (last full year)) and the Thames Water contract.

Profits in the collection business were down reflecting reduced volumes and price pressure due to current market conditions. Viridor's commercial and industrial collection fleet plays an increasing role in feeding the company's recycling and EfW plants.

Renewable energy
Energy can be viably recovered from waste in two ways, either via gas utilisation (notably landfill gas and through anaerobic digestion (AD)) or controlled combustion (in EfW plants and similar facilities, some of which may be a part of combined heat and power (CHP) schemes). Energy recovery from waste currently accounts for around 20% of total UK renewable energy (the bulk from landfill gas and the balance from combustion) equating to approaching 2% of total UK electricity production.

Viridor's landfill gas power generation output increased by a further 7% to 618 Gigawatt hours (GWh) (2011/12 576GWh), reflecting intensive management focus and is now at its peak. Average prices fell slightly reflecting the reduced Renewables Obligation Buyout Recycle (ROBOR) fund payment element of Renewables Obligation Certificate (ROC) prices. Total landfill gas power generation operational capacity remained unchanged at 107MW, (excluding 3MW capacity at sub-contract sites in Suffolk). The proportion of operational capacity eligible for ROCs remained at 74% with the remaining 26% being on (lower priced) NFFO contracts. Viridor's NFFO contracts end in tranches after which the capacity for all Viridor's sites will transfer to ROCs (about 60% will move across in 2013/14 with the balance in the period up to 2016/17).

As well as the 107MW of landfill gas capacity, Viridor has a further 30MW of renewable energy capacity across its Bolton EfW facility and its share of the Lakeside EfW facility and Greater Manchester AD operations.

In addition to the above operational projects, Viridor is pursuing a number of other EfW opportunities to provide a long-term alternative to landfill disposal of residual waste as noted above. These will also provide significant amounts of renewable energy. Six EfW plants are already under construction on fixed price contracts – Runcorn Phases 1 and 2 , Cardiff, Exeter, Ardley, Oxfordshire and Glasgow; and one is due to start imminently in Peterborough.

Viridor and its partners have a total operational, under construction and committed capacity of 2.5 million tonnes, of which 1.3 million tonnes is backed by long-term base-load municipal contracts. It has a further 0.6 million tonnes of capacity with planning permission.

Since the start of 2012/13 Viridor has made significant further progress in developing its pipeline of long-term PPP and EfW projects:
- financial close achieved for the Glasgow Design Build Finance Operate project (July 2012) and planning application for the associated Recycling and Renewable Energy Centre approved (January 2013) - construction commenced
- financial close achieved for the South London Waste Partnership PPP (November 2012) and planning permission achieved for the associated Beddington EfW facility (May 2013)
- planning approval (January 2013) and financial close (February 2013) achieved for the Peterborough PPP: construction of the EfW facility to start imminently
- preferred bidder achieved for the South East Wales residual waste project (Prosiect Gwrydd) (March 2013)
- Dunbar EfW planning enhanced to cover all of Scotland (October 2012).


'Trio' recycling collection vehicle, Salford


Landfill gas power plant, Dorset

Joint ventures

Total joint ventures' contribution (comprising both Lakeside and Viridor Laing (Greater Manchester) (VLGM)), which consists of interest on shareholder loans and share of profit after tax, rose 31% to £15.1 million (2011/12: £11.5 million).

Lakeside
The first of Viridor's EfW projects continues to perform very strongly and is ahead of management expectations. The 2012/13 contribution was £7.2 million (2011/12 £5.1 million); interest receivable on shareholder loans was unchanged at £1.4 million; and the share of profit after tax from Lakeside was £5.8 million (up £2.1 million on the previous year) reflecting strong waste inputs and electricity generation.

Viridor Laing (Greater Manchester)
The 25-year Greater Manchester Waste PFI contract (being delivered through VLGM) is the UK's largest ever combined waste and renewable energy project. The company is a joint venture between Viridor and John Laing Infrastructure. As part of the VLGM contract a separate contractor was mandated to construct 43 facilities. Operation of the associated facilities (both existing facilities and those which are to be developed) is being carried out on a sub-contract basis by Viridor. At 31 March 2013, 41 of the 43 facilities planned had been formally taken over by Viridor.

Solid recovered fuel produced from the waste will be used to generate heat and power at a plant being built at the Runcorn Phase 1 EfW facility in Cheshire. Phase 1 is being built primarily for the Greater Manchester Waste PFI contract by TPSCo, a joint venture between Ineos, John Laing Infrastructure and Viridor. Phase 2 is 100% owned by Viridor and will be available for the market generally as steeply rising landfill tax drives residual waste disposal away from landfill towards recycling and EfW.

The ongoing delays in takeover of the remaining mechanical biological treatment (MBT) plant and the delay in completing the Runcorn Phase 1 EfW facility could have the potential to impact the VLGM and also the TPSCo credit agreements. Runcorn is around nine months behind schedule, but TPSCo and Viridor have contractual protection, including via liquidated damages. Viridor is continuing commercial discussions with its joint venture partners and the contractors to resolve the construction issues and protect its and TPSCo's financial position. At this point in time, based on available information, Viridor does not expect this matter to have a material impact on the completion and operation of the Greater Manchester PFI or TPSCo.

Interest receivable on shareholder loans from the VLGM joint venture was £7.9 million, up £1.8 million due to the increased average balance on shareholder loans (loans fully drawn during 2011/12). Share of profit after tax from VLGM on an IFRIC 12 basis was nil, down £0.3 million (£4.4 million profit UK GAAP, down £0.2 million).

Landfill

The landfill market is being replaced by recycling and EfW as local capacity becomes available, in line with government policies. Reflecting this trend, Viridor's landfill disposal volumes decreased by 0.4 million tonnes (12.7%) to 2.7 million tonnes in 2012/13 in line with the market more generally. Average gate fees increased by 8.1% to £25 per tonne but costs also increased by 8.1% reflecting the impact of reduced volumes on fixed costs. Consented landfill void reduced from 65.4 million m^3 at 31 March 2012 to 61.5 million m^3 at 31 March 2013 reflecting usage during the period.

Business review
Continued

Key relationships

All recycling and waste management operations in England and Wales require Environmental Permits issued and regulated by the Environment Agency (EA) and Natural Resources Wales. In Scotland the Scottish Environmental Protection Agency issues and regulates similar waste management licences or pollution, prevention and control (PPC) permits. Viridor maintains a positive working relationship with these and other relevant regulatory bodies by means of proactive liaison and management of any issues at both site and strategic levels.

Viridor has pioneered an innovative online data sharing portal, known as 'OpenSpace', with the EA, embracing latest data management practice to supply environmental monitoring data effectively live online to the regulator. This replaces the need to supply huge volumes of written quarterly and annual reports, thus saving significant time and resources for all parties. OpenSpace has been further developed during the year between Viridor and the EA to explore the application of such systems in other regulated sectors.

With regard to Viridor's largest customer groups, local authorities account for 31% of the company's revenue, although no individual authority accounts for more than 12%. Viridor's ROC energy contracts account for 7% of revenue, primarily with one customer.

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

1 Viridor and 'Metal Matters' recycling campaign partnership
2 Viridor and West Sussex partnership waste, electrical and electronic equipment (WEEE) recycling campaign
3 Materials recycling facility (MRF), Trafford Park, Manchester
4 EfW facility, Runcorn, under construction
5 Viridor support services

People

The achievements, commitment and professionalism of its employees, particularly in the ongoing challenging market conditions, remains a source of pride to Viridor. The company values and thanks them all for their contributions and continued hard work and innovation.

A safe, healthy workforce and the continued professional development of employees, remain the top operational priorities for Viridor. Whilst there was a disappointing increase in the RIDDOR incidence rate over the previous year (45 reportable incidents, giving a rate of 1,429 per 100,000 employees compared with 1,238 in 2011/12*), a reduction of 42% in the rolling three-year incidence rate confirms progress is being made in this vital area.

Almost 4,000 training days were delivered across Viridor during the year, underlining the company's commitment to the training and development of employees throughout the business. Around 200 employees are participating in apprenticeship programmes and 40 managers are enrolled on the innovative Viridor Foundation Degree course, developed and delivered in partnership with Edge Hill University.

* Change in RIDDOR reporting criteria (see page 53 for details).

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Outlook for Viridor

Viridor has successfully transformed itself over the last decade to be one of the UK's leading recycling, renewable energy and waste management companies. The company continues to face near-term headwinds in recycling and the ongoing trend decline in landfill. Although recyclate levels per tonne appear to have stabilised, and indeed have recovered a little from their lows of October to December 2012, they remain significantly below the first half of 2011/12 levels. The company remains cautious about the prospects for further recovery in prices in the short-term.

Strong progress has been made on Viridor's PPP/EfW pipeline this year and these projects are already making a significant contribution to Viridor's bottom line. The growing pipeline of current and future projects is expected to drive the company's long-term profit growth.

The UK Government has set out guidance for local authorities on the infrastructure required to meet the requirements of the revised EU Waste Framework Directive. It has also published its Waste and Resources Evidence Plan setting out policy priorities and how the sector can contribute to sustainable economic growth, alongside new regulations and guidance on recycling quality and the important contribution of EfW.

Within this policy framework and changing market demands, Viridor continues to focus on delivering vital infrastructure and quality services to provide essential renewable energy, resource recovery and waste management for its customers across all sectors.

Group
Financial review

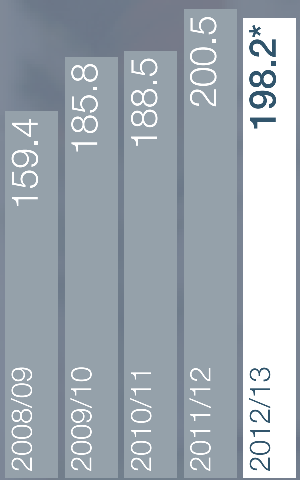
Notwithstanding current challenges, the Group has delivered overall profit before tax (before exceptional net charges) broadly in line with last year.

Performance overview

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

Profit before tax

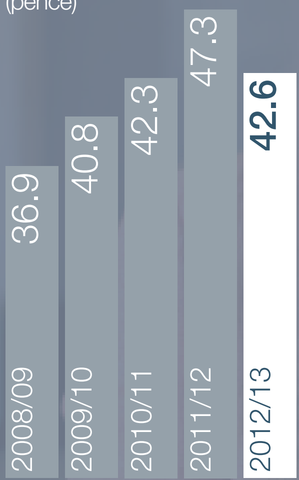
before exceptional net charges (£m)



£198.2m
-1.1%

Earnings per share

before exceptional net charges and deferred tax (pence)



42.6p
-9.9%

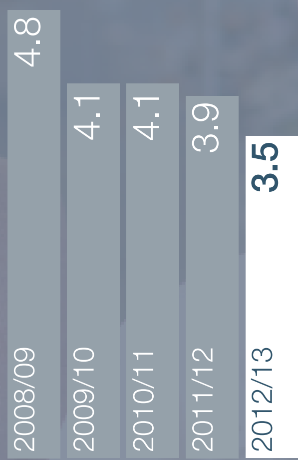
Dividend per share

(pence)

28.46p
+7.3%

Interest rate on average net debt

(%)



3.5%

*** Statutory basis £21.8 million.**

Reconciliation of earnings

	2012/13 Profit after tax (£m)	2012/13 Earnings per share (p)	2011/12 Profit after tax (£m)	2011/12 Earnings per share (p)
Statutory earnings	**26.9**	**7.4**	**172.4**	**48.1**
Deferred tax before exceptional net charges	**(12.2)**	**(3.4)**	**(2.8)**	**(0.8)**
Exceptional net charges (post tax)	**140.2**	**38.6**	**–**	**–**
Earnings before exceptional net charges and deferred tax	**154.9**	**42.6**	**169.6**	**47.3**

Note: Earnings per share figures in this business review exclude exceptional net charges and deferred tax. The Directors believe excluding deferred tax provides a more useful comparison on business trends and performance. 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: £1,150 million cash and facilities at 31 March 2013, including £782 million of new (including hybrid capital issuance) and refinanced facilities sourced during the year.

The year's financial highlights

South West Water recorded a strong performance against the 2010-2015 regulatory contract and is well placed to deliver outcomes and outperform assumptions.

Viridor had a mixed year with trading significantly down on last year from declines in recycling and landfill more than outweighing continued growth in joint ventures.

We have secured further funding to finance continuing growth, including a £300m hybrid capital issuance in March 2013 which strengthens the Group balance sheet as well as providing funding. By the year-end we had £1,150 million in cash and facilities in place to fund the major growth in Viridor's projects under construction and EfW/PPP pipeline, together with South West Water's K5 (2010-2015) capital programme.

Capital investment increased by 61% to £439 million due to the major investment in Viridor's energy from waste plants which are expected to drive future growth.

We have secured funding at a cost that is low in absolute terms. The Group interest rate on average net debt improved to 3.5% (2011/12 3.9%).

Revenue
Group revenue decreased by 2.6% to £1,201.1 million. South West Water's revenue increased by 5.2% to £498.6 million as a result of tariff increases and new connections, partially offset by lower demand and a reduction in revenue from customers switching from unmeasured to metered charges. Viridor's revenue was down by 7.5% to £703.8 million due primarily to the declines in recycling and landfill operations.

Operating profit
(before exceptional charges)
Group operating profit decreased by 8.4% to £246.3 million with South West Water up by 5.1% to £215.2 million, but Viridor down by 51.6% to £30.8 million.

Net finance costs
(before exceptional net income)
We continued our effective management of interest rates in 2012/13 with net interest payable on average net debt equating to 3.5% (2011/12 3.9%). During the year net finance costs (excluding pensions, net interest, discount unwind on provisions and IFRIC 12 contract interest receivable) were £59.3 million (2011/12 £74.9 million) covered 4.2 times (2011/12 3.6 times) by Group operating profit. Investment income totalling £10.8 million (2011/12 £5.7 million) has been achieved with the objective of enhancing returns on the Group's substantial pre-funding of around £500 million.

Profit before tax
(before exceptional net charges)
Profit before tax was £198.2 million, a decrease of 1.1%. Pages 18 and 25 give a detailed description of the financial performance of South West Water and Viridor respectively. On a statutory basis profit before tax was £21.8 million reflecting exceptional net charges of £176.4 million.

Taxation
(before exceptional net charges)
The Group's UK corporation tax charge for the year was £43.3 million (2011/12 £30.9 million) after release of prior year credits of £13.0 million (2011/12 £16.2 million). The increase primarily reflects the absence of tax relief of around £9 million on 2011/12's accelerated pension deficit recovery contribution. Deferred tax for the year was a credit of £12.2 million (2011/12 £2.8 million) which included a credit of £13.6 million from the impact of the introduction of the 23% corporation tax rate from April 2013.

Earnings per share
(before exceptional net charges and deferred tax)
Earnings per share were down by 9.9% to 42.6p reflecting the higher corporation tax charge. The weighted average number of shares in issue during the year was 363.6 million (2011/12 358.7 million). Net assets per share at book value at 31 March 2013 were 292p.

Exceptional net charges
During the year South West Water terminated a lease facility and received a consent fee arising from the sale of a finance lease between financial institutions, which resulted in a net exceptional gain of £12.5 million.

An exceptional impairment charge of £78.2 million has been recognised to write-down the carrying values of property, plant and equipment, primarily in landfill activities, to reflect reducing landfill volumes and our expectations on recyclate prices. The impairment charge has no cash impact. In addition £20.6 million has been provided against onerous contracts (principally from recycling activities) and other items.

An exceptional charge of £90.1 million has been recognised for environmental provisions, primarily landfill aftercare costs, where we have increased the expected period of aftercare to 60 years (2012 30 years) following a reassessment based upon independent external advice. This also has no immediate cash impact and reflects the present value of costs expected to be incurred at individual sites over the 60 year period.

The exceptional net charges total £140 million net of tax.

To view our online annual report:
www.pennonannualreport.co.uk/2013

Financial review
Continued

Dividends and retained earnings
The statutory net profit of £26.9 million has been transferred to reserves.

The Directors recommend the payment of a final dividend of 19.70p per share for the year ended 31 March 2013. With the interim dividend of 8.76p per share paid on 4 April 2013 this gives a total dividend for the year of 28.46p, an increase of 7.3% over 2011/12 (reflecting 4% real growth plus RPI of 3.3% for the twelve months to 31 March 2013).

Proposed dividends totalling £103.8 million are covered 1.5 times by net profit (before exceptional net charges and deferred tax) (2011/12 1.8 times). Dividends are charged against retained earnings in the year in which they are paid.

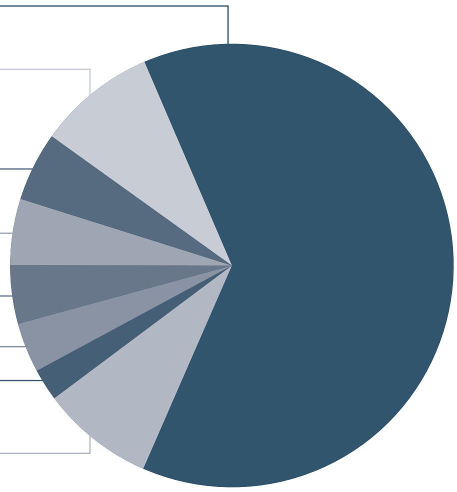
Dividend policy
The Group's policy is to increase the dividend each year by 4% above inflation up to the end of 2014/15. The Group is well positioned to meet future challenges and to continue delivering shareholder value. We remain committed to this increase.

Operating costs
(before exceptional charges)
Operating costs for the year totalled £955 million. The most significant areas of expenditure were:

Expenditure	£m
Manpower	**159**
Depreciation	**146**
Landfill tax	**143**
Raw materials and consumables*	**93**
Transport	**59**
Power	**31**
Business rates	**29**
Abstraction and discharge consents	**7**

* Excludes elements of transport costs.

Group investment
The Group's capital expenditure on property, plant and equipment, including service concession arrangements, increased by 61% to £439 million (2011/12 £273 million) primarily from investment in Viridor's growth projects of £292 million. The major categories of expenditure were:



Cash flow
In 2012/13 the Group once again had a strong operating cash flow. Net borrowings reduced by £96 million primarily due to the issuance of the hybrid securities, partially offset by further capital investment.

Summarised cash flow £m	2012/13	2011/12
Cash inflow from operations	**385**	**390**
Net interest paid	**(50)**	**(61)**
Dividends and tax paid	**(97)**	**(111)**
Capital expenditure	**(422)**	**(274)**
Acquisitions/investment in joint ventures	**(14)**	**(43)**
Loan repayments and dividends received from joint ventures	**9**	**4**
Pension contributions	**(14)**	**(49)**
Net cash outflow	**(203)**	**(144)**
Hybrid securities issuance	**295**	**–**
Shares issued	**4**	**2**
Debt acquired with acquisitions	**(1)**	**–**
Debt indexation/interest accruals	**1**	**(29)**
Decrease/(increase) in net borrowings	**96**	**(171)**

Liquidity and debt profile

The Group has a strong liquidity and funding position with £1,150 million cash and facilities at 31 March 2013. This includes cash and deposits of £635 million (including £143 million of restricted funds representing deposits with lessors against lease obligations) and undrawn facilities of £515 million. A total of £782 million in new or renewed debt facilities were arranged during the year, being:

- £304 million term loans and revolving credit facilities renewed
- £178 million of new term loans and Revolving Credit Facilities
- £300 million hybrid capital issuance.

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 2013 the Group's loans and finance lease obligations totalled £2,644 million. After the £635 million held in cash this gives a net debt figure of £2,009 million, a reduction of £96 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, Exeter, Cardiff and Glasgow increased to £438 million at 31 March 2013.

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A strong liquidity and funding position to finance growth.

David Dupont, Group Director of Finance
Pennon Group

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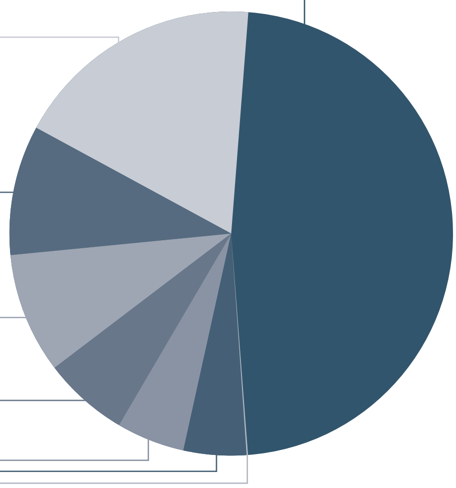
Major components of the Group's debt finance at 31 March 2013



The Group's debt has a maturity of up to 44 years with an average maturity of 22 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 at an average interest rate of 3.4%. A further £382 million of South West Water's debt is index-linked to 2041-2057 at an overall real rate of 1.7%. As a result of these initiatives South West Water's cost of finance is amongst the lowest in the industry.

The Group's and South West Water's interest rates on average net debt for the year to 31 March 2013 were 3.5% and 4.1% respectively (after adjusting for capitalised interest of £13.6 million and notional interest items totalling £5.4 million, as detailed in note 8 to the financial statements).

Just under half of the Group's gross debt is finance leasing giving us a long maturity profile. Interest payable benefits from the fixed credit margins which were secured at the inception of each lease.

At 31 March 2013 the fair value of the Group's non-current borrowings was £208 million less than its book value (2012 £200 million) as detailed in note 28 to the financial statements.

Financial review
Continued

Capital structure – overall position
At the end of the financial year the Group's net debt of £2,009 million gave a gearing ratio of net debt to (equity plus net debt) of 65.4% at 31 March 2013 (2012 71.9%) with the reduction attributable to the £300 million hybrid capital issuance.

South West Water's debt to Regulatory Capital Value (RCV) was 55% at 31 March 2013 (2012 56%) which compares to 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 £676 million (2012 £517 million) equivalent to 8.7 times EBITDA (2012 4.7 times). During the year Viridor's equity base was increased by £151 million through revised intragroup funding.

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. These 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 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 ensure we do not engage in any practices which avoid paying tax at the appropriate levels. We manage the taxes we pay having regard to the interests of our shareholders and 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 2012/13

Landfill tax
£162m

Employment taxes
£51m

Business rates
£29m

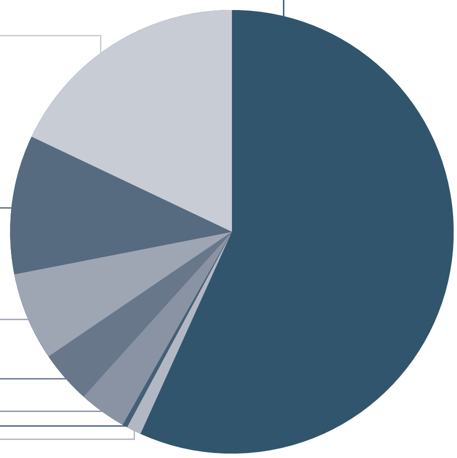
UK corporation tax
£19m

Fuel Excise Duty
£11m

Environmental payments
£10m

Carbon Reduction Commitment
£1m

Other
£3m



The Group made a net payment of £18.5 million of UK corporation tax in the year (2011/12 £41.4 million) which reflects settlement of previous years' tax computations and tax relief on the exceptional charge for aftercare costs. South West Water paid £34.0 million (2011/12 £28.5 million) of UK corporation tax on profit before tax of £164.6 million (2011/12 £141.5 million).

The total tax charge for the year (before exceptional net charges) of £31.1 million was less than the charge which would have arisen had the accounting profit before tax of £198.2 million been taxed at the statutory rate of 24%. A reconciliation is provided in note 9 to the financial statements.

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

Total taxes amounted to £261 million of which £39 million was collected on behalf of the authorities for employee payroll taxes.

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

- Landfill tax of £139 million was collected by the Group on behalf of HM Revenue & Customs (HMRC). This amount includes £10 million paid to local environment bodies via the Landfill Tax Credits Scheme. Landfill tax is an operating cost which is recovered from customers and is recognised in revenue. In addition the Group incurred landfill tax of £23 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 £25 million was recovered by the Group from HMRC. The repayment has arisen chiefly as a result of the large capital expenditure incurred by Viridor on EfW plants. VAT has no material impact on profit before tax
- business rates of £29 million paid to local authorities. This is a direct cost to the Group and reduces profit before tax
- employment taxes of £51 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. This amount includes PAYE of £2 million on pension payments made by the Group pension scheme
- Fuel Excise Duty of £11 million related to transport costs. This reduces profit before tax
- payments to Environment Agency and other regulatory bodies total £10 million. This reduces profit before tax
- Carbon Reduction Commitment payment for the Group was £1 million; this payment includes a credit of £1 million arising from Viridor energy production. This reduces profit before tax.

The corporation tax rate for 2012/13 used to calculate the current year's tax is 24%. The corporation tax rate has been reduced to 23% for 2013/14 and is expected to fall further, subject to legislation being enacted, to 20% from 1 April 2015.

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.

At 31 March 2013 the Group's pension schemes showed a deficit (before deferred tax) of £110 million (2011/12 £99 million), the increase primarily reflecting a reduction in the long-term net discount rate of 0.53%, the main factor being lower AA bond yields.

Net liabilities of £85 million (after deferred tax) represented around 4% of the Group's market capitalisation at 31 March 2013. The revision to IAS 19, to be implemented in 2013/14, is expected to result in a net finance cost in 2013/14 of £4 million (2012/13 credit of £4 million). A further £1 million is expected to be charged to operating profit to recognise administration costs as they are incurred. Pension liabilities will reduce by £10 million as at 31 March 2013 as a result of the change.

South West Water's cash contributions to the schemes remain within Ofwat's Final Determination for the K5 period.

The last actuarial valuation of the main scheme was at 31 March 2010 and the triennial valuation at 31 March 2013 is currently under way. The deficit is expected to be higher than IAS 19 due to the lower gilt rates used to discount liabilities.

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 70 of our corporate governance report.

Key

↑ **Increased during year**
↔ **Unchanged during the year**
↓ **Reduced during the 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.

South West Water

Law and regulation

Risk	Commentary	Mitigation	Change
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 material adverse effect on South West Water. Examples of legal and regulatory change include:**	**The general direction of travel of UK Government policy is known and South West Water is actively involved in consultations on regulatory changes.**	
Uncertainty arising from regulatory reform	DEFRA issued its Strategic Policy Statement to Ofwat (the Economic Regulator) in March 2013 outlining direction and priorities. Within that context Ofwat is reforming the regulatory approach. 2012/13 has seen the modification of company operating licences in preparation for the next price review and a number of methodology change proposals.	South West Water has contributed fully to the consultation on regulatory reform and has had dialogue with regulators and stakeholders in order to effectively portray its views. Methodology changes will continue to be considered over the coming months in the lead into the next price review.	↑
Legislative and regulatory compliance	As a regulated business South West Water is subject to numerous and changing obligations.	Performance against key regulatory outputs is reported to the Board on a monthly basis and where performance falls short corrective programmes are developed and implemented to target recovery in a specific area.	↔

Risk	Commentary	Mitigation	Change
		Internal monitoring and assurance programmes are undertaken through the year. Annual data is supported by external verification to provide assurance on the company's compliance with its obligations.	
New regulations, obligations and standards could increase costs	Issues are addressed through the five-year regulatory price review mechanism; obligations which arise within price control periods such as private sewers and bathing water obligations are funded through future adjustments to price limits.	South West Water continues to manage cost pressures as they arise in addition to achieving operating cost efficiencies and managing inflationary increases.	

Economic conditions

Risk	Commentary	Mitigation	Change
Economic conditions could materially affect South West Water's revenues and profitability.	**South West Water has exposure to reduced economic activity and inflation/deflation.**	**South West Water's revenues are economically regulated through the price review mechanism.**	
Non-recovery of customer debt	Customer debt and affordability are key areas of focus given the continued challenging economic conditions.	In addition to existing strategies, which are kept under review, South West Water continues to implement new initiatives to improve and secure cash collection through: • use of third party collection agencies • external trace data to track down previous occupiers • developing a new strategy for previous and earlier debt collections • working with social housing partners • continued use of property charging orders. The company has also continued to fund and promote ways to help customers struggling to pay bills (WaterCare, Restart, Fresh Start Fund) which seek to reduce bad debt exposure. South West Water is one of the few companies to have implemented a social tariff following the introduction of its WaterCare tariff from 2013/14. This tariff is designed to assist around 10,000 households in the region by reducing their bills to an amount they can better afford to pay. The Government's commitment to tackle the 'unfairness' issue for South West Water customers, in which around 3% of the population are effectively paying for a third of the UK's bathing waters, has resulted in a household customer's bill being reduced by £50 per annum from 2013/14.	

Principal risks and uncertainties
South West Water (continued)

Economic conditions (continued)

Risk	Commentary	Mitigation	Change
Loss of revenue	South West Water revenue can be impacted by changes in customer demand and other income streams. The company has around 75% of its customer base metered and as a result the revenue from metered charges can be volatile from changes in customer usage which can be affected by: • abnormal weather impacts • increased water efficiency • recession impacting commercial customers.	The financial impact of changes in customer demand is mitigated through the Revenue Correction Mechanism whereby shortfalls in revenue in one five-year regulatory pricing period are adjusted in the following period.	↑
Financial loss arising from insolvency of a major supplier	South West Water does not have material exposure to payment before receipt of goods and services.	The company uses third party credit monitoring services to identify changes to major suppliers' financial status and creditworthiness to supplement an annual risk review of key and strategic suppliers.	↔

Operating performance

Risk	Commentary	Mitigation	Change
Poor operating performance or a failure or interruption of 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 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 and eventually reduced demand for services and increased fixed costs.**	**South West Water monitors its operating performance through a wide range of systems and management reviews and invests as appropriate to maintain target performance.**	
Non-compliance or avoidable health and safety incident occurrences	South West Water is committed to achieving the appropriate level of health and safety compliance. This year has seen the continued delivery of the behavioural safety programme including safety leadership training for a number of staff, as well as innovative behaviour training. In addition senior management visits were completed during the year across a number of sites.	The number of RIDDOR accidents for 2012 has fallen by over 50%. Continuous training is being provided to ensure that appropriate health and safety working practices are embedded and this reducing trend continues.	↓

Risk	Commentary	Mitigation	Change
Operational failure at clean and waste water sites	Due to the nature of South West Water's business there are continued risks arising during the normal course of business, including risk of failure of assets, processes or systems which could otherwise impact on the health, safety and security of the company's people or customers, or on its financial position and reputation.	The company is able to monitor its significant assets by automated and remote operation and has routine controls and operating procedures in place that are constantly kept under review. Asset management techniques are employed to pre-empt the failure of assets. Where issues do arise there are appropriate contingency plans to deal with such instances and these are updated through experience of such events.	↔
Contamination of water supplies	South West Water has established procedures and controls in place, as well as contingency plans and incident management procedures.	It also maintains insurance policies in relation to these risks, although there can be no assurance that all or any of the costs associated with these risks would be covered or that coverage will continue to be available in the future.	↔
Extreme weather and climate change	2012 has been a challenging year in terms of weather impacts. The continued dry weather from 2011 into the early part of 2012 placed pressure on the company's water resources. This was followed by a period of extreme rain – South West Water's wettest spring/summer in 100 years – which placed significant pressure on its network and resulted in higher levels of flooding incidents.	The business is well placed to manage such extreme incidents. Key mitigation is having detailed contingency plans, sufficient emergency resources and a capital programme that supports ongoing efforts to manage these risks. In the longer term the impacts of climate change are being considered. The company has plans ready and will adapt the way it conducts its business to respond effectively to climate changes.	↔
Increased flooding incidents	The extreme wet weather during the year resulted in a significant increase in the number of flooding incidents, both for customers and at South West Water sites.	The company has identified targeted capital investments to reduce the risk to specific customers in key affected areas.	↑
Pollution events	South West Water is committed to minimising the impact on the environment.	As a result of the extreme weather during the year the number of acute pollution incidents has increased from the prior year. Whilst this is regrettable the number of more serious incidents has fallen from the prior year.	↑
Water resources adequacy	South West Water has a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs) and promotes conservation measures and customer water efficiency measures.	Whilst there has been a strong recovery in the company's water resources, as a result of the extremely wet weather seen over spring/summer 2012, the company continues to monitor reservoir levels to maintain sufficient water resources for drier periods such as those seen in recent years.	↔

Principal risks and uncertainties
South West Water (continued)

Operating performance (continued)

Risk	Commentary	Mitigation	Change
		South West Water also considers the longer term resource situation. It prepares a new Water Resources Management Plan every five years and reviews it annually for a range of climate change and demand scenarios. The Draft Water Resources Management Plan for 2015-2040 has recently been submitted to DEFRA and will be publicly available later in the year. The plan indicates that the company has a surplus of resources through to the horizon of 2040. However investment is needed to develop the overall trunk main infrastructure, to expand treatment capacity and to enhance certain pumped storage facilities.	
Poor service provided to customers	Customer service remains paramount to South West Water and the company focuses on improving customer satisfaction and reducing customer complaints.	The company has delivered significant improvements in customer service during K5 with a 51% reduction in written complaints and an 88% increase in the Service Improvement Mechanism (SIM) score. Continued improvement is being targeted.	⟷
	South West Water could incur a financial penalty under Ofwat's Service Incentive Mechanism (SIM) for below average customer service performance.	While the company has seen improvements in customer service particularly through reduced written complaints, South West Water's relative position will remain unclear until industry data is published. There is an ongoing strategy to improve customer service further.	
Failure to deliver operating cost efficiencies	In line with its track record South West Water remains confident of delivering Ofwat's assumed operating cost savings.	The company has delivered cumulative operating cost efficiencies ahead of K5 targets.	⟷

Capital investment

Risk	Commentary	Mitigation	Change
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 South West Water's financial position and reputation.	South West Water may not deliver its capital programme within the price limits and with the efficiencies determined by Ofwat.	South West Water has a track record of delivering its capital programme in accordance with regulatory requirements and progress is regularly monitored and reviewed.	⟷

Business systems

Risk	Commentary	Mitigation	Change
Major failure of IT systems.	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.	South West Water has well developed IT systems and continuity systems in place. These include a geographically separate alternative data centre, which is hosted by a third party communications provider. This reduces the impact of any failure or disruption.	↔

Market

Risk	Commentary	Mitigation	Change
Uncertainty arising from market reform.	Whilst the Draft Water Bill recognised an approach to reform that was 'evolutionary' rather than 'revolutionary' the development of greater competition in the water industry could reduce South West Water's revenues.	As part of the risk management and business strategic planning processes the company continues to evaluate developments and proposals for competition. South West Water is prepared for the development of retail competition for non-household customers during the next regulatory period and has developed enhanced services offered to commercial customers through 'Source for Business'.	↑

Reputation

Risk	Commentary	Mitigation	Change
Loss of key stakeholder support and prolonged negative media campaign.	South West Water has a number of key stakeholders, including customers, and aims to balance their needs with environmental responsibilities and legislative and regulatory obligations.	The company is committed to engaging with key stakeholders for both South West Water's long-term strategy and coming regulatory period through its independently chaired WaterFuture Customer Challenge Panel which includes representatives from stakeholder organisations. In addition South West Water actively manages communications with customers and stakeholders both online and through social media.	↔

Principal risks and uncertainties

Viridor

Law and regulation

Risk	Commentary	Mitigation	Change
Changes in law, regulation or decisions by governmental bodies or regulators could have a material adverse effect on Viridor's 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 Viridor.** **It remains possible that government policies and regulations may change in unforeseen ways which adversely affect Viridor.**	**The general direction of travel of UK Government policy is known and Viridor is actively involved in consultations on regulatory changes. It maintains a transparent and proactive relationship with regulators.** **Viridor policy is to meet or exceed regulatory requirements which represents a potential competitive advantage for the company.**	↔
Landfill diversion and recycling targets could increase costs/ reduce profitability	The UK has landfill diversion, recycling and recovery targets which, together with the impact of 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. Escalating landfill tax increases the economic attractiveness of recycling and energy from waste. The resource efficiency agenda from the EU and the UK Government's attention to resource and energy security are expected to provide further opportunities for Viridor. Reflecting the above Viridor has undertaken a thorough review of landfill site lives on a prudent basis, and has written down landfill asset values accordingly.	↓
Higher regulatory standards could increase costs	The ever increasing demand for higher standards, in areas such as health and safety, environmental performance and employee welfare, increases costs.	Wherever possible Viridor passes on these higher costs through contractual arrangements with waste authorities and other customers (via legislation and technical clauses). However as government cutbacks continue to bite, local authorities (via austerity measures) are looking for price reductions for already contracted waste streams. Continually improved management controls and investment in its business management systems help Viridor to keep the cost base as low as possible whilst maintaining compliance. 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.	↔

Economic conditions

Risk	Commentary	Mitigation	Change
Economic conditions could materially affect Viridor's revenues and profitability.	**Viridor has exposure to reduced economic activity, inflation/deflation, the impact of the current Eurozone uncertainties and any potential slow down in the Chinese economy.**	**Viridor has a diversified revenue stream which includes domestic sales as well as exports to countries such as China and India and the rest of the EU. Nevertheless Viridor remains exposed to general weakening in worldwide economic conditions.**	↔
Reduced waste volumes could impact Viridor revenue/profit	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.	↔
Reduced recyclate prices could impact Viridor revenues/profit	Viridor's commodity trading arm, Viridor Resource Management, 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. China's recent 'Green Fence' initiative, effectively banning certain waste streams from the country, has placed further burdens on exporters to that country.	Viridor has attempted to mitigate this price reduction via customer supply contracts and by extensive cost control and other management actions. Closure/ mothballing of sites has now taken place and an asset impairment charge has been recognised accordingly.	↔
Viridor enters into long-term contracts which potentially subject the company to contract performance risk for many years	The Government's ongoing spending review is putting increased pressure on local authority services, including waste management, and creating an ongoing search for efficiencies.	Viridor provides best value services and competitive procurement bids to its public sector customers and is protected by the terms of its contracts which run for periods of up to 25 years. Some local authorities are seeking price reductions. Viridor's position remains that it will consider renegotiation of contracts where appropriate to mutual benefit. Nevertheless Viridor remains exposed to such pressures particularly when contracts come to an end.	↑
	Poor performance in the contract or poor initial pricing at the tender stage could impact on the company's long-term profitability and financial condition.	The company's strategy of identifying long-term profitable contracts includes a full evaluation of the benefits from a mix of responses to the requirements of client organisations ensuring that profit is recognised at each stage of the supply chain.	↔
		The company has strict contract authorisation procedures which reflect the size, duration and potential risks of different types of contract. Authorisation of long-term contracts is given at Board or senior management level.	↔

Principal risks and uncertainties
Viridor (continued)

Economic conditions (continued)

Risk	Commentary	Mitigation	Change
		The company has recognised that certain historic contracts, particularly from acquired businesses, have unsatisfactory pricing structures and where appropriate has recognised a diminution in value.	↓

Operating performance

Risk	Commentary	Mitigation	Change
Poor operating performance or a failure or interruption of Viridor's operations may have a material adverse impact on both its financial position and reputation.	**Poor operating performance 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 and, eventually, reduced demand for services and increased fixed costs.**	**Regulatory performance is subject to continued and extensive internal and external inspection, including business management systems and compliance policy.**	↔

Environmental provisioning

Risk	Commentary	Mitigation	Change
Landfill aftercare and restoration liabilities are long-term in nature and could increase which may have a material adverse impact on Viridor's financial position.	**The high cost of moving landfills from active operation, through restoration and into aftercare, continues to increase. This is compounded by shorter remaining landfill lives (due to reduced tonnages).**	**Extensive modelling work has been undertaken with the assistance of outside professional advisers to fully understand the true cost of restoration and aftercare. This has resulted in the period of provision having been increased to 60 years and provisions having increased accordingly.**	↓

Capital investment

Risk	Commentary	Mitigation	Change
The failure or increased costs of capital projects, and acquisitions or joint ventures not achieving predicted revenues or performance, could have a material adverse effect on both Viridor's financial position and reputation.	**Within Viridor there are risks of project delays, cost overruns 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.**	**This has been recognised as a key risk and systems and procedures are in place to address it. More recently the Viridor board has been strengthened by the appointment of a Capital Projects and Engineering Director. The establishment of 'oversight boards' for each of the major projects has added additional rigour to their delivery. Nevertheless the scale of the investment has increased significantly and the quantum of risk has accordingly risen.**	
	With the increase in Viridor's project pipeline, Viridor recognises that this risk is increasing and is addressing it.	Viridor's experienced and dedicated project/contract teams carry out detailed due diligence on all projects, suppliers, technologies and acquisitions prior to commencement.	

Risk	Commentary	Mitigation	Change
		Wherever possible back-to-back agreements with, and guarantees from, suppliers are entered into which provide a significant degree of protection. 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.	↑
Contractor failing to deliver progress could increase Viridor's costs	Despite extensive due diligence and significant protection of back-to-back contracts and/or penalty clauses in contracts to deliver new technologies on time and on budget, Viridor remains exposed to contractors' failure to deliver new projects which may in extreme circumstances require lengthy legal action or other redress. The Runcorn EfW/CHP plant is believed to have fallen about nine months behind schedule and such delay without an increase in liquidated damages would have an adverse effect on Viridor's associated joint ventures and ultimately on Viridor itself.	Viridor, through its Capital Projects and Engineering Director, proactively manages its contractors. It has enhanced its team, both from internal and external resources, to reflect the increased scale of its capital programme.	↑

Competitive pressures

Risk	Commentary	Mitigation	Change
A reduced customer base, increased competition affecting prices or reduced demand for services could have a material adverse impact on Viridor's financial position.	**As a result of current weak economic conditions compounded by the recent spike in global commodity prices, Viridor is experiencing increased competitive pressures in a number of areas of its business, including in particular recyclate volumes and prices, landfill gate fees and bidding for Public Private Partnership contracts (PPPs).**	**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. In general terms Viridor's strategy is to establish a long-term sustainable competitive advantage in the business in which it operates; this is designed to protect long-term shareholder returns.**	↔
	Recycling has been recognised as an attractive business by an increasing number of businesses who are now competing aggressively for volume leading to depressed prices.	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. We believe there is competitive shake-out taking place among marginal competitors which will in due course benefit Viridor as a market leader.	↓
Over capacity in the UK EfW market could impact demand for Viridor's new plants.	There is significant consented EfW capacity in the UK which has yet to be built.	Viridor has fully evaluated projected demand and competing capacity for each of its planned facilities and is confident that they can be filled profitably. With landfill tax to reach £80 per tonne in April 2014, large scale energy from waste facilities of the type Viridor is building will be the low cost way of disposing of residual waste.	↔

Principal risks and uncertainties
Viridor (continued)

Competitive pressures (continued)

Risk	Commentary	Mitigation	Change
		Reflecting government policies and trends there will be a need for around 20 million tonnes of capacity in the UK in 2020. When reviewing current competing projects and take account of planning barriers, financing difficulties and the lack of further large base load municipal contracts, it is expected that there will be a capacity shortfall of up to 25%. Of the 2.5 million tonnes capacity Viridor is committed to operating by 2020 more than half (1.3 million tonnes) is already backed by long-term municipal contracts.	↔
Over capacity in parts of Europe could impact the UK EfW market.	Some waste is being converted into solid recovered fuel (SRF) and, in the absence of sufficient EfW capacity in the UK, is being sent under EA licence for disposal in adjacent parts of Northern Europe where there is currently surplus capacity.	The costs of producing SRF to the required quality and of shipping it to Europe are significant. Disposal and generation of the associated renewable energy in EfWs in the UK is generally lower cost (and better for the UK economy). Nevertheless small amounts of SRF may continue to be exported especially if UK EfW capacity remains insufficient.	↔

Business systems

Risk	Commentary	Mitigation	Change
Information technology and business continuity systems and processes may fail which may cause material disruption to Viridor's business and could have a material adverse impact on both its financial position and reputation.	**Some of Viridor's IT systems require replacement, development or upgrading to meet the growing requirements of the business.**	**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. Nevertheless Viridor recognises the risks associated with IT upgrades.**	↔
	In some areas new technology being introduced may not operate or perform according to stated specification requirements.	Project Enterprise, charged with developing a fully scaleable Enterprise Resource Planning (ERP) type platform is now well advanced, led by the Director of Business Transformation with external professional assistance as required. Nevertheless this is a major project which, as with all IT systems, carries risks.	↔
	Existing systems are beginning to prove inadequate or are unsupported which may lead to an inability to perform key business functions.	Project Enterprise is significantly addressing these issues as a matter of priority.	↔

Group

Finance and funding

Risk	Commentary	Mitigation	Change
The Group may be unable to raise sufficient funds to finance its activities or such funds may be only available at higher cost.	**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 Company has robust treasury policies in place.**	

Risk	Commentary	Mitigation	Change
	The Group had £1.15 billion of cash and facilities as at 31 March 2013 including around £0.8 billion of new/refinanced facilities sourced during the year.	Policies include always having pre-funded at least one year's estimated cash flow through cash and/or committed facilities and ensuring no more than 20% of net borrowings 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 with 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.	↓

Pensions

Risk	Commentary	Mitigation	Change
Pension costs may increase due to higher costs for future service and growing deficits in relation to past service in the defined benefit schemes.	**All defined benefit schemes (apart from the Greater Manchester Waste PFI scheme) have been closed to new entrants since April 2008.** Indications are that the actuarial deficit has increased since the last valuation in 2010.	**Employee and employer contributions are kept under review and a formal actuarial valuation is being undertaken as at 31 March 2013.** Pension trustees keep investment policies under review and use professional investment advisers to seek to maximise investment returns at an appropriate level of risk.	↑

Succession planning

Risk	Commentary	Mitigation	Change
Pennon's employees are the cornerstone to its success and further development. High quality, well motivated, trained and competent people at all levels must be in place to ensure sustained business development.	Ensuring the right people in the right places at the right time does not happen by accident; it needs careful planning.	Succession plans are in place for Board Directors and senior management, and further down the organisation as appropriate. These are normally updated annually. Both South West Water and Viridor have introduced training and development programmes including apprenticeships, graduate training and management development.	↔

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 section on principal risks and uncertainties.

Sustainability report

As one of the largest environmental and resource management groups in the UK, Pennon's business is all about sustainability. We deliver high quality water and sewerage services and recycling, renewable energy and waste management services that are essential to the well-being of our society.

South West Water provides high quality drinking water, together with effective waste water treatment for Devon, Cornwall and parts of Dorset and Somerset.

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

Our ongoing investment, and our commitment to continuously improving levels of service and operational performance, will help society meet its fundamental requirements in water and resource management services in the long-term.

2012/13 achievements

South West Water

- 16 consecutive years without water restrictions, industry-leading leakage control, top quality drinking water and best ever waste water treatment performance
- Two further awards won for 'Upstream Thinking', South West Water's flagship catchment management initiative
- Park Lake, the former china clay quarry now used as a water storage resource, and awarded County Wildlife Status following the company's work to enhance the landscape and habitat
- Community engagement strengthened with South West Water's employee volunteering programme and support for the successful bid for a University Technical College in South Devon
- South West Water customer service score improved
- Introduction of a new social tariff for customers in 2013/14.

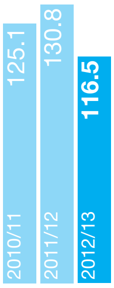
Viridor

- Viridor announced as a 'Bronze' company in the Business in the Community Corporate Responsibility Index
- Viridor first in its sector to achieve ISO 50001 (Energy Management System) accreditation
- Viridor's groundbreaking 'OpenSpace' web portal used for 'live reporting' of environmental compliance data further developed and used by the Environment Agency as model of best practice for other regulated industries
- 40 employees enrolled on Viridor Foundation Degree course designed for future company leaders and around 200 on a variety of apprenticeships
- Viridor won Best Practice in Health & Safety and Best Communications Campaign titles at Chartered Institution of Wastes Management Awards 2012
- £10.5 million provided by Viridor and distributed for environmental and amenity projects across the UK via the Landfill Communities Fund.

We are pleased to report our performance against our strategic sustainability objectives and KPIs.

Objective: **Manage Pennon Group as a sustainable and successful business for the benefit of shareholders and other stakeholders.**

Capital Investment
(£m)

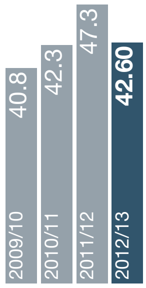


South West Water

As a well managed and responsible Group, with sustainability driving its business strategy and at the core of its operations, we aim to deliver strong performance and lasting value for all our stakeholders. Our services and methods of operation at all times look to provide clear community benefits and to protect and enhance the environment.

In addition to our long-term investment performance, Pennon was pleased to have increased its 2013 score in the FTSE4Good Index – Environmental, Social and Governance ratings assessment to 4.2 out of 5 (2012: 3.8).

Earnings per share before deferred tax and exceptional net charges (pence)



Pennon Group

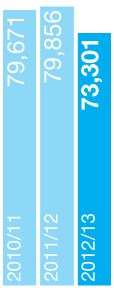
Capital Investment
(£m)

Viridor

* Includes investment in contracts in which local authorities have a residual interest. Previous years restated.

Objective: **Aim to ensure that all our business activities have a positive economic, social and environmental impact on the communities in which we operate.**

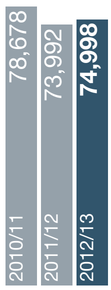
Community support, sponsorship & donations
(£)



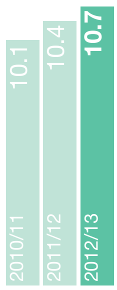
Pennon recognises it has a responsibility to contribute positively towards communities affected by our operations. In addition to investing in a high quality water and waste management service, we create local employment, use local supply chains, provide financial support to community projects and enhance the environment.

Pennon Group and its subsidiaries support communities and charities within their operational areas and Viridor continues to provide substantial funding to environmental and community projects via the Landfill Communities Fund. Viridor and South West Water also both fundraise for their preferred charities: WaterAid, the Cystic Fibrosis Trust and Trees for Cities.

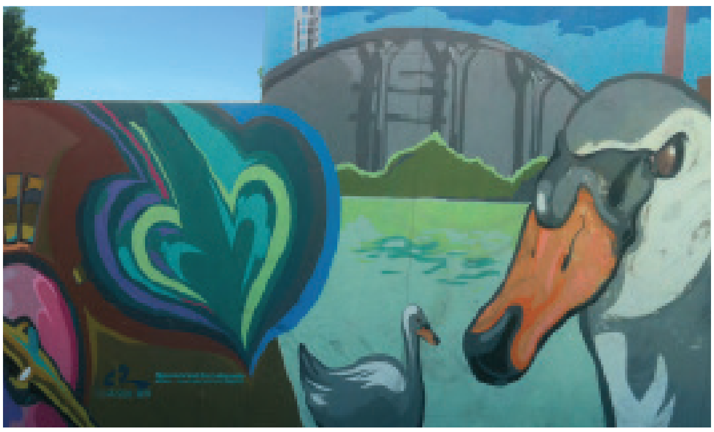
Charitable donations
(£)



Community support, sponsorship & donations
(£m)



Wakeboarding at Siblyback Lake, Cornwall



Community mural in Slough featuring Lakeside EfW

Sustainability report
Continued

Objective: **Aim to ensure that all our business activities have a positive economic, social and environmental impact on the communities in which we operate.**
Continued

Economic impact

South West Water

The company has introduced an innovative 'mixed economy' model for the current regulatory period to source its capital programme. This means using a significant number of smaller local contractors to provide specialised services, so providing inward investment into the local economy. Research compiled by Plymouth University Business School in February 2013 suggests that the company generates over 4,500 jobs in the region.

South West Water's £2 billion investment in 'Clean Sweep' has delivered improved waste water treatment around the coast, improving the amenity of beaches and bathing waters, which is fundamental to the success of the tourist industry in Devon and Cornwall.

Since privatisation of the water industry in 1989, around 3% of the country's population who live in the South West have effectively been paying for the clean-up and protection of one third of the nation's bathing waters. Following four years of close work alongside MPs of all parties and consumer groups, South West Water has been delighted to see the UK Government funding a £50 per annum bill reduction to all household customers in the region, which is designed to address this historic unfairness. This arrangement was implemented for 2013/14 charges and is planned to run until at least 2020.

Viridor

Viridor's current programme of investment of around £1.5 billion in recycling and energy from waste facilities, including £292 million of capital investment in growth projects in 2012/13, is creating significant employment and training opportunities. These include construction jobs (for example, around 1,000 people were employed at the Runcorn energy from waste (EfW) development site alone at the turn of the year) and jobs in its supply chain, as well as the long-term employment opportunities for plant managers, operatives and technicians. Both Viridor and its construction partners are providing training and apprenticeship programmes on these projects.

Social impact

South West Water

South West Water has further developed its affordability toolkit for customers who are struggling to pay their water bills. The company has introduced a new social tariff for 2013/14 to help its most hard-pressed customers, and established new partnerships with Age UK to target support for older customers and with housing associations to engage with low income customers. 'Battle the Bills' sessions have provided advice on water and energy use to the all important small businesses in the region.

South West Water's expanding apprenticeship scheme continues to identify and nurture talent in the region. The company is proud to have supported the successful bid for a University Technical College in South Devon, which will provide students with relevant skills in water, environment and engineering. Recognising that this sector plays a significant part in female participation rates, some of the company's female scientists and engineers have visited schools to encourage girls to study science, technology, engineering and mathematics (STEM).

Viridor

Viridor continues its programmes of proactive community sponsorship, focusing on environmental and science, technology, engineering and maths (STEM) – focused education initiatives in its areas of operation.

The company also continues to provide funding to Viridor Credits, an independent Environmental Body and registered charity, via the Landfill Communities Fund. In 2012/13 Viridor provided £10.5 million for amenity and environmental improvement projects in the vicinity of permitted landfill sites across the UK. Approximately 275 projects were supported and it is estimated these benefited some 200,000 people.

Some of the major service contracts signed during 2012/13, such as those with Glasgow City Council and Peterborough City Council, include significant community benefit packages whereby Viridor is committed to delivering education, training and local 'capacity building' services to complement the core waste treatment requirements.

South West Water contracts the provision of conservation, access and recreation at its reservoir sites to South West Lakes Trust. The public can participate in quiet recreation, such as camping, walking, cycling and fishing, or take part in a wide range of boating and watersports activities. The company has further developed its community engagement strategy by providing opportunities for employee volunteering. During summer 2012 teams of employees participated in a series of beach cleans around the region, in conjunction with Keep Britain Tidy.

Complementing its sponsorship in STEM education in schools and colleges, Viridor also operates or supports 10 education centres on or near its sites. These help to promote understanding and best practice in waste prevention, recycling, recovery and resource management, as well as wider issues of sustainability. During 2012/13 the centres welcomed 15,792 visitors from schools, colleges and community groups. All Viridor centres hold the 'Learning Outside the Classroom Quality Badge', the nationally recognised indicator of good quality educational provision.

Environmental impact

South West Water

Following the acquisition of Park and Stannon china clay pits from Imerys, South West Water is now restoring the landscape and wildlife amenity at these sites. In recognition of the significant improvements at Park, Cornwall County Council has awarded the site County Wildlife Status.

The extreme wet weather in the latter half of 2012 and the start of 2013 caused widespread flooding in the south west of England. The number of internal and external sewer flooding incidents increased as a direct result. South West Water worked in partnership to minimise the impact of these events. Steps have been taken to improve resilience to extreme weather; for example the £2 million investment in flood defences at Pynes Water Treatment Works in Exeter.

South West Water experienced four Category 2 or 'significant' pollution incidents in 2012.

In 2012 the company was the subject of 17 prosecution cases brought by the Environment Agency for pollution incidents in 2010 and 2011. South West Water regrets the increase in prosecutions, but is confident that the targeted programme of action over the last two years is delivering significant improvements in performance.

The South West has more designated bathing waters than any other region in England and Wales and in the past two decades South West Water has made significant advances in helping to improve bathing water quality.

The summer of 2012 was the wettest on record for 100 years. Bad weather can adversely affect bathing water quality because heavy rain impacts on urban drainage and agricultural run-off. Heavy storms can also trigger the operation of combined sewer overflows (CSOs) in the sewerage system.

Following this and changes to the way in which guideline standards were recorded in line with new bathing water quality standards, 93% of England's bathing waters met the 'good' (mandatory) European standard, with over 58% meeting the tighter 'excellent' (guideline) standard. Of the 146 bathing waters in the South West region, 133 or 91% met the 'good' standard and 88 or 60% achieved the 'excellent' standard.

Despite the wet weather, fewer than half the year's failures occurred during the operation of CSOs. This illustrates why the company continues to work with its partners to tackle all the other issues that can affect bathing water quality – urban drainage, agricultural run-off, birds and other wildlife, private sewers and misconnections (homes wrongly connected to surface drainage instead of to public foul sewers). South West Water is proud that in 2013 its service area was awarded 14 Blue Flags and 18 Seaside Awards notwithstanding the tougher standards introduced by the awarding body last year.

Viridor

Viridor continues to proactively create, assist and manage quality habitats on both its own sites and in the vicinity of its operations. The company is now implementing its biodiversity strategy which will look to prioritise biodiversity enhancement opportunities and to implement good stewardship practice on all relevant sites. Viridor is the industry leader in achieving the Wildlife Trust's Biodiversity Benchmark at around 30% of its closed landfills and is working to extend this list as further sites come into closure.

The unusually wet weather in 2012 caused local management challenges especially at landfill sites, associated with the collection and disposal of leachate. Over 90% of the company's major operational facilities have been developed and managed in a manner that has demonstrated climate change resilience in line with the Environment Agency's best practice guidance which Viridor has also helped to develop.

A Category 1 or 'major' pollution incident occurred at Viridor's Lean Quarry Landfill in Cornwall, whereby a quantity of leachate was released into the local water course as a result of vandalism out of hours. Due to Viridor's swift and effective corrective actions, the Environment Agency is considering civil sanctions rather than a formal prosecution and fine.


Landfill Communities Fund biodiversity improvement project, Denge and Pennypot, Kent

Sustainability report
Continued

Objective: **Engage with all our stakeholders and foster good relationships with them.**

Pennon aims to be a good neighbour, and liaises with its stakeholders in order to determine and respond to their priorities.

Both subsidiaries are actively engaging with stakeholders via social media, developing their online presence to enable customer and community queries and issues to be raised and addressed in this way.

South West Water

As part of preparing its 2015-2020 business plan South West Water has commissioned extensive independent research to ascertain customer priorities, future service and investment. It has established a WaterFuture Customer Challenge Panel comprising regulators and representatives from domestic customers, the business community and environmental groups to ensure the company's business plan reflects stakeholders' opinions.

The company's 'Upstream Thinking' project includes extensive stakeholder engagement, liaising with regulators, the charitable sector, landowners and universities. This approach was recognised when the company won the Environment Award at the Utility Industry Achievements Awards.

South West Water's Twitter feed has helped improve scope for communicating in real time with the public: for example during the flooding in December 2012. 94,000 of its household customers have registered with the 'My account' web page and approximately 4,000 customers are using the company's mobile 'App'.

The number of beaches covered by 'BeachLive' has been increased. This online service provides real time information on the operation of Combined Sewer Overflows and their impact on over 40 beaches in the region.

Viridor

Viridor registered its first submission in Business in the Community's (BitC) Corporate Responsibility Index (CR Index), an annual benchmarking of responsible business management. The company was pleased to be ranked as Bronze within the Index, a very creditable performance for a first entry.

The CR Index is the UK's leading and most in-depth voluntary benchmark of corporate responsibility, helping companies to accurately measure and manage all aspects of their social and environmental performance and improve corporate responsibility throughout their business operations, and benchmark themselves against competitors.

There is room for improvement within the community investment and marketplace sections and these will be looked at carefully in the coming months to see where progress can be made. On all counts Viridor scored well within sight of the averages for both its sector and the Index as a whole.

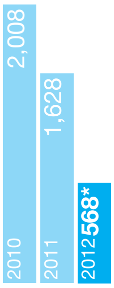
During the year Viridor further developed its 'OpenSpace' web portal – one of the most ground-breaking projects between the Environment Agency and the waste industry, embracing contemporary data management practice to enable timely review of the environmental performance of regulated facilities. In addition the Scottish Environment Protection Agency is trialling the system.

Advice being given by Source for Business

Pilsworth landfill restoration scheme, Bury

Objective: **Strive for the highest standards of health and safety in the workplace so as to minimise accidents, incidents and lost time.**

RIDDOR incidence rate per 100,000 employees



Actual number 7

A safe and healthy workforce will always be a top priority for the Pennon Group.

* Reportable incidents are now reported over seven days absence (2011, after three days absence).

RIDDOR incidence rate per 100,000 employees

Actual number 45

South West Water

South West Water is pleased to report further improvement in its health and safety performance during 2012. The total number of RIDDOR reportable incidents for the calendar year 2012 was 7, compared with 20 in 2011. Innovative behavioural training has been rolled out to employees during the year.

South West Water employs an independent occupational health service which provides a range of services such as health surveillance for shift workers and field staff. The company has introduced a third party nurse-led absence reporting process to support the reduction of absence and to provide employees with advice on specific medical issues when they report absence from work.

Viridor

Viridor achieved a 42% reduction in its three-year rolling RIDDOR incidence rate since 2009, against a target of a 10% reduction. However, the company's performance in 2012 saw an increase in this incidence rate over the previous year (from 1,238 per 100,000 employees in 2011 to 1,429 in 2012). This increase is very disappointing and Viridor is redoubling its efforts to continue to drive down the number of accidents.

The company continues its strenuous efforts to ensure a genuine 'health and safety culture' throughout the organisation. It is giving top priority to a range of employee engagement and training initiatives, alongside ongoing focus on fundamental risk assessment systems and safety management procedures, following last year's full review.

Viridor won the Health and Safety Best Practice Award at the Chartered Institution of Wastes Management Awards for Environmental Excellence 2012.

Water treatment works, Tottiford

Landfill restoration and habitat management at Dimmer, Somerset

Sustainability report
Continued

Objective: **Develop and motivate our employees, treat them fairly and ensure that they are fully engaged in all aspects of the Pennon Group's objectives.**

Pennon's success is fundamentally due to the quality and diligence of our employees. We recruit talented and committed personnel and provide training packages to equip them with the skills they need to deliver the Group's objectives.

South West Water

South West Water has silver status in the Investors in People standard. The company's equal opportunities policy is regularly updated to reflect current legislation and good practice. The company's recruitment procedures ensure objectivity and focus on appointing the best person for the job, without diversity bias.

South West Water is training supervisors in strong leadership skills to facilitate behaviour change, and operators are being upskilled through the acquisition of NVQs. This approach is helping to ensure that its employees have the necessary skills to support the introduction of remote operating systems, known as 'PUROS'*. Further training programmes are developing current and future managers.

* Phased Utilisation of Remote Operating Systems

Viridor

Viridor reviewed its employment and workplace policies during 2012/13 and its employment handbook and management guide are made available to all employees to help them understand and interpret company policies and ensure consistency and fairness in their application. HR training courses (such as those on investigations, absence management and performance management) support new managers and contribute to the consistency of application across the company's business regions. The company continues to expand its Investors in People registrations in certain parts of the country.

The company has a structured approach to assessment and training throughout the business and nearly 4,000 training days were delivered in 2012/13. Over 200 employees are taking the sustainable waste management apprenticeship, which Viridor helped to design, and 15 other apprenticeships are also underway. The innovative Viridor Foundation Degree course, developed with Edge Hill University and focused on professional development for the company's future leaders, started in April 2012 and currently has 40 employees enrolled. Viridor also plans to implement its new Employee Engagement and Internal Communications Strategy and Plan during 2013/14.

Colliford Lake, Cornwall

Environmental data management at Longley Lane MBT facility, Manchester

Objective: **Aspire to leadership in minimising emissions that contribute to climate change, and develop climate change adaption strategies.**

For many years, Pennon has recognised the need to manage its carbon emissions and adapt to the consequences of climate change.

With a score of 71 in the internationally recognised Carbon Disclosure Project (CDP) in 2012, Pennon moved slightly down the rankings to 96th place out of 240 respondents from the FTSE 350. Pennon is working with CDP and their scoring partner, PricewaterhouseCoopers, to identify and implement areas for further improvement.

Pennon Group continued to comply with the Carbon Reduction Commitment Energy Efficiency Scheme, which was evidenced by a successful audit during the middle of 2012 covering the first compliance year.

South West Water

South West Water's energy strategy is designed to limit greenhouse gas emissions through a combination of energy efficiency and renewable energy schemes.

The company remains committed to its ambitious long-term target to reduce its carbon emissions by 80% by 2050. Consequently the company set a stretching target to be achieved by 2014/15. In 2012/13 its greenhouse gas emissions remained below the 2009/10 baseline, but the extreme weather meant the company was unable to maintain the downward trend of the previous two years. South West Water remains focused on delivering improvements towards its carbon reduction target. The company continues to be accredited to the Certified Emissions Measurement and Reduction Scheme (CEMARS).

South West Water's award winning 'Upstream Thinking' programme is revolutionising the water industry's approach to catchment management. The company is undertaking scientific research in conjunction with universities to assess how land management practices impact on raw water quality and working in partnership to deliver changes which will deliver a more secure and sustainable water supply and improve resilience against climate change. South West Water's work focuses on moorland restoration in the uplands, which capitalises on the water storing capacity of peat, and encourages farmers to implement measures which benefit adjacent water courses. During the year this project won the large company category of the inaugural Institute of Chartered Accountants in England and Wales (ICAEW) Finance for the Future Awards and the environmental category of the Utility Industry Achievement Awards.

South West Water continues to target energy efficiency through its programme of pump refurbishments and replacements at both drinking water and waste water treatment sites. The optimisation of its assets and networks is complemented by the use of remote technologies to control processes and equipment from a central hub as part of the PUROS project.

In addition South West Water's 'Powerdown' energy efficiency campaign promotes company-wide energy efficiency. An example of this in 2012/13 was the saving of 1.1GWh through lighting refits at several of its largest sites.

Viridor

In March 2013 Viridor became the first recycling and waste management company in the UK to receive ISO 50001 certification from the British Standards Institute for its energy management systems. This followed a number of years developing energy management systems (including procedures, databases and metering systems). ISO 50001 now provides Viridor with a continual improvement framework for reducing its energy consumption and greenhouse gas emissions in both the short and long-term.

Viridor has set an objective of reducing its energy consumption relative to its growth by 20% over five years from 2010 and has reached the end of the second year of its plan. There were a number of energy efficiency projects implemented throughout 2012/13, including voltage optimisation schemes and energy efficient LED lighting installations at a number of the company's processing facilities. Successful pilot projects have resulted in a national level project being implemented in early 2013 to install LED lighting at the majority of its MRFs and transfer stations. This should see significant carbon savings accrue throughout the third year of the reduction plan.

During 2012/13, an energy efficiency technical group was established to pull together technical expertise from across the business. The focus of the group is to identify projects for Board approval for rapid implementation at scale across the business. Further training will be provided to Viridor personnel as energy efficiency workshops are rolled out across the regions.

Viridor continues, with its carbon reporting tool, to assist its customers in identifying the carbon saving benefits of recycling, recovery and good waste and resource management. In 2012 an updated second version of the reporting tool was made available to customers, with a third update scheduled for summer 2013.

Sustainability report
Continued

Pennon Group Greenhouse gas emissions

	tCO_2e 2011/12	2012/13
Scope 1[1]	**1,967,935**	**1,934,332**
Scope 2[2]	**159,360**	**164,712**
Scope 3[3]	**45,970**	**43,948**
Total gross emissions	**2,173,265**	**2,142,992**
Carbon offsets	**0**	**0**
Netted off renewable electricity export to grid up to total amount of electricity purchased and consumed by organisation	**(159,360)**	**(164,712)**
Total annual net emissions	**2,013,905**	**1,978,280**
Intensity measure: tCO_2e (scope 1+2)/£100,000 revenue	173 tCO_2e/£100,000 revenue	175 tCO_2e/£100,000 revenue

[1] **Scope 1 (Direct emissions)**
Activities owned or controlled by our organisation that release emissions straight into the atmosphere. These are direct emissions.

[2] **Scope 2 (Energy indirect)**
Emissions being released into the atmosphere associated with our consumption of purchased electricity, heat, steam and cooling. These are indirect emissions that are a consequence of our activities but which occur at sources we do not own or control.

[3] **Scope 3 (Other indirect)**
Emissions that are a consequence of our actions, which occur at sources which we do not own or control and which are not classed as scope 2 emissions.

Notes

1 Change in emissions
Our reported emissions fell between 2011/12 and 2012/13 largely as a result of fewer fugitive emissions recorded from Viridor's landfill sites.

2 Methodology and approach
We have followed the Government's Guidance on how to measure and report your greenhouse gas emissions. We have used the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) and GHG conversion factors published by DECC/DEFRA.

3 Organisational boundary
The emissions listed here cover the Pennon Group of companies using the financial control approach.

4 Operational scopes
We have measured our scope 1, 2 and some scope 3 emissions where information is available.

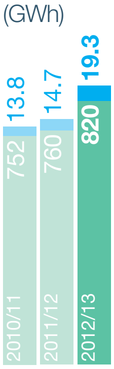
5 Intensity measurement
We have chosen an intensity measure of scope 1 and 2 gross emissions in tCO_2e per £100,000 revenue.

6 Carbon offsets
We do not purchase any carbon offsets, instead we rely on self-generated renewable energy to reduce our overall emissions.

7 Green tariffs/renewable energy export
We do not purchase green tariff electricity; instead we can reduce our net emissions by exporting our self-generated renewable energy to other users.

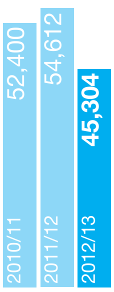
Objective: **Aspire to leadership in all aspects of waste prevention and resource efficiency.**

Renewable energy generation (GWh)



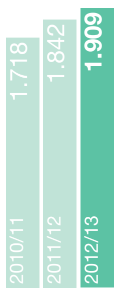
South West Water
Viridor

Recycling volumes (tonnes of dry solids)



Pennon is delivering solutions for society to address the environmental challenge of depleting natural resources by maximising the value of residual materials, transforming waste and improving energy efficiency.

Recycling volumes (million tonnes)



South West Water

South West Water's goal is to have 30GWh of its energy usage supplied from renewable sources by 2015. In 2012/13 excellent progress was made, with more power from renewables generated than ever before. In total, 19.3GWh was harnessed from a combination of solar, wind, hydro and combined heat and power (CHP) from sewage sludge.

The company's 25 existing solar PV installations performed well and an additional seven schemes were installed, five of which were operational by the year-end, with the other two becoming operational in April 2013. The wind turbine at Lowermoor water treatment works also outperformed its generation target for the year.

Following the success of the grit and screenings composting trial, South West Water is now rolling this process out across the region, in order to reduce volumes of waste sent to landfill.

Viridor

Viridor provides waste prevention, recycling, resource efficiency and renewable energy generation best practice audits, advice and services to clients across the public and private sectors. The amount of material recovered (via re-use, recycling or energy recovery) as a proportion of total waste inputs handled by the company rose to 37% in 2012/13 (2011/12: 35%) and a total of 2.6 million tonnes of material was recovered. This was an increase of 8% on the previous year and included 340,463 tonnes of organic (food and garden) waste composted.

A total of 1,909,000 tonnes of dry recyclates were processed, producing high quality recycled commodities to be sold to customers in the UK, Europe and globally for remanufacturing, thus making a significant contribution towards greater overall resource efficiency.

Viridor, in partnership with the Greater Manchester Waste Disposal Authority, was pleased to win the Best Communications Campaign at the 2012 Chartered Institution of Wastes Management Awards for Environmental Excellence for its innovative work promoting waste prevention and recycling through the 'Recycle for Greater Manchester' initiative.

The provision of renewable energy from waste sources also makes a substantial contribution to energy security and resource efficiency in the UK. During 2012/13 Viridor's output of renewable power from landfill gas, energy from waste and anaerobic digestion facilities rose to 820 gigawatt hours (GWh) from 760GWh in 2011/12.

Governance

Programmes and performance contributing to the sustainability of the businesses are overseen by the Pennon Sustainability Committee. Details are given on page 68. The subsidiaries develop a range of targets as part of their business planning processes and monitor and report progress to their respective boards and to the Pennon Sustainability Committee throughout the year.

Verification

Pennon's sustainability performance and reporting has been audited by Carnstone Partners LLP, an independent management consultancy, specialising in corporate responsibility and sustainability.

South West Water and Viridor sustainability reports

The full sustainability reports for South West Water and Viridor will be published in July and August respectively and will be available to view at **www.pennon-group.co.uk** and also on the subsidiaries' websites. Full details of the sustainability targets for South West Water and Viridor for 2012/13, and their performance against them, are given in their respective sustainability reports.

Bodmin Moor in spring

Materials recycling facility, Manchester

Other statutory information

Principal activities and business review
The principal activities of the Company and its subsidiaries ('the Group') are the provision of water and sewerage services, recycling, renewable energy and waste management. 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 4 to 57 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 (2010 Edition) 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 38, 39, 44 and 47. Further information on ESG aspects of the Group's business are included in the Group sustainability report on pages 48 to 57. The principal subsidiaries of the Company are listed in note 41 to the financial statements on pages 139 to 140.

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 60, 61 and 64 to 71 of this Annual Report which are hereby included within this Directors' report by reference.

Financial results and dividend
Group profit after taxation and exceptional items on ordinary activities after taxation was £26.9 million. The Directors recommend a final dividend of 19.70p per Ordinary share to be paid on 4 October 2013 to shareholders on the register on 9 August 2013, making a total dividend for the year of 28.46p, the cost of which will be £103.8 million, leaving a transfer from reserves of £76.9 million. The business review on pages 30 to 35 analyses the Group's financial results in more detail and sets out other financial information.

Directors
In accordance with the provisions of the UK Corporate Governance Code (2010 Edition) (the Code) all Directors are offering themselves up for re-election (or, in respect of Gill Rider, election) at this year's Annual General Meeting (AGM) with the exception of Dinah Nichols who will be retiring as a Non-executive Director at the end of the AGM having completed in excess of nine years as a Director.

The Board continues to believe that each Director standing for re-election or election makes an effective and valuable contribution to the Board, demonstrating continued commitment to his or her role. The Non-executive Directors, Martin Angle and Gill Rider, are considered to be independent in accordance with the provisions of the Code. Gerard Connell, subject to his 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 Gerard remains independent as he demonstrates independence of character and judgement in his conduct of matters with the Board. The Non-executive Directors do not have service contracts; they have contracts for services terminable upon three months' notice.

The Chairman, Ken Harvey, similarly has a contract for services, which is terminable upon 12 months' notice. David Dupont, Executive Director, has a service contract which is due to expire when he reaches age 60 (June 2014). David's contract is expected to continue subject to 12 months' notice when he reaches age 60. In respect of Chris Loughlin, who has reached age 60, his contract now continues subject to 12 months' notice and Colin Drummond who had previously reached age 60 and had a contract continuing subject to 12 months' notice will now retire from being an Executive Director when a successor is appointed, currently expected to be by the end of September 2013.

Formal resolutions for the above Directors' re-election or election, as appropriate, will be proposed at the Annual General Meeting. The Directors' biographies are set out on pages 62 and 63.

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 78. Further details relating to the Directors and their service agreements or contracts for services are set out on pages 76 and 77 and details of the Directors' interests in shares of the Company are given on pages 79 to 82.

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 himself or herself 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 financial statements on pages 96 to 98.

Employment policies and employee involvement
The Group has a culture of continuous improvement through investment in people at all levels within the Group. The Group is committed to pursuing equality and diversity in all its employment activities including recruitment, training, career development and promotion and ensuring there is no bias or discrimination in the treatment of people. In particular, applications for employment are welcomed from persons with disabilities and special arrangements and adjustments as necessary are made to ensure that applicants are treated fairly when attending for interview or for pre-employment aptitude tests.
Wherever possible the opportunity is taken to retrain people who become disabled during their employment in order to maintain their employment within the Group. The Group 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 69.

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 cascades information monthly to all employees to provide them with important and up to date information about key events and to obtain feedback from them.

Further information about employment matters relating to the Group are set out on pages 20, 28 and 54 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 2013 around one-third of the Group's employees was participating in these plans.

Research and development
Research and development within the Group involving water and waste treatment processes amounted to £0.2 million during the year (2011/12 £0.2 million).

Pennon Group donations
During the year the Company and its subsidiaries made charitable donations of £83,301 (2011/12 £73,992) divided between environmental purposes (£3,700) and social and community purposes (£79,601). In addition some £10.5 million was provided via the Landfill Communities Fund for environmental and community projects. Further details are included on page 49 of the Group sustainability report. No political donations were made or political expenditure incurred and no contributions were made to a non-EU political party (2011/12 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 2014 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 2012/13 and the amount owed to its trade creditors at 31 March 2013, was 43 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 2012) which was valid as at 31 March 2013 and remains currently valid. Of the 3,632,705 shares held in Treasury at 31 March 2012, 1,526,869 were subsequently re-issued under the Company's employee share schemes for proceeds of £4.6 million.

Major shareholdings
Details of major shareholdings notified to the Company in accordance with FSA Disclosure and Transparency Rule 5 are set out on page 144 'Shareholder information'.

Independent auditors
PricewaterhouseCoopers LLP were appointed auditors until the conclusion of the twenty-fourth 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-fourth Annual General Meeting of the Company will be held at the Sandy Park Conference Centre, Sandy Park Way, Exeter, Devon EX2 7NN on 1 August 2013 at 11.00am. Details of the resolutions are summarised below 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
25 June 2013

2013 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 and Mr C Loughlin and elect Ms G A Rider, 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).

Corporate governance report
Chairman's introduction

The Board recognises that the highest standards of corporate governance are key to managing Pennon Group successfully 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 2013 on behalf of the Board.

The Annual Report continues to be 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 (2010 Edition) have been applied in practice. The Code is publicly available on the Financial Reporting Council (FRC) website **www.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 continue to 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 again facilitated by an external governance consultancy, 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.

This year the Board has received presentations from senior management on material developments in the businesses including waste and renewable energy policy developments; our energy from waste plant projects; and regulatory and legislative changes proposed by Ofwat and Government. The Board has also visited new plants under construction in the Greater Manchester area to obtain first hand knowledge of the projects.

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

We have always pursued a remuneration policy of setting pay at a level which is adequate 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 that no changes are necessary to 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 70 meetings with institutional shareholders and 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 and the Chief Executive of Viridor also participated when appropriate. The Group Director of Finance continues to report 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 2013 Annual General Meeting on 1 August all our Directors intend 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.

To view our online annual report:
www.pennonannualreport.co.uk/2013

Contents of the corporate governance report

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 (2010 Edition) with no exceptions to report. The Code was revised in September 2012 to apply to companies' financial years beginning on or after 1 October 2012. We believe we are also compliant with the revised Code but it will not formally apply to our reporting to shareholders until next year.

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
25 June 2013

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, HonFSE
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.

Colin is due to retire from the Board when a successor has been appointed which is expected to be around the end of September 2013. At that time Colin will become the chairman of the board of Viridor Limited and will retain his directorship of that company.

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. Chris started his career as a chartered engineer working in both the consulting and contracting sectors and subsequently held a number of senior positions with British Nuclear Fuels. Between April 2008 and March 2012 he was chairman of Water UK. Currently Chris is vice-chairman of the Cornwall Local Enterprise Partnership, President of the Institute of Water and a trustee and member of the audit committee of the global charity, WaterAid.

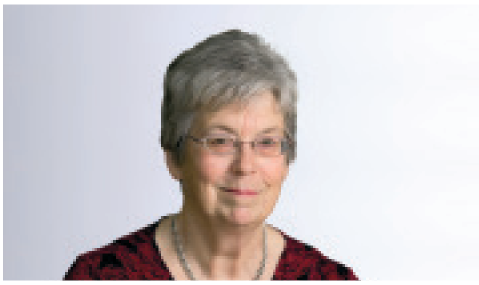
Non-executive Directors

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 Group 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. He is also a governor of King's College School, Wimbledon. Gerard is due to retire from the Board at the conclusion of the Annual General Meeting in 2014.



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, chair of Keep Britain Tidy and an external member of council of the National Trust. Dinah is due to retire from the Board at the conclusion of the Annual General Meeting on 1 August 2013.

Gill Ann Rider CB, PhD, FCIPD
Non-executive Director
Committees: Audit, Sustainability (Chairman with effect from 2 August 2013), Nomination, Remuneration

Appointed on 1 September 2012. Gill currently holds non-executive directorships with Charles Taylor Consulting Plc, the Chartered Institute of Personnel & Development where she is president, De La Rue Plc where she is chairman of the remuneration committee and she is chair of council of the University of Southampton. Formerly Gill was head of the Civil Service Capability Group in the Cabinet Office reporting to the Cabinet Secretary and prior to that held a number of senior positions with Accenture culminating in the post of chief leadership officer for the global firm.

Company Secretary

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, their independence and responsibilities
The Board of Directors at the end of the year comprised the Chairman, three Executive Directors and four Non-executive Directors. All of 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 (2010 Edition) (the Code) applied to them other than in respect of Dinah Nichols who, following the Annual General Meeting last year, had served on the Board for more than nine years since her first election. Following this year's Annual General Meeting and subject to re-election, Gerard Connell will also have served on the Board for more than nine years since his first election. However Dinah and Gerard have been determined by the Board to be independent. The Board is satisfied that they do and will continue to demonstrate independence of character and judgement in the performance of their roles on the Board.

In accordance with the Board's planned succession process, as reported last year, Dinah Nichols will be retiring from the Board at the close of the Annual General Meeting this year and Gerard Connell will retire at the close of the Annual General Meeting in 2014.

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 62 and 63 demonstrate collectively a broad range of business, financial and other relevant 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 63). Martin Angle is also a member of the Audit Committee and he has relevant financial experience as set out in his biography, also on page 63.

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 Board
The Directors on the Board and their attendance at the 11 scheduled meetings of the Board during 2012/13 are shown below:

Board membership	Appointment date	Attendance
Chairman		
Kenneth Harvey	**March 1997**	**11/11**
Non-executive Directors		
Martin Angle	**December 2008**	**11/11**
Gerard Connell	**October 2003**	**10/11**
Dinah Nichols	**June 2003**	**11/11**
Gill Rider	**September 2012**	**7/7**
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 and 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 Board's performance evaluation process each year.

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 once again administered 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.

The Board considered the findings of the evaluation and, while performance was again considered to be satisfactory overall, a number of areas were identified where enhancements to Board practice could be made. These included more liaison with subsidiary boards and allocating more time for strategic discussion and presentations from management on key business issues. The Board will be monitoring implementation of these enhancements over the coming months to ensure that they are successfully implemented.

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 did not change during the year and the Board was satisfied that such commitments did not prejudice the Chairman's performance in relation to his Group role. He will be relinquishing his non-executive directorship on the Board of National Grid in July 2013.

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 corporate governance report on pages 66 to 69 and the Directors' remuneration report on pages 72 and 73.

Board Committees' Terms of Reference

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

The Remuneration Committee

Details of the Remuneration Committee and the Directors' remuneration report can be found on pages 72 to 83.

Corporate governance and internal control
Continued

The Audit Committee

Gerard Connell, Audit Committee Chairman

Committee membership	Appointment date	Meeting attendance
Committee Chairman		
Gerard Connell	**October 2003**	**6/6**
Members		
Martin Angle	**December 2008**	**6/6**
Dinah Nichols	**June 2003**	**6/6**
Gill Rider	**September 2012**	**4/4**

Our activities during the year
A continuing focus has been reviewing the systems and controls in place in Viridor to manage its complex and regionalised businesses across the UK. Viridor has been re-assessing and enhancing its processes and controls, including planning for the development of a new suite of IT systems, to manage the strong growth expected from its energy from waste plants, its recycling businesses and its major contracts with waste authorities. The Committee was pleased to note, for example, that audit review of the self-assessment processes implemented at site level and a focus on the control responsibilities of local business managers have together contributed to an enhancement of the quality of the risk assessment and monitoring within Viridor's regional activities.

Towards the year-end there was particular focus on the impairment review in Viridor. The Committee reviewed and challenged the key assumptions on which cashflow projections were based and considered a number of alternative scenarios with appropriate sensitivity analysis, to test the appropriateness and prudence of management estimates. Key issues debated included discount rates and the determination of cash generating units.

At Group level the 'going concern' position was reviewed and it was concluded that there was a reasonable expectation that the Group had adequate resources to continue its operations for the foreseeable future.

In South West Water the emphasis has been on continuing to improve the efficiency of its systems 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 reviewed and refreshed its risk assessment and internal control processes during the year in preparation for revised reporting protocols to Ofwat and its next Periodic Review in 2015.

We also re-assessed our overall Group risk review processes during the year bearing in mind that it was 12 years since the Group introduced detailed risk management policies and procedures in accordance with the Turnbull Recommendations. Deloitte undertook a full review and, whilst concluding that the Group's risk culture and processes were generally satisfactory, made a number of recommendations to enable more focused attention on key risks at Board level. As part of the Group's risk review process the key areas of sensitivity to the Group have been reassessed and these are set out on pages 36 to 47. We have concentrated on the high level key risks to the Group and have, where appropriate, 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 an ongoing need to use our auditors' firm for non-audit services.

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 and in line with the latest edition (September 2012) UK Corporate Governance Code it is now our policy to review the external auditor appointment by putting it out to tender at least every 10 years. 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' independent senior partner periodically to discuss the scope and performance of their work.

Set out on page 103 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 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 their specialist knowledge and the limited number of consultants with the expertise to undertake such engagements.

These PPP 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 contract opportunities is now declining which should lead to a corresponding decline in corporate finance fees payable.

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 led by an experienced head of function who makes a significant contribution to the ability of the Audit Committee to deliver its responsibilities.

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 ongoing risk management reviews. This approach seeks to ensure that there is a 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 and there are regular informal discussions and meetings between the Group Audit Manager and the Audit Committee Chairman.

The areas of the business that received attention from Group Internal Audit over the past year included:

- Pennon - group treasury and group insurance
- Viridor - acquisitions and due diligence; recycling including trading and foreign exchange management; Lakeside EfW; core sales processes including landfill and collections; and environmental provisions
- South West Water - core income and billing processes; bank payment processes; developer services and new connections; business development & sales ledger; reactive maintenance; and credit management.

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 the 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
- Reviewing 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.

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 respective audits.

Corporate governance and internal control
Continued

The Sustainability Committee

Dinah Nichols, Sustainability Committee Chairman

Committee membership	Appointment date	Meeting attendance
Committee Chairman		
Dinah Nichols	**November 2006**	**6/6**
Members		
Martin Angle	**December 2008**	**6/6**
Gerard Connell	**November 2006**	**5/6**
Colin Drummond	**November 2006**	**6/6**
Christopher Loughlin	**November 2006**	**6/6**
Gill Rider	**September 2012**	**2/2**

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:

- developments and progress in carbon management and reduction
- driving sustainability through the Group's supply chains
- increasing the sustainability of the Group's transport fleet and operations
- the impact of the Group's charitable donations and community support
- the Group's health and safety performance and plans
- the Group's workplace policies and performance, including diversity and equality of opportunity, employee training and development, opportunities including apprenticeship schemes and the Viridor in-house degree.

In addition the Committee considered:

- The 2012/13 Group, South West Water and Viridor sustainability reports; and the associated verifier's reports for 2012/13 and his recommendations for the 2013/14 Reports
- Progress against the sustainability targets for 2012/13
- Sustainability targets for 2013/14
- The annual review of the coverage and appropriateness of Group policies.

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 48 to 57 contains the Group's 2013 annual sustainability report.

The Nomination Committee

Ken Harvey, Nomination Committee Chairman

Committee membership	Appointment date	Meeting attendance
Committee Chairman		
Kenneth Harvey	**March 1997**	**5/5**
Members		
Martin Angle	**December 2008**	**5/5**
Gerard Connell	**October 2003**	**4/5**
Dinah Nichols	**June 2003**	**5/5**
Gill Rider	**September 2012**	**2/2**

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 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 appointment of an executive director to the Viridor board and a non-executive director to the Board, both with the assistance of external search consultants (KORN/FERRY Whitehead Mann and Norman Broadbent respectively) who have no other connection with the Company; reviewed succession plans throughout the Group; and commenced the process, with the assistance of an external search consultant, (Zygos) which has no other connection with the Company, for the appointment of a successor to the Chief Executive, Viridor, who is due to retire from his post when an appointment has been made (currently expected to be September 2013).

The Board's diversity policy

In accordance with the UK Corporate Governance Code (2010 edition) the Committee is pleased to report that the Board has 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
  - A minimum of 25% female representation on the Group's senior management team by 2015.

Currently the Group has 25% female representation at Board level although this will reduce to 14% when Dinah Nichols retires from the Board after this year's Annual General Meeting. In a workforce of around 4,500 at 31 March 2013 around 16% were women. In senior/middle management executive positions the female representation was around 16%.

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.

Corporate governance and internal control
Continued

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 2012/13 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 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 Policy is applied by all business units within the Group in accordance with an annual timetable.

Risk identification
A full risk and control assessment is undertaken annually by the management of each business to identify financial and non-financial risks 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. In addition the Group Director of Finance is responsible for monitoring the Group Risk Register and for reporting on key risks and how they are managed at regular intervals to the Audit Committee and to the Board.

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 36 to 47.

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 2012/13 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 Group Risk Management Policy and the internal control framework and their operation within the Group.

Further information on the internal control review is set out on page 66 in relation to the Audit Committee.

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

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 62 and 63, confirms that, to the best of his or her 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 4 to 59 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 2013:

a) Details of the Company's issued share capital, which consists of Ordinary shares of nominal value 40.7 pence each, are set out in note 33 to the financial statements on pages 131 to 133. 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 144;

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 59 '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) £49,141,234 (such amount to be reduced by any shares allotted or rights granted under (ii) below in excess of £49,141,234) or; (ii) £98,282,468 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 2012 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, hybrid capital securities 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
25 June 2013

Directors' remuneration report

Martin Angle, Remuneration Committee Chairman

The Remuneration Committee

Committee membership	Appointment date	Meeting attendance
Committee Chairman		
Martin Angle	**December 2008**	**4/4**
Members		
Gerard Connell	**October 2003**	**4/4**
Dinah Nichols	**June 2003**	**4/4**
Gill Rider	**September 2012**	**1/1**

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, remuneration consultants, on calculating the Company's total shareholder return compared with two comparator groups for the Company's Performance and Co-investment Plan and subsequent to the year-end Deloitte provided advice to the Committee on the form of the Directors' remuneration report and on remuneration trends. Deloitte also provided tax and corporate structure and risk management review advice to the Company during the year
- Aon Hewitt Limited, pensions and remuneration consultants, on providing advice on pension benefits. Aon Hewitt also provided actuarial advice to the Company and to the Trustees of the Group's pension schemes.

Dear shareholder

I am pleased to present the remuneration report for 2013 on behalf of the Board. We will be presenting this report for your approval at our Annual General Meeting on 1 August 2013.

We appreciate that there continues to be investor concern relating to executive director remuneration generally and that there is a need for all sectors to continue to take account of this concern in reviewing and setting their remuneration policies and overall remuneration practice. We have once again reviewed our remuneration levels and benefits structure with the assistance of our remuneration consultants 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. Our current remuneration arrangements have been in place without amendment for the past six years.

We have been following the Department for Business, Innovation & Skills (BIS) consultations and draft regulations on reporting of executive remuneration. Whilst the regulations are not in force and final guidance has not yet been issued we have decided to adopt some of the new requirements earlier than necessary to further enhance our reporting of remuneration matters. Therefore this year, based on the requirements of the new regulations, we have divided the report into two distinct sections, these being:

1) **Remuneration Policy** which sets out the components of our reward package, how they are designed to support our business strategy and how they apply to each Executive Director and also to the Chairman and the Non-executive Directors (pages 73 to 77); and
2) **Implementation of the Remuneration Policy** which contains the remuneration of the Executive Directors for the year 2012/13 including the 'single remuneration figure' table showing each element in value terms of remuneration for each Executive Director (pages 78 to 83). (This section also contains the information required to be reported under current regulations).

We believe this demonstrates our commitment to transparent reporting and highlights our approach to remuneration.

Remuneration policy - Executive Directors

The Group's remuneration policy which will be applied in 2013/14, 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. 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 and ensure that remuneration is directly linked to the Group's strategy
- 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 ensuring base salaries for Executive Directors do not form the majority part of the total reward opportunity
- Have a remuneration package which is fair and consistent with other companies in the sector and which provides incentives for outperformance.

In setting executive remuneration the Committee not only takes account of employment market conditions, but also of pay and benefits differentials across the Group. The Committee considers annual summary reports of relevant workforce remuneration and terms and conditions of employment within each operating company from the Executive Directors and the Group Company Secretary and has regard to these in setting salary and other benefits for 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. Where appropriate individual performance objectives specifically relate to achieving non-financial, including ESG, targets (as outlined on page 74).

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 in accordance with the Shareholding Guideline.

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

Elements of remuneration

Type of remuneration	Description	Purpose	Details on pages
Fixed			
Basic salary	Annual salary set at a competitive level appropriate for role and based on individual skills, experience and performance.	Rewards appropriately for the role undertaken and assists in retention and recruitment.	74 and 78
Pension	Final salary (defined benefit) for existing Directors and defined contribution benefits for any new appointees or cash alternative commensurate with market level pension arrangements.	Assists in retention and recruitment.	76 and 79
Variable			
Short-term – annual Annual Incentive Bonus Plan – Maximum 100% of basic salary – up to 50% paid in cash and up to 50% in shares deferred for three years.	Assessed against Group and business 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 retention and recruitment.	74 and 81
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 retention and recruitment.	75 and 80

Directors' remuneration report
Continued

Remuneration policy
Continued

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

(i) **Basic salary and benefits**
These are set out on page 78 for each Executive Director and are not performance related. The Committee reviews salaries annually taking account of market data available from independent remuneration consultants. 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 include a maximum of 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 2012/13 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 48 to 57 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 Committee also has discretion to moderate any performance-related bonus awards in the event of any extenuating circumstances arising during the year.

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. Those options were exercised by the Executive Directors at the end of the three-year restricted period in September 2012. Details of the options are set out in the table in paragraph (d) on page 82. No further options were granted in 2012/13 but it is anticipated that they will once again be granted in 2013/14 to the value of £30,000 in conjunction with the Bonus Plan.

Set out below is a summary of the performance targets determined by the Committee for each Executive Director for 2013/14. These are similar to the targets applied for 2012/13.

Executive Director	Performance targets
Colin Drummond	Out-performance of: • **Group earnings per share against budget** • **Profit before tax and net debt budgets of Viridor** • **Personal objectives relating to key business targets for Viridor.**
David Dupont	Out-performance of: • **Group earnings per share against budget** • **Profit before tax of South West Water and Viridor** • **Net debt and net interest of the Group** • **Personal objectives relating to Group financing and other Group initiatives.**
Chris Loughlin	Out-performance of: • **Group earnings per share against budget** • **Average of the bonus earned by the other Executive Directors of South West Water (which relate to out-performance 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)** • **Personal objectives relating to implementing South West Water's new strategies and projects and meeting compliance targets.**

The achievements of the Executive Directors against their 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 benefit of advice from the Chairman of the Company, Ken Harvey, and also a report from the chairman of the Audit Committee on the outcome of the financial performance of the Group.

(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 2012 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 2012 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 2011 and July 2010. 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:

Water/waste index measure
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:

- National Grid
- Shanks Group
- Séché Environnement
- Suez Environnement
- Severn Trent
- United Utilities

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

For the PCP awards made in July 2010 and July 2011 the comparator group was the same as set out above with the exception of National Grid which replaced Northumbrian Water Group following its delisting from the London Stock Exchange in October 2011. The Committee in respect of the July 2010 and July 2011 awards, at the end of the three-year Restricted Period in respect of each award, 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 that date onwards, or adopt an alternative approach.

Level of vesting	
Above the index + 15%	**50%**
Equal to the index	**15%**
Straight-line vesting in between above positions	
Below the index	**0%**

FTSE 250 Index* measure
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.

Level of 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%**

* Excluding investment trusts.

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.

Directors' remuneration report
Continued

For the PCP awards made in July 2009 the same performance measures were used as set out on the previous page except that Northumbrian Water Group was included in the sector comparator group (instead of National Grid). As this company was delisted from the London Stock Exchange in October 2011 the Committee included the company in the calculation of the index up to the date of delisting and excluded it from that date onwards.

The calculation of TSR performance over the three-year performance period (being 1 April 2009 to 1 April 2012) for these PCP awards was undertaken by Deloitte LLP for the Committee. The table below summarises the calculation:

Comparator group	Portion of award	Performance	Percentile rank	Final vesting level
Waste/Water index	**50%**	**47.7% out-performance against index**	**–**	**50.0%**
FTSE 250*	**50%**	**71 out of 178**	**60.5%**	**29.3%**
Total vesting				**79.3%**

* Excluding investment trusts.

The Committee was satisfied that the 'Underpin' condition referred to overleaf had been met and therefore approved the vesting of 79.3% of the July 2009 award as calculated by Deloitte with the remaining 20.7% lapsing. Shares equivalent to the value of the dividends declared during the Restricted Period were then added to the shares that vested in accordance with the terms of the Plan.

(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 service contract is due to expire when he reaches his normal retirement age of 60. However it is expected that his contract will be extended by agreement between him and the Company. Colin Drummond and Chris Loughlin reached their normal retirement dates on 22 February 2011 and 20 August 2012 respectively, and have continued in employment with the Company each in the same position as Chief Executives of their respective businesses and as Directors of the Pennon Group Board. Colin Drummond will be retiring upon the appointment of his successor which is currently expected to be at the end of September 2013. His service contract will terminate at that time and he will then become non-executive Chairman of the Viridor board. Chris Loughlin's 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:

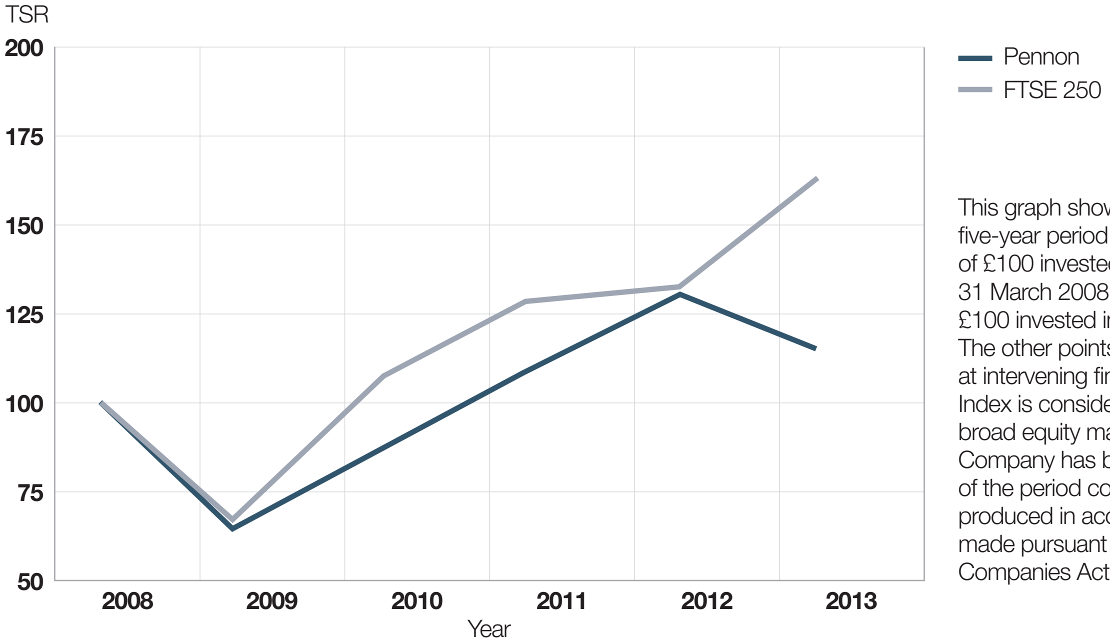
Colin Drummond	**5 March 1992**
David Dupont	**2 January 2003**
Chris Loughlin	**16 May 2006**

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

Previously Colin Drummond and David Dupont participated in the Group's defined benefit pension schemes. Their benefits from these schemes are set out in the table on page 79.

In determining remuneration arrangements for Executive Directors, it is the policy of the Committee to give full consideration to their impact on the pension schemes' funds and costs of providing individual pension arrangements.

Total shareholder return (TSR)



This graph shows the value, over the five-year period ending on 31 March 2013, of £100 invested in Pennon Group on 31 March 2008 compared with the value of £100 invested in the FTSE 250 Index. The other points plotted are the values at intervening financial year-ends. This Index is considered appropriate as it is a broad equity market index of which the Company has been a constituent over most of the period covered. The graph has been produced in accordance with regulations made pursuant to Section 421 of the Companies Act 2006.

Non-executive Directors and the Chairman

The Non-executive Directors' remuneration (excluding that of the Chairman, Ken Harvey) consisting of fees only as set out in the Implementation Section on page 78, 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. For this and subsequent years the policy expected to be applied in respect of Non-executive Directors' fees will be to set fees at a fair 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 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. 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 terminable on three months' notice and subject to the Articles of Association of the Company. They 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**	**1 August 2013**
Gill Rider	**22 June 2012**	**30 August 2015**

Directors' remuneration report
Continued

Implementation of the remuneration policy

Emoluments of Directors
The salaries/fees of Directors in 2012/13 were increased by approximately 3%.

The emoluments of individual Directors holding office during the period were:

Director	Salary/ fees (£000)	Performance related bonus payable[1] (£000)	Other emoluments[2] (£000)	Total 2013 Year to 31 March (£000)	Total 2012 Year to 31 March (£000)
Chairman					
Ken Harvey	248	–	24	272	263
Executive Directors					
Colin Drummond	370[3]	37	136	543	588
David Dupont	370	106	52	528	618
Chris Loughlin	370	118	136	624	647
Non-executive Directors					
Martin Angle	57	–	–	57	55
Gerard Connell	60	–	–	60	58
Dinah Nichols	57	–	–	57	55
Gill Rider	31	–	–	31	–
Total	1,563	261	348	2,172	2,284

[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 81.

[2] Other emoluments are car benefit, health cover and cash payments in lieu of pension provision equivalent to 30% of basic salary for each Executive Director. David Dupont's cash payment was reduced in the year by £86,000 to take account of the balance of the £94,062 augmentation to his pension entitlement which he received in 2011/12 and which was reported in last year's Annual Report.

[3] In 2012/13 Colin Drummond decided to forego his salary increase in the year and arranged for an equivalent sum (£11,000) to be paid into the Viridor staff welfare fund. The salary he received was therefore £359,000.

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

The base Non-executive Director fee in the year was £42,000 per annum. The Audit, Remuneration and Sustainability 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.

Executive Directors' pensions

Defined benefit pensions accrued and payable on retirement for Executive Directors holding office during 2012/13 were:

Director	**Increase/ decrease in accrued pension during 2012/13** (net of inflation) (£000)	**Increase/ decrease in accrued pension during 2012/13** (£000)	**Accrued pension at 31 March 2013** (£000)	**Transfer value of the accrued pension at 31 March 2013** (£000)	**Transfer value of the accrued pension at 31 March 2012** (£000)	**Increase in transfer value** (net of Directors' contributions) (£000)	**Increase/ decrease in transfer value of accrued pension during 2012/13** (net of inflation and Directors' contributions) (£000)	**Increase in pension since the date the pension first became payable** (£000)
	a	b	c	d	e		f	
Colin Drummond	3	6	130	3,621	3,379	241	90	9
David Dupont	-1	2	135	4,086	3,918	168	-41	2

Colin Drummond and David Dupont were both pensioner members of the Pennon Group's pension schemes during the year. As such no further benefits were accrued and no employee or employer pension contributions were paid (other than the employer's deficit reduction contributions).

The accrued pensions at 31 March 2013 (column c) therefore show the actual pensions in payment at 31 March 2013. The increases in accrued pensions over the year (column b) are solely as a result of indexation of the pensions as set out in the Schemes' Rules.

The increase in transfer value over the year (column f) is as a result of a small fall in gilt yields between 31 March 2012 and 31 March 2013 and because actual pension increases awarded in the year in accordance with the Schemes' Rules were higher than assumed.

Directors' share interests

(a) Shareholdings
The number of Ordinary shares of the Company in which Directors held beneficial interests (including those of their connected persons) were:

Director	**Ordinary shares** (40.7p each) **at 31 March 2013**	**Ordinary shares** (40.7p each) **at 31 March 2012**
Ken Harvey	26,209	26,209
Colin Drummond	332,841	288,163
David Dupont	316,415	262,671
Chris Loughlin	150,766	97,745
Martin Angle	–	–
Gerard Connell	4,098	4,000
Dinah Nichols	4,549	4,549
Gill Rider	–	–

Since 31 March 2013, 1,946 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, 276 additional Ordinary shares (40.7p each) in the Company have been acquired by David Dupont as a result of dividend reinvestment in an ISA and 53 additional Ordinary shares (40.7p each) in the Company have been acquired by Gerard Connell as a result of participation in the Company's Scrip Dividend Alternative.

There have been no other changes in beneficial interests or the non-beneficial interests of the Directors in the Ordinary shares of the Company between 1 April 2013 and 24 June 2013.

Directors' remuneration report
Continued

Implementation of the remuneration policy
Continued

(b) Performance and Co-investment Plan (long-term incentive plan)
In addition to the above beneficial interests, the following Directors have or have 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 or the number of shares which have vested under the plan, as appropriate:

Director and date of award	Conditional awards held at 1 April 2012	Conditional awards made in year	Market price upon award of each share in year	Vesting in year*	Market price of each share upon vesting	Conditional awards held at 31 March 2013	Date of end of period for qualifying conditions to be fulfilled
Colin Drummond							
1/7/09	67,831	–	486.50p	60,437	758.18p	–	30/6/12
2/7/10	63,186	–	546.00p	–	–	63,186	1/7/13
1/7/11	51,432	–	698.00p	–	–	51,432	30/6/14
3/7/12	–	48,145	768.50p	–	–	48,145	2/7/15
David Dupont							
1/7/09	67,831	–	486.50p	60,437	758.18p	–	30/6/12
2/7/10	63,186	–	546.00p	–	–	63,186	1/7/13
1/7/11	51,432	–	698.00p	–	–	51,432	30/6/14
3/7/12	–	48,145	768.50p	–	–	48,145	2/7/15
Chris Loughlin							
1/7/09	64,748	–	486.50p	57,690	758.18p	–	30/6/12
2/7/10	63,186	–	546.00p	–	–	63,186	1/7/13
1/7/11	51,432	–	698.00p	–	–	51,432	30/6/14
3/7/12	–	48,145	768.50p	–	–	48,145	2/7/15

*79.3% of the July 2009 award shares vested on 6 August 2012 as explained in the section (iii) 'Long-term incentive plan' on page 75 of this report at a market price of 758.18p per share. 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 were then added to the total number of shares that vested and are included within the vested figures. 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 2012	Conditional awards made in year	Market price of each share upon award in year	Vesting in year	Market price of each share upon vesting	Conditional awards held at 31 March 2013	Date of end of period for qualifying condition to be fulfilled
Colin Drummond							
29/9/09[1]	16,730	–	473.40p	14,545	614.37p	–	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
27/7/12	–	12,823	754.50p	–	–	12,823	26/7/15
David Dupont							
29/9/09[1]	17,880	–	473.40p	15,695	614.37p	–	28/9/12
27/2/10	755	–	524.50p	–	–	755	26/2/13[2]
27/7/10	25,938	–	572.50p	–	–	25,938	26/7/13
27/7/11	–	22,365	725.00p	–	–	22,365	26/7/14
27/7/12	–	18,532	754.50p	–	–	18,532	26/7/15
Chris Loughlin							
29/9/09[1]	19,562	–	473.40p	17,377	614.37p	–	28/9/12
27/2/10	1,261	–	524.50p	–	–	1,261	26/2/13[2]
27/7/10	25,133	–	572.50p	–	–	25,133	26/7/13
27/7/11	–	22,141	725.00p	–	–	22,141	26/7/14
27/7/12	–	20,650	754.50p	–	–	20,650	26/7/15

[1] 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 82. These awards were made in conjunction with the operation of the Bonus Plan. These ESOS options were exercised by the Directors on 29 September 2012 and shares from the Bonus Plan equivalent in value to the gain on the ESOS options were 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 74.

[2] The qualifying condition in respect of these awards has been met and the awards are in the process of being released.

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

Colin Drummond – £20,088

David Dupont – £21,143

Chris Loughlin – £21,838.

Chris Loughlin received Ordinary shares (40.7p each) in the Company as a result of participation in the Company's Scrip Dividend Alternative. All 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 2013 given on page 79.

A further conditional award of shares will be made in 2013/14 to the value of the amount of the performance-related cash bonus shown in the Emoluments of Directors table on page 78. Paragraph (ii) 'Performance-related bonus' on page 74 sets out the provisions relating to the conditional award of shares pursuant to the Bonus Plan.

Directors' remuneration report
Continued

Implementation of the remuneration policy
Continued

(d) Executive Share Option Scheme
The following Directors had 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 74.

Director and date of award	Options held at 1 April 2012	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 2013	Options held at 31 March 2013	Maturity date
Colin Drummond								
29/9/09	6,337	–	6,337*	473.40p	722.50p	–	–	–
David Dupont								
29/9/09	6,337	–	6,337*	473.40p	722.50p	–	–	–
Chris Loughlin								
29/9/09	6,337	–	6,337*	473.40p	722.50p	–	–	–

* All three Executive Directors exercised their options during the year realising a gain of £15,785 each.

(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 award	Options held at 1 April 2012	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 2013	Options held at 31 March 2013	Exercise period/ Maturity date
Colin Drummond								
6/7/09	2,351	–	2,351[1]	386.00p	735.00p	–	–	–
29/6/12	–	1,530	–	588.00p	–	623.00p	1,530	1/9/15 - 28/2/16
David Dupont								
3/7/07	3,136	–	3,136[2]	522.00p	736.50p	–	–	–
Chris Loughlin								
3/7/07	3,136	–	3,136[3]	522.00p	739.50p	–	–	–

1 Colin Drummond's gain on the exercise of his option was £8,205.
2 David Dupont's gain on the exercise of his option was £6,727.
3 Chris Loughlin's gain on the exercise of his option was £6,821.

(f) Share price
The market price of the Ordinary shares (40.7p each) of the Company at 31 March 2013 was 623.00p (2012 711.50p) and the range during the year was 598.00p to 796.00p (2011/12 620.00p to 737.50p).

Single Total Figure Table (£000)

The information below is not provided for the Chairman or the other Non-executive Directors due to them not being participants in any of the Group's incentive plans (as permitted by the latest draft of the new remuneration reporting regulations ('the draft regulations')). The information provided is based upon the Company's interpretation of the draft regulations.

Director	**i** (£000)	**ii** (£000)	**iii** (£000)	**iv** (£000)	**v** (£000)	**Total 2013** Year to 31 March (£000)
Executive Directors						
Colin Drummond	370	25	111	37	583	1,126
David Dupont	370	27	25	106	591	1,119
Chris Loughlin	370	25	111	118	582	1,206

The headings **i** to **v** above are as follows:

i Total amount of salary and fees.

ii All taxable benefits.

iii All pension related benefits (cash in lieu of pension).

iv Money or other assets received or receivable as a result of achievement of performance conditions in 2012/13 only (cash bonus).

v Money or other assets received or receivable in 2012/13 or shortly thereafter relating to 2012/13 and previous reporting periods (cash in lieu of dividend on Deferred Bonus Shares; 2009 Deferred Bonus Shares and PCP vesting; and ESOS exercise).

Basis of preparation

The Directors' 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 Directors' 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 85. The other sections are not subject to audit nor are the pages referred to from within the audited sections.

The Directors' remuneration report was approved by the Board of Directors and signed on its behalf by:

Martin Angle
Chairman of the Remuneration Committee
25 June 2013

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 2013 which comprise the 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 parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement on pages 70 to 71, 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 parent 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 parent company's affairs as at 31 March 2013 and of the Group's profit and Group's and parent 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 parent 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 Report set out on pages 60 to 61 and with respect to internal control and risk management systems set out on pages 64 to 71 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 parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- The parent company financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- Certain disclosures of directors' remuneration specified by law are not made; or
- We have not received all the information and explanations we require for our audit; or
- A corporate governance statement has not been prepared by the parent company.

Under the Listing Rules we are required to review:

- The Directors' statement, set out on page 70, 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
25 June 2013

Consolidated income statement
For the year ended 31 March 2013

	Notes	Before exceptional items 2013 £m	Exceptional items (Note 6) 2013 £m	Total 2013 £m	2012 £m
Revenue	5	**1,201.1**	**–**	**1,201.1**	1,233.1
Operating costs	7				
Manpower costs		**(158.6)**	**–**	**(158.6)**	(155.4)
Raw materials and consumables used		**(125.2)**	**–**	**(125.2)**	(133.9)
Other operating expenses		**(521.8)**	**(104.9)**	**(626.7)**	(528.0)
Depreciation, amortisation and impairment		**(149.2)**	**(84.0)**	**(233.2)**	(147.0)
Operating profit	5	**246.3**	**(188.9)**	**57.4**	268.8
Finance income	8	**127.6**	**15.4**	**143.0**	119.3
Finance costs	8	**(181.5)**	**(2.9)**	**(184.4)**	(191.6)
Net finance costs	8	**(53.9)**	**12.5**	**(41.4)**	(72.3)
Share of post-tax profit from joint ventures	20	**5.8**	**–**	**5.8**	4.0
Profit before tax	5	**198.2**	**(176.4)**	**21.8**	200.5
Taxation (charge)/credit	9	**(31.1)**	**36.2**	**5.1**	(28.1)
Profit for the year		**167.1**	**(140.2)**	**26.9**	172.4
Profit attributable to ordinary shareholders' equity		**167.1**	**(140.2)**	**26.9**	172.4
Earnings per share (pence per share)	11				
– Basic				**7.4**	48.1
– Diluted				**7.4**	47.8

Consolidated statement of comprehensive income
For the year ended 31 March 2013

	Notes	Before exceptional items 2013 £m	Exceptional items (Note 6) 2013 £m	Total 2013 £m	2012 £m
Profit for the year		**167.1**	**(140.2)**	**26.9**	172.4
Other comprehensive loss					
Actuarial losses on defined benefit pension schemes	30	**(15.1)**	**–**	**(15.1)**	(51.7)
Cash flow hedges		**(0.9)**	**2.9**	**2.0**	(24.7)
Share of other comprehensive profit/(loss) from joint ventures	20	**2.7**	**–**	**2.7**	(5.4)
Deferred tax credit/(charge) on items taken directly to or transferred from equity	9, 31	**2.7**	**(0.7)**	**2.0**	16.0
Other comprehensive (loss)/gain for the year net of tax	36	**(10.6)**	**2.2**	**(8.4)**	(65.8)
Total comprehensive income for the year		**156.5**	**(138.0)**	**18.5**	106.6
Total comprehensive income attributable to ordinary shareholders' equity		**156.5**	**(138.0)**	**18.5**	106.6

The notes on pages 91 to 142 form part of these financial statements.

Balance sheets
At 31 March 2013

	Notes	Group 2013 £m	Group 2012 (Restated note 40) £m	Company 2013 £m	Company 2012 £m
Assets					
Non-current assets					
Goodwill	15	**339.0**	326.5	**–**	–
Other intangible assets	16	**12.5**	22.0	**–**	–
Property, plant and equipment	17	**3,279.6**	3,083.6	**0.2**	0.2
Other non-current assets	19	**183.3**	138.4	**502.5**	352.0
Deferred tax assets	31	**–**	–	**2.3**	4.6
Derivative financial instruments	23	**31.0**	21.9	**–**	–
Investments in subsidiary undertakings	20	**–**	–	**1,323.3**	1,172.1
Investments in joint ventures	20	**0.1**	0.1	**–**	–
		3,845.5	3,592.5	**1,828.3**	1,528.9
Current assets					
Inventories	21	**10.5**	9.0	**–**	–
Trade and other receivables	22	**267.7**	238.5	**136.3**	91.7
Financial assets at fair value through profit	24	**1.2**	0.5	**–**	–
Derivative financial instruments	23	**10.5**	9.7	**9.7**	8.9
Current tax recoverable	27	**–**	–	**–**	2.6
Cash and cash deposits	25	**634.5**	425.3	**398.9**	158.9
		924.4	683.0	**544.9**	262.1
Liabilities					
Current liabilities					
Borrowings	28	**(138.6)**	(325.5)	**(357.1)**	(534.4)
Derivative financial instruments	23	**(21.7)**	(16.6)	**–**	–
Trade and other payables	26	**(277.2)**	(242.5)	**(7.7)**	(10.8)
Current tax liabilities	27	**(67.0)**	(60.3)	**(18.9)**	–
Provisions	32	**(40.6)**	(26.3)	**–**	–
		(545.1)	(671.2)	**(383.7)**	(545.2)
Net current assets/(liabilities)		**379.3**	11.8	**161.2**	(283.1)
Non-current liabilities					
Borrowings	28	**(2,504.6)**	(2,204.4)	**(692.7)**	(356.8)
Other non-current liabilities	29	**(77.9)**	(76.9)	**(8.7)**	(8.7)
Financial liabilities at fair value through profit	24	**(23.0)**	(16.7)	**–**	–
Derivative financial instruments	23	**(31.5)**	(32.0)	**–**	–
Retirement benefit obligations	30	**(109.7)**	(98.6)	**(8.7)**	(7.8)
Deferred tax liabilities	31	**(243.1)**	(277.3)	**–**	–
Provisions	32	**(170.7)**	(76.3)	**–**	–
		(3,160.5)	(2,782.2)	**(710.1)**	(373.3)
Net assets		**1,064.3**	822.1	**1,279.4**	872.5
Equity					
Share capital	33	**149.2**	148.2	**149.2**	148.2
Share premium account	34	**7.0**	8.0	**7.0**	8.0
Capital redemption reserve	35	**144.2**	144.2	**144.2**	144.2
Retained earnings and other reserves	36	**469.1**	521.7	**684.2**	572.1
Total ordinary shareholders' equity		**769.5**	822.1	**984.6**	872.5
Perpetual capital securities	37	**294.8**	–	**294.8**	–
Total equity		**1,064.3**	822.1	**1,279.4**	872.5

The notes on pages 91 to 142 form part of these financial statements.
The financial statements on pages 86 to 142 were approved by the Board of Directors and authorised for issue on 25 June 2013 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

Statements of changes in equity
For the year ended 31 March 2013

Group	Share capital (Note 33) £m	Share premium account (Note 34) £m	Capital redemption reserve (Note 35) £m	Retained earnings and other reserves (Note 36) £m	Perpetual capital securities (Note 37) £m	Total equity £m
At 1 April 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
Profit for the year	–	–	–	26.9	–	26.9
Other comprehensive loss for the year	–	–	–	(8.4)	–	(8.4)
Total comprehensive income for the year	–	–	–	18.5	–	18.5
Transactions with equity shareholders						
Dividends paid	–	–	–	(96.0)	–	(96.0)
Adjustment for shares issued under the Scrip Dividend Alternative	1.0	(1.0)	–	18.1	–	18.1
Adjustment in respect of share-based payments (net of tax)	–	–	–	3.1	–	3.1
Issue of perpetual capital securities	–	–	–	–	294.8	294.8
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	–	–	–	(0.9)	–	(0.9)
Proceeds from treasury shares re-issued	–	–	–	4.6	–	4.6
Total transactions with equity shareholders	1.0	(1.0)	–	(71.1)	294.8	223.7
At 31 March 2013	**149.2**	**7.0**	**144.2**	**469.1**	**294.8**	**1,064.3**

The notes on pages 91 to 142 form part of these financial statements.

Company	Share capital (Note 33) £m	Share premium account (Note 34) £m	Capital redemption reserve (Note 35) £m	Retained earnings and other reserves (Note 36) £m	Perpetual capital securities (Note 37) £m	Total equity £m
At 1 April 2011	147.0	9.2	144.2	525.8	–	826.2
Profit for the year (note 10)	–	–	–	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
Profit for the year (note 10)	–	–	–	185.7	–	185.7
Other comprehensive loss for the year	–	–	–	(1.1)	–	(1.1)
Total comprehensive income for the year	–	–	–	184.6	–	184.6
Transactions with equity shareholders						
Dividends paid	–	–	–	(96.0)	–	(96.0)
Adjustment for shares issued under the Scrip Dividend Alternative	1.0	(1.0)	–	18.1	–	18.1
Adjustment in respect of share-based payments (net of tax)	–	–	–	0.8	–	0.8
Issue of perpetual capital securities	–	–	–	–	294.8	294.8
Proceeds from treasury shares re-issued	–	–	–	4.6	–	4.6
Total transactions with equity shareholders	1.0	(1.0)	–	(72.5)	294.8	222.3
At 31 March 2013	**149.2**	**7.0**	**144.2**	**684.2**	**294.8**	**1,279.4**

The notes on pages 91 to 142 form part of these financial statements.

Cash flow statements
For the year ended 31 March 2013

	Notes	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	38	**341.1**	324.7	**(205.2)**	18.9
Interest paid	38	**(75.8)**	(74.5)	**(23.4)**	(22.7)
Tax (paid)/repaid		**(18.5)**	(41.4)	**26.7**	2.6
Net cash generated/(outflow) from operating activities		**246.8**	208.8	**(201.9)**	(1.2)
Cash flows from investing activities					
Interest received		**26.0**	13.2	**30.3**	23.3
Dividends received	45	**8.5**	–	**177.6**	117.5
Acquisition of subsidiary undertakings (net of cash acquired)	40	**(14.8)**	(29.2)	**–**	–
Investments in subsidiary undertakings	20	**–**	–	**(151.2)**	(140.1)
Loans advanced to joint ventures		**–**	(13.4)	**–**	–
Loan repayments received from joint ventures		**0.3**	3.6	**–**	–
Purchase of property, plant and equipment		**(397.2)**	(262.2)	**(0.1)**	–
Proceeds from sale of property, plant and equipment		**4.5**	4.6	**–**	–
Net cash (used in)/received from investing activities		**(372.7)**	(283.4)	**56.6**	0.7
Cash flows from financing activities					
Proceeds from treasury shares re-issued	33	**4.6**	1.9	**4.6**	1.9
Proceeds from issue of perpetual capital securities	37	**294.8**	–	**294.8**	–
Purchase of Ordinary shares by the Pennon Employee Share Trust		**(0.9)**	(0.3)	**–**	–
Deposit of restricted funds (net)		**(21.0)**	(0.1)	**–**	–
Proceeds from new borrowing		**409.9**	25.0	**409.9**	25.0
Repayment of borrowings		**(267.2)**	(71.0)	**(246.1)**	(35.0)
Finance lease sale and lease back		**85.0**	79.5	**–**	–
Finance lease principal repayments		**(103.1)**	(14.0)	**–**	–
Dividends paid		**(77.9)**	(69.1)	**(77.9)**	(69.1)
Net cash received from/(used in) financing activities		**324.2**	(48.1)	**385.3**	(77.2)
Net increase/(decrease) in cash and cash equivalents		**198.3**	(122.7)	**240.0**	(77.7)
Cash and cash equivalents at beginning of the year	25	**292.2**	414.9	**157.5**	235.2
Cash and cash equivalents at end of the year	25	**490.5**	292.2	**397.5**	157.5

The notes on pages 91 to 142 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 87. 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 notes (b), (v) and (n) respectively) and in accordance with International Financial Reporting Standards (IFRS) and interpretations of the IFRS Interpretations Committee as adopted by the European Union, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. A summary of the principal accounting policies is set out below, together with an explanation where changes have been made to previous policies on the adoption of new accounting standards and interpretations in the year.

The going concern basis has been adopted in preparing these financial statements as stated by the Directors on page 70.

New or revised standards or interpretations which were mandatory for the first time in the year beginning 1 April 2012 did not have a material impact on the net assets or results of the Group.

For the preparation of these financial statements IFRS 11 Joint Arrangements and IAS 19 (Revised) Employee Benefits were in issue, but not yet effective. 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 (Revised) Employee Benefits on 1 April 2013 will have a material impact on the financial statements of the Group. In the year to 31 March 2014 the revised standard is expected to result in a net finance cost of £4 million and a further £1 million is expected to be charged to operating profit to recognise administration costs as they are incurred. Pension liabilities will reduce by £10 million as at 31 March 2013 as a result of the change.

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.

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 (note 40).

(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.

(d) Landfill tax
Landfill tax is included within both revenue and operating costs.

Notes to the financial statements
Continued

2. Principal accounting policies Continued

(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 reportable 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, less any subsequent impairment charges.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash generating units or group of cash generating units, that is expected to benefit from the synergies of the combination. Each unit or group of units to which goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal reporting purposes. Goodwill is allocated and monitored at the reportable operating segment level. Further details are contained in accounting policy (j).

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

(g) Other intangible assets
Other intangible assets 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 and impairment charges. Expenditure to increase capacity or enhance infrastructure assets is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the Group. The cost of day-to-day servicing of infrastructure components is recognised in the income statement as it arises.

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

Dams and impounding reservoirs	200 years
Water mains	40 – 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 the 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

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

The cost of assets includes directly attributable labour and overhead costs which are incremental to the Group. Borrowing costs directly attributable to the construction of a qualifying asset (an asset necessarily taking a substantial period of time to be prepared for its intended use) are capitalised as part of the asset. Assets transferred from customers are recognised at fair value as set out in accounting policy (v).

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.

Non-financial assets other than goodwill that have been impaired are reviewed for possible reversal of the impairment at each reporting date.

(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.

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

Notes to the financial statements
Continued

2. Principal accounting policies Continued

v) Derivative financial instruments and hedging activities
The Group uses derivative financial instruments, principally interest rate swaps 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 deemed held for trading 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.

vi) Financial instruments at fair value through profit
Financial instruments at fair value through profit reflect the fair value movement of the hedged risk on a hedged item which has been designated in a fair value hedging relationship. The fair values of these financial instruments are initially recognised on the date the hedging relationship is entered into and 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.

The Group includes a number of companies, including the parent company, which are part of a tax group for certain aspects of the tax legislation. One of these aspects relates to group relief whereby current tax liabilities can be offset by current tax losses arising in other companies within the same tax group. Payment for group relief is made equal to the tax benefit and amounts are included within the current tax disclosures.

Deferred tax is provided in full on temporary differences between the carrying amount of assets and liabilities in the financial statements and the tax base, except 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.

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

The Group's policies on specific provisions are:

i) Landfill restoration costs
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. Further provisions required after the operational life of a site are recognised immediately in the income statement.

iii) Onerous contracts
Where the unavoidable costs of meeting a contract's obligations exceed the economic benefits derived from that contract, the unavoidable costs, less revenue anticipated under the terms of the contract, are recognised as a provision and charged to the income statement. An impairment loss on any assets dedicated to that contract is also recognised as described in accounting policy (j).

(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 as past service cost in the income statement.

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.

(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) 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.

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

(x) Perpetual capital securities
Perpetual capital securities are issued securities that qualify for recognition as equity. Accordingly any periodic returns are accounted for as dividends and recognised directly in equity and as a liability at the time the Company becomes obligated to pay the periodic return. This reflects the nature of the periodic returns being only made at the Company's discretion.

(y) Exceptional items
Exceptional items are those that in the Directors' view are required to be separately disclosed by virtue of their size or incidence to enable a full understanding of the Group's financial performance.

Notes to the financial statements
Continued

3. Financial risk management

(a) Financial risk factors
The Group's activities expose it to a variety of financial risks: liquidity risk, market risk (interest rate 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 liquidity, 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) 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 bank facilities are provided in note 28.

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.

Contractual undiscounted cash flows, including interest payments, at the balance sheet date were:

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Over 5 years £m	Total £m
Group					
31 March 2013					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	97.0	216.5	440.8	1,397.7	2,152.0
Interest payments on borrowings	24.5	21.8	47.6	630.4	724.3
Finance lease liabilities including interest	56.6	63.0	228.0	2,045.3	2,392.9
Derivative financial liabilities					
Derivative contracts – net payments	19.1	26.3	26.3	8.6	80.3
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
Company					
31 March 2013					
Non-derivative financial liabilities					
Borrowings	75.9	185.4	347.5	160.2	769.0
Interest payments on borrowings	15.3	12.5	19.2	12.8	59.8
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

ii) 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 54% (2012 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 19% (2012 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 note 23.

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

The Group has no significant interest-bearing assets upon which the net return fluctuates from market risk. Deposit interest receivable is expected to fluctuate in line with interest payable on floating rate borrowings. Consequently the Group's income and cash generated from operations (note 38) are independent of changes in market interest rates.

For 2013 if interest rates on variable net borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year and equity would have decreased/increased by £2.0 million (2012 £1.3 million).

For 2013 if RPI on index-linked borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year and equity would have decreased/increased by £1.4 million (2012 £1.3 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.

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

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

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

The Group's policy is to have 12 months pre-funding of projected capital expenditure. At 31 March 2013 the Group had cash and facilities, excluding restricted funds, of £1 billion.

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

The Group monitors capital on the basis of the gearing ratio. This ratio is calculated as net borrowings divided by total capital. Net borrowings are analysed in note 39 and calculated as total borrowings less cash and cash deposits. Total capital is calculated as total shareholders' equity plus net borrowings.

The gearing ratios at the balance sheet date were:

	2013 £m	2012 £m
Net borrowings (note 39)	**2,008.7**	2,104.6
Total equity	**1,064.3**	822.1
Total capital	**3,073.0**	2,926.7
Gearing ratio	**65.4%**	71.9%

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

	2013 £m	2012 £m
Regulatory Capital Value	**2,915.7**	2,826.7
Net borrowings	**1,600.3**	1,584.9
Net borrowings/Regulatory Capital Value	**54.9%**	56.1%

Notes to the financial statements
Continued

3. Financial risk management Continued

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 Group's financial instruments are valued principally using level 2 measures as analysed in note 23.

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

The carrying values, less 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. Estimates are based on factors including historical experience and expectations of future events that management believe to be reasonable. However, given the judgemental nature of such estimates, actual results could be different from the assumptions used.

Impairment of non-financial assets and goodwill
In order to determine whether impairments are required the Group estimates the recoverable amount of an individual asset or assets grouped at the lowest level for which there are separately identifiable cash flows (cash generating units). For the purposes of assessing impairment of goodwill, the waste management segment is considered to be a single cash generating unit as it is an integrated business and this is the lowest level to which goodwill is allocated and monitored by management.

Impairment calculations are based on projections of future cash flows for the cash generating unit and the use of a terminal value to incorporate expectations of growth after the period covered by specific plans. The cash flows are discounted by the weighted average cost of capital appropriate to the business activity which is reviewed on an annual basis.

If the cash flow or discount rate assumptions were to change because of market conditions, the level of impairment could be different and could result in the impairment being increased or reversed, in part or in full, at a future date.

The principal assumptions used to assess impairment are set out in notes 15 and 17 of the financial statements.

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.

Environmental and landfill restoration provisions
Environmental control and aftercare costs are incurred during the operational life of each landfill site and for a considerable period thereafter. The period of aftercare post-closure and the level of costs expected are uncertain and can vary significantly from site to site. Key factors are the type of waste, the speed at which it decomposes, the volume of leachate requiring treatment and regulatory requirements specific to the site. The amounts expected to be incurred have been re-assessed, re-estimated and aligned to the revised landfill site operating lives established from the anticipated decline in landfill activity. The revised provision includes a change in the estimate of the aftercare period to 60 years after site closure (2012 30 years) to align with updated technical assessment using independent external advice, as well as incorporating updated assumptions based on recent historic data and future cost estimates.

The provisions are recognised in the financial statements at the net present value of the estimated future expenditure required to settle the Group's obligations. A discount rate is applied to recognise the time value of money and is unwound over the life of the provision. This is included in the income statement as a financial item within finance costs.

As at 31 March 2013 the Group's environmental and landfill restoration provisions were £184.2 million (note 32).

Where a restoration provision gives access to future economic benefits, an asset is recognised and depreciated in accordance with the Group's depreciation policy. As at 31 March 2013 these assets had a net book value of £35.5 million (note17).

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 30 of the financial statements.

Taxation
The Group current income tax provision of £67.0 million (note 27) 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 the tax position is assessed as 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. In estimating the operational life of a landfill site consideration is given to the expected ongoing decline in the landfill market. Where Viridor plans to build a competing energy from waste facility at certain existing landfill sites, void which consequently is no longer expected to be used is excluded from the calculation of operational life. 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.

Useful economic lives of property, plant and equipment
The carrying value of property, plant and equipment as at 31 March 2013 was £3,279.6 million (note 17) and the Group's accounting policy is set out in note 2(h). In the year ended 31 March 2013 additions totalled £410.1 million and the depreciation charge was £147.7 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, the 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, except for assets subject to impairment, 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 year-end. Estimated usage is based on historic data, judgement and assumptions.

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.

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. As at 31 March 2013 the Group's current trade receivables were £212.4 million, against which £76.4 million had been provided for impairment (note 22).

Notes to the financial statements
Continued

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

The 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.

	2013 £m	2012 £m
Revenue		
Water and sewerage	**498.6**	474.0
Waste management	**703.8**	761.1
Other	**10.8**	9.8
Less intra-segment trading*	**(12.1)**	(11.8)
	1,201.1	1,233.1
Segment result		
Operating profit before depreciation, amortisation and exceptional items (EBITDA)		
Water and sewerage	**317.5**	305.2
Waste management	**77.9**	110.3
Other	**0.1**	0.3
	395.5	415.8
Operating profit before exceptional items		
Water and sewerage	**215.2**	204.7
Waste management	**30.8**	63.7
Other	**0.3**	0.4
	246.3	268.8
Profit before tax and exceptional items		
Water and sewerage	**152.1**	141.5
Waste management	**36.5**	57.6
Other	**9.6**	1.4
	198.2	200.5
Profit/(loss) before tax		
Water and sewerage	**164.6**	141.5
Waste management	**(152.4)**	57.6
Other	**9.6**	1.4
	21.8	200.5

* 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.

	Water and sewerage £m	Waste management £m	Other £m	Eliminations £m	Group £m
Balance sheet					
31 March 2013					
Assets (excluding investments in joint ventures)	**2,922.6**	**1,450.0**	**1,347.9**	**(950.7)**	**4,769.8**
Investments in joint ventures	**–**	**0.1**	**–**	**–**	**0.1**
Total assets	**2,922.6**	**1,450.1**	**1,347.9**	**(950.7)**	**4,769.9**
Liabilities	**(2,157.0)**	**(1,108.5)**	**(1,390.8)**	**950.7**	**(3,705.6)**
Net assets/(liabilities)	**765.6**	**341.6**	**(42.9)**	**–**	**1,064.3**
31 March 2012 (Restated note 40)					
Assets (excluding investments in joint ventures)	2,938.2	1,214.3	912.2	(789.3)	4,275.4
Investments in joint ventures	–	0.1	–	–	0.1
Total assets	2,938.2	1,214.4	912.2	(789.3)	4,275.5
Liabilities	(2,159.6)	(830.8)	(1,252.3)	789.3	(3,453.4)
Net assets/(liabilities)	778.6	383.6	(340.1)	–	822.1

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 2013					
Amortisation of other intangible assets	16	**–**	**3.7**	**–**	**3.7**
Capital expenditure (including acquisitions)		**116.5**	**308.3**	**0.1**	**424.9**
Depreciation		**102.3**	**43.4**	**(0.2)**	**145.5**
Impairment	16,17	**–**	**84.0**	**–**	**84.0**
Finance income	8	**41.1**	**24.3**	**77.6**	**143.0**
Finance costs	8	**91.7**	**24.4**	**68.3**	**184.4**
31 March 2012					
Amortisation of other intangible assets	16	–	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	8	59.3	23.2	36.8	119.3
Finance costs	8	122.5	33.2	35.9	191.6

Notes to the financial statements
Continued

5. Segmental information Continued

Geographic analysis of revenue based on location of customers

	2013 £m	2012 £m
Revenue		
United Kingdom	**1,142.1**	1,162.4
Rest of European Union	**11.2**	13.3
China	**39.7**	51.0
Rest of World	**8.1**	6.4
	1,201.1	1,233.1

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. Exceptional items

Exceptional items are those that in the Directors' view are required to be separately disclosed by virtue of their size or incidence to enable a full understanding of the Group's financial performance.

	Notes	2013 £m	2012 £m
Operating costs			
Impairment of property, plant and equipment (a)	17	**(78.2)**	–
Environmental and landfill restoration provisions (b)	32	**(90.1)**	–
Onerous contracts and other (c)		**(20.6)**	–
		(188.9)	–
Net finance costs	8		
Receipt on transfer and subsequent termination of lease (d)		**15.4**	–
Fair value loss on associated interest rate swap transferred from equity on termination of lease (d)		**(2.9)**	–
		12.5	–
Loss before tax		**(176.4)**	–
Tax credit arising on exceptional items (e)	9	**36.2**	–
Loss for the year		**(140.2)**	–

a) The impairment charge relates to the write-down of the carrying values of property, plant and equipment in landfill and recycling activities reflecting reduced landfill volumes and recyclate prices. The impairment charge is net of a credit arising from the reassessment of landfill site residual values linked to gas production at landfill sites post-closure.

(b) Environmental control and aftercare costs are incurred during the operational life of each landfill site and for a considerable period thereafter. The period of aftercare post-closure and the level of costs expected are uncertain and can vary significantly from site to site. Key factors are the type of waste, the speed at which it decomposes, the volume of leachate requiring treatment and regulatory requirements specific to the site. The amounts expected to be incurred have been re-assessed, re-estimated and aligned to the revised landfill site operating lives established from the anticipated decline in landfill activity. The revised provision includes a change in the estimate of the aftercare period to 60 years after site closure (2012 30 years) to align with updated technical assessment using independent external advice, as well as incorporating updated assumptions based on recent historical data and future cost estimates. This exceptional charge reflects only the incremental change in the assessment of the provisions.

(c) Onerous contracts principally arise from long-term contractual obligations to purchase materials for recycling at input prices which lead to an expected loss after reflecting directly attributable and unavoidable costs of processing.

(d) South West Water Limited received a consent fee related to the transfer and subsequent termination of a lease arising from the sale of a finance lease between financial institutions.

(e) The total tax credit on exceptional items is below the current rate of corporation tax (24%) due to tax relief not being available on ineligible expenditure on which no deferred tax has previously been accounted for (principally land and buildings).

7. Operating costs

	Notes	2013 £m	2012 £m
Manpower costs	13	**158.6**	155.4
Raw materials and consumables		**125.2**	133.9
Other operating expenses include:			
Profit on disposal of property, plant and equipment		**(1.8)**	(2.8)
Operating lease rentals payable:			
– Plant and machinery		**12.9**	6.6
– Property		**8.9**	8.0
Research and development expenditure		**0.2**	0.2
Trade receivables impairment	22	**9.9**	9.2
Depreciation of property, plant and equipment:			
– Owned assets		**107.8**	110.5
– Under finance leases		**37.7**	35.1
Amortisation of other intangible assets	16	**3.7**	1.4

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

	2013 £000	2012 £000
Fees payable to the Company's auditors and its associates for the audit of parent Company and consolidated financial statements	**124**	73
Fees payable to the Company's auditors and its associates for other services:		
The audit of Company's subsidiaries	**597**	410
Audit related assurance services	**172**	76
Tax advisory services	**361**	242
Corporate finance services	**880**	707
Other non-audit services	**177**	97
Total fees	**2,311**	1,605
Fees payable to the Company's auditors in respect of Pennon Group pension schemes:		
Audit	**27**	26

Expenses reimbursed to the auditors in relation to the audit of the Group were £45,000 (2012 £37,000).

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

Audit related fees of £65,000 (2012 nil) were recognised directly in equity relating to the issuance cost of the perpetual capital securities.

A description of the work of the Audit Committee is set out in its report on pages 66 and 67 which includes an explanation of how the auditor's objectivity and independence are safeguarded when non-audit services are provided by the auditors' firm.

Notes to the financial statements
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8. Net finance costs

	Notes	2013 Finance cost £m	2013 Finance income £m	2013 Total £m	2012 Finance cost £m	2012 Finance income £m	2012 Total £m
Cost of servicing debt							
Bank borrowing and overdrafts		**(40.0)**	**–**	**(40.0)**	(50.0)	–	(50.0)
Interest element of finance lease rentals		**(39.8)**	**–**	**(39.8)**	(38.8)	–	(38.8)
Other finance costs		**(5.4)**	**–**	**(5.4)**	(5.5)	–	(5.5)
Interest receivable		**–**	**5.8**	**5.8**	–	6.2	6.2
Interest receivable on shareholder loans to joint ventures		**–**	**9.3**	**9.3**	–	7.5	7.5
		(85.2)	**15.1**	**(70.1)**	(94.3)	13.7	(80.6)
Other finance income							
Investment income received		**–**	**66.8**	**66.8**	–	67.3	67.3
Fair value losses on derivative financial instruments providing commercial hedges		**(63.4)**	**–**	**(63.4)**	(63.9)	–	(63.9)
		(63.4)	**66.8**	**3.4**	(63.9)	67.3	3.4
Notional interest							
Interest receivable on service concession arrangements		**–**	**6.0**	**6.0**	–	3.3	3.3
Retirement benefit obligations	30	**(28.6)**	**32.3**	**3.7**	(29.1)	32.7	3.6
Unwinding of discounts in liabilities		**(4.3)**	**–**	**(4.3)**	(4.3)	–	(4.3)
		(32.9)	**38.3**	**5.4**	(33.4)	36.0	2.6
Net gains on non-designated derivative financial instruments		**–**	**7.4**	**7.4**	–	2.3	2.3
		(181.5)	**127.6**	**(53.9)**	(191.6)	119.3	(72.3)
Exceptional items	6	**(2.9)**	**15.4**	**12.5**	–	–	–
		(184.4)	**143.0**	**(41.4)**	(191.6)	119.3	(72.3)

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.

9. Taxation

	Notes	Before exceptional items 2013 £m	Exceptional items (Note 6) 2013 £m	Total 2013 £m	2012 £m
Analysis of charge in year					
Current tax charge/(credit)		**43.3**	**(15.6)**	**27.7**	30.9
Deferred tax – other		**1.4**	**(21.5)**	**(20.1)**	23.6
Deferred tax arising on change of rate of corporation tax		**(13.6)**	**0.9**	**(12.7)**	(26.4)
Total deferred tax credit	31	**(12.2)**	**(20.6)**	**(32.8)**	(2.8)
Tax charge/(credit) for year		**31.1**	**(36.2)**	**(5.1)**	28.1

Current tax is calculated at 24% (2012 26%) of the estimated assessable profit for the year.

Included in deferred tax is a non-recurring credit of £12.7 million (2012 £26.4 million) arising from a 1% reduction (2012 2%) 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 (24%) from:

	2013 £m	2012 £m
Profit before tax	**21.8**	200.5
Profit before tax multiplied by the standard rate of UK corporation tax of 24% (2012 26%)	**5.2**	52.1
Effects of:		
Expenses not deductible for tax purposes	**8.5**	3.5
Other	**4.6**	(0.6)
Change in rate of corporation tax	**(12.7)**	(26.4)
Adjustments to tax charge in respect of prior years	**(10.7)**	(0.5)
Tax (credit)/charge for year	**(5.1)**	28.1

Credit adjustments to the 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 before exceptional items was 16% (2012 14%).

In addition to the amount recognised in the income statement, a deferred tax credit relating to actuarial gains on defined benefit pension schemes of £2.0 million (2012 £10.2 million) have been credited directly to other comprehensive income. In 2012 a deferred tax credit relating to losses on cash flow hedges of £5.8 million was also recognised. A deferred tax charge relating to share-based payments of £0.5 million (2012 £0.1 million) has been recognised directly to equity.

10. Profit of the parent company

	2013 £m	2012 £m
Profit attributable to ordinary shareholders' equity dealt with in the accounts of the parent company	**185.7**	116.3

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

11. Earnings per share

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of Ordinary shares outstanding during the year, excluding those held in the employee share trust (note 36), which are treated as cancelled.

For diluted earnings per share, the weighted average number of Ordinary shares in issue is adjusted to include all dilutive potential Ordinary shares. The Group has two types of dilutive potential Ordinary shares – those share options granted to employees where the exercise price is less than the average market price of the Company's Ordinary shares during the year; and the contingently issuable shares under the Group's Performance and Co-investment Plan 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 statutory earnings per share during the year.

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

	2013	2012
Number of shares (millions)		
For basic earnings per share	**363.6**	358.7
Effect of dilutive potential Ordinary shares from share options	**2.2**	2.2
For diluted earnings per share	**365.8**	360.9

Notes to the financial statements
Continued

11. Earnings per share Continued

Basic and diluted earnings per share
Earnings per share before exceptional items and deferred tax are presented as the Directors believe that this measure provides a more useful comparison on business trends and performance. 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:

	2013			2012		
	Profit after tax £m	**Earnings per share Basic p**	**Diluted p**	Profit after tax £m	Earnings per share Basic p	Diluted p
Statutory earnings	**26.9**	**7.4**	**7.4**	172.4	48.1	47.8
Deferred tax credit (before exceptional items)	**(12.2)**	**(3.4)**	**(3.3)**	(2.8)	(0.8)	(0.8)
Exceptional items (net of tax)	**140.2**	**38.6**	**38.2**	–	–	–
Earnings before exceptional items and deferred tax	**154.9**	**42.6**	**42.3**	169.6	47.3	47.0

12. Dividends

	2013 £m	2012 £m
Amounts recognised as distributions to ordinary equity holders in the year:		
Interim dividend paid for the year ended 31 March 2012: 8.22p (2011 7.50p) per share	**29.7**	26.8
Final dividend paid for the year ended 31 March 2012: 18.30p (2011 17.15p) per share	**66.3**	61.4
	96.0	88.2
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2013: 8.76p (2012 8.22p) per share	**31.9**	29.7
Proposed final dividend for the year ended 31 March 2013: 19.70p (2012 18.30p) per share	**71.9**	66.3
	103.8	96.0

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

The proposed interim dividend for 2013 was paid on 4 April 2013 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting.

13. Employment costs

	Notes	**2013 £m**	2012 £m
Wages and salaries		**134.3**	130.9
Social security costs		**13.1**	12.6
Pension costs	30	**16.9**	16.6
Share-based payments	33	**3.6**	3.6
Total employment costs		**167.9**	163.7
Charged:			
Manpower costs		**158.6**	155.4
Capital schemes		**9.3**	8.3
Total employment costs		**167.9**	163.7

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

	2013	2012
Employees (average number)		
The average monthly number of employees (including Executive Directors) was:		
Water and sewerage	**1,354**	1,335
Waste management	**3,180**	3,148
Other	**50**	46
Group totals	**4,584**	4,529

The total number of employees at 31 March 2013 was 4,511 (2012 4,592).

14. Directors' emoluments

	2013 £000	2012 £000
Executive Directors:		
Salary	**1,110**	1,077
Performance-related bonus paid or payable	**261**	393
Share-based payments	**1,147**	1,094
Other emoluments, including payments in lieu of pension provision	**324**	383
Non-executive Directors	**477**	431
	3,319	3,378

The cost of share-based payments represents the amount charged to the income statement, as described in note 33.

The aggregate gains on vesting of Directors' share-based awards amounted to a total of £1,644,000 (2012 £1,002,000).

Total gains made by Directors on the exercise of share options were £69,000 (2012 nil).

Total emoluments include £1,541,000 (2012 £1,570,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2013 there were no Directors accruing retirement benefits under defined benefit pension schemes (2012 nil).

No pension contributions were payable to defined contribution schemes but three Directors received payments in lieu of pension provision (2012 three).

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 72 to 83.

Notes to the financial statements
Continued

15. Goodwill

	(Restated note 40) £m
Cost:	
At 1 April 2011	300.4
Recognised on acquisition of subsidiaries	26.1
At 31 March 2012	326.5
Recognised on acquisition of subsidiaries (note 40)	12.5
At 31 March 2013	339.0
Carrying amount:	
At 1 April 2011	300.4
At 31 March 2012	326.5
At 31 March 2013	**339.0**

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 and this is the lowest level at which goodwill is monitored.

Impairment testing of goodwill
The Group tests goodwill for impairment annually, or more frequently if there are any indications that impairment may have arisen. The recoverable amount of goodwill is determined based on value-in-use calculations which, under IAS 36 'Impairment of Assets', require the use of base cash flow projections that reflect reasonable and supportable assumptions with specific restrictions on the estimates to be used. These include limitations on reflecting cash flows to take account of future cost restructuring, or improvement or enhancement of asset performance. Uncommitted projects are excluded. Discount rates are required to be derived independently of the Group's capital structure and reflect management's prudent estimate of a rate that investors would require if they were to choose a similar investment.

The base cash flow projections have been derived by prudently adjusting key assumptions underlying the Group's detailed budget and strategic plan projections. These cover a period of 7 years and are prepared as part of the annual planning cycle. This period is believed to lead to a more realistic estimate of future cash flows than 5 years.

These plans are based on detailed market-by-market forecasts of projected volumes, prices and costs for each business activity. These forecasts reflect, on an individual operational site basis, numerous assumptions and estimates. The key assumptions include: anticipated changes in market size and volumes; recyclate prices; energy selling prices; gate fees; the level of future landfill tax; and cost inflation. Management has determined the value assigned to each assumption based on historical experience, market surveys, industry analysis and current legislation. For business activities with an indefinite life a terminal growth rate has been used.

The key assumptions which management has applied to the cash flow projections include:

Assumption	Basis for assumption
Discount rate	
Pre-tax discount rates used range from 8% to 11% (across the segment's business activities)	Discount rates have been determined based on an estimate of the waste management segment's weighted average cost of capital adjusted for the different risk profiles of the segment's business activities to the extent that the cash flows have not already been adjusted. Investments in joint ventures reflect an expected equity return only.
Long term growth rate	
2.5% applied to periods beyond the period of the detailed projections	Based on forecasts of growth in waste management markets and the UK economy.

Using management's cash flow projections on the above basis, the value-in-use of the waste management business exceeds the carrying amount by £400 million ("headroom"). The headroom relative to the Company's investment in the waste management business (note 20) is £197 million. A reasonably possible change, with all other variables held constant, of a 0.5% increase in discount rates, a 0.5% reduction in the long-term growth rate or a 5.0% reduction in overall net cash flows, as a result of movements in key assumptions, would reduce headroom by £133 million, £60 million and £70 million respectively.

16. Other intangible assets

	Customer contracts (Restated note 40) £m	Patents £m	Total (Restated note 40) £m
Acquired intangible assets			
Cost:			
At 1 April 2011	12.5	0.2	12.7
Recognised on acquisition of subsidiaries	19.0	–	19.0
At 31 March 2012 and 31 March 2013	31.5	0.2	31.7
Accumulated amortisation:			
At 1 April 2011	8.3	–	8.3
Charge for year	1.3	0.1	1.4
At 31 March 2012	9.6	0.1	9.7
Charge for year	3.7	–	3.7
Impairment charge for year	5.8	–	5.8
At 31 March 2013	19.1	0.1	19.2
Carrying amount:			
At 1 April 2011	4.2	0.2	4.4
At 31 March 2012	21.9	0.1	22.0
At 31 March 2013	**12.4**	**0.1**	**12.5**

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 five 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.

The principal assumptions used to assess impairment are set out in note 17 of the financial statements.

Notes to the financial statements
Continued

17. Property, plant and equipment

	Land and buildings (Restated note 40) £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers (Restated note 40) £m	Landfill restoration £m	Construction in progress £m	Total (Restated note 40) £m
Group							
Cost:							
At 1 April 2011	441.1	1,467.9	614.2	1,369.9	53.4	146.5	4,093.0
Arising on acquisitions	0.3	–	–	1.4	–	–	1.7
Additions	17.0	14.9	1.7	19.0	–	204.8	257.4
Assets adopted at fair value	–	46.7	–	–	–	–	46.7
Other	–	–	–	–	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	440.4	1,541.0	621.0	1,468.8	55.0	264.4	4,390.6
Arising on acquisitions (note 40)	0.2	–	–	3.6	–	–	3.8
Additions	7.5	11.7	1.4	32.9	–	356.6	410.1
Assets adopted at fair value	–	3.3	–	–	–	–	3.3
Other (note 32)	–	–	–	–	8.4	–	8.4
Grants and contributions	–	(1.0)	–	–	–	–	(1.0)
Disposals	–	(1.2)	–	(9.6)	–	–	(10.8)
Transfers/reclassifications	10.8	16.9	10.6	54.3	–	(92.6)	–
At 31 March 2013	458.9	1,570.7	633.0	1,550.0	63.4	528.4	4,804.4
Accumulated depreciation:							
At 1 April 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
Charge for year	15.2	23.0	10.9	96.8	1.8	–	147.7
Impairment charge for year	51.7	–	–	20.2	6.3	–	78.2
Disposals	–	(1.2)	–	(6.9)	–	–	(8.1)
At 31 March 2013	257.2	156.0	191.9	891.8	27.9	–	1,524.8
Net book value:							
At 1 April 2011	252.3	1,355.0	444.0	689.3	35.6	146.5	2,922.7
At 31 March 2012	250.1	1,406.8	440.0	687.1	35.2	264.4	3,083.6
At 31 March 2013	**201.7**	**1,414.7**	**441.1**	**658.2**	**35.5**	**528.4**	**3,279.6**

Of the total depreciation charge of £147.7 million (2012 £147.5 million), £1.4 million (2012 £1.4 million) has been charged to capital projects, £0.8 million (2012 £0.5 million) has been offset by deferred income and £145.5 million (2012 £145.6 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 nil million (2012 £4.4 million).

During the year borrowing costs of £13.6 million (2012 £3.0 million) have been capitalised on qualifying assets, at an average borrowing rate of 4.5%.

Impairment testing for property, plant and equipment and other intangible assets
Property, plant and equipment and finite lived intangible assets are reviewed for impairment when any indicators of impairment are identified. Most of the individual assets do not generate independent cash flows and as a result, for the purposes of impairment reviews, the assets are grouped into cash generating units (CGUs). The CGUs of the waste management segment comprise individual sites which constitute the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or group of assets.

The carrying value of these individual sites is compared to the recoverable amount of the CGUs, which is based predominantly on value-in-use. Value-in-use calculations use the same base cash flow projections used for testing goodwill (note 15) and are derived by adjusting the Group's detailed budget and strategic plan which cover a period of 7 years and are approved by the Board annually. The key assumptions are the same as for the impairment testing of goodwill (note 15).

For certain CGUs the recoverable amount is determined by reference to the fair value less costs to sell of the underlying assets using external and internal valuations of property and equipment and management's estimate of disposal costs.

Impairment charges of £78.2 million for property, plant and equipment and £5.8 million for other intangible assets have been identified in the waste management segment relating to certain CGUs, principally landfill (£43.3 million) and recycling (£31.4 million) activities, to reflect reduced landfill volumes and recyclate prices. For the purposes of disclosing the results of the impairment review the CGUs have been grouped together by business activity as each CGU within a business activity exhibits a similar risk profile. The key assumptions in the Group's detailed budget and strategic plan are the same as those used for testing goodwill (note 15). The assumptions applied to these cash flow projections are:

Assumption	Basis for assumption
Discount rate	
Pre-tax discount rates used are 8% for landfill and 8.5% for recycling	Discount rates have been determined based on an estimate of the waste management segment's weighted average cost of capital adjusted for the different risk profiles of the segment's business activities to the extent that the cash flows have not already been adjusted.
Long-term growth rate	
2.5% applied to periods beyond the strategic plan period up to the end of the life of the assets for recycling. For landfill activities a finite life has been identified based on projected volumes.	Based on forecasts of growth in waste management markets and the UK economy.

Using management cash flow projections a 0.5% increase in the discount rate or a 0.5% decrease in the estimated long-term growth rate, with all other variables held constant, would not have a material impact on the impairment charge.

Notes to the financial statements
Continued

17. Property, plant and equipment Continued

Assets held under finance leases included above were:

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Landfill restoration £m	Construction in progress £m	Total £m
Cost:							
At 31 March 2012	–	357.0	465.2	379.9	–	0.3	1,202.4
At 31 March 2013	–	357.0	465.2	383.8	–	0.3	1,206.3
Accumulated depreciation:							
At 31 March 2012	–	31.3	97.0	189.0	–	–	317.3
At 31 March 2013	–	36.6	104.9	180.3	–	–	321.8
Net book amount:							
At 31 March 2012	–	325.7	368.2	190.9	–	0.3	885.1
At 31 March 2013	**–**	**320.4**	**360.3**	**203.5**	**–**	**0.3**	**884.5**

	Fixed and mobile plant, vehicles and computers £m
Company	
Cost:	
At 1 April 2011	0.4
At 31 March 2012	0.4
Additions	0.1
Disposals	(0.1)
At 31 March 2013	0.4
Accumulated depreciation:	
At 1 April 2011	0.1
Charge for year	0.1
At 31 March 2012	0.2
Charge for year	0.1
Disposals	(0.1)
At 31 March 2013	0.2
Net book value:	
At 1 April 2011	0.3
At 31 March 2012	0.2
At 31 March 2013	**0.2**

Asset lives and residual values are reviewed annually.

18. Financial instruments by category

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

	Notes	Fair value			Amortised cost		
		Derivatives used for fair value hedging £m	Derivatives used for cash flow hedging £m	Derivatives deemed held for trading £m	Loans and receivables £m	Trade receivables and trade payables (Restated note 40) £m	Total (Restated note 40) £m
Group							
31 March 2013							
Financial assets							
Trade receivables	22	–	–	–	–	136.0	136.0
Other receivables	19,22	–	–	–	181.0	–	181.0
Derivative financial instruments	23	31.0	0.8	9.7	–	–	41.5
Cash and cash deposits	25	–	–	–	634.5	–	634.5
Total		31.0	0.8	9.7	815.5	136.0	993.0
Financial liabilities							
Borrowings	28	–	–	–	(2,643.2)	–	(2,643.2)
Derivative financial instruments	23	(9.2)	(41.1)	(2.9)	–	–	(53.2)
Trade payables	26	–	–	–	–	(86.9)	(86.9)
Total		(9.2)	(41.1)	(2.9)	(2,643.2)	(86.9)	(2,783.3)
31 March 2012							
Financial assets							
Trade receivables	22	–	–	–	–	121.4	121.4
Other receivables	19,22	–	–	–	140.0	–	140.0
Derivative financial instruments	23	22.7	6.6	2.3	–	–	31.6
Cash and cash deposits	25	–	–	–	425.3	–	425.3
Total		22.7	6.6	2.3	565.3	121.4	718.3
Financial liabilities							
Borrowings	28	–	–	–	(2,529.9)	–	(2,529.9)
Derivative financial instruments	23	(6.5)	(42.1)	–	–	–	(48.6)
Trade payables	26	–	–	–	–	(87.2)	(87.2)
Total		(6.5)	(42.1)	–	(2,529.9)	(87.2)	(2,665.7)
Company							
31 March 2013							
Financial assets							
Amounts owed by subsidiaries	19,22	–	–	–	637.0	–	637.0
Derivative financial instruments	23	–	–	9.7	–	–	9.7
Cash and cash deposits	25	–	–	–	398.9	–	398.9
Total		–	–	9.7	1,035.9	–	1,045.6
Financial liabilities							
Borrowings	28	–	–	–	(1,049.8)	–	(1,049.8)
Trade payables	26	–	–	–	–	(0.4)	(0.4)
Total		–	–	–	(1,049.8)	(0.4)	(1,050.2)
31 March 2012							
Financial assets							
Amounts owed by subsidiaries	19,22	–	–	–	441.7	–	441.7
Derivative financial instruments	23	–	6.6	2.3	–	–	8.9
Cash and cash deposits	25	–	–	–	158.9	–	158.9
Total		–	6.6	2.3	600.6	–	609.5
Financial liabilities							
Borrowings	28	–	–	–	(891.2)	–	(891.2)
Trade payables	26	–	–	–	–	(0.1)	(0.1)
Total		–	–	–	(891.2)	(0.1)	(891.3)

Notes to the financial statements
Continued

19. Other non-current assets

Non-current receivables

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Amounts owed by subsidiary undertakings	**–**	–	**502.0**	350.9
Amounts owed by related parties (note 45)	**79.9**	69.0	**–**	–
Service concession arrangements	**90.1**	58.8	**–**	–
Other receivables	**13.3**	10.6	**0.5**	1.1
	183.3	138.4	**502.5**	352.0

Non-current receivables were due:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Between 1 and 2 years	**21.0**	15.5	**126.2**	89.2
Over 2 years and less than 5 years	**24.4**	15.9	**376.3**	262.8
Over 5 years	**137.9**	107.0	**–**	–
	183.3	138.4	**502.5**	352.0

The fair values of non-current receivables were:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Amounts owed by subsidiary undertakings	**–**	–	**509.2**	354.7
Amounts owed by related parties	**161.6**	147.7	**–**	–
Service concession arrangements	**90.1**	58.8	**–**	–
Other receivables	**13.3**	10.6	**0.5**	1.1
	265.0	217.1	**509.7**	355.8

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% (2012 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 13.0% (2012 14.0%).

Other receivables include site development and pre-contract costs of £12.8 million (2012 £9.6 million).

20. Investments

Subsidiary undertakings

	£m
Company	
At 1 April 2011	1,032.0
Additions	140.1
At 31 March 2012	1,172.1
Additions	151.2
At 31 March 2013	**1,323.3**

Joint ventures

	£m
Group	
At 1 April 2011	1.5
Share of post-tax profit	4.0
Share of other comprehensive loss	(5.4)
At 31 March 2012	0.1
Share of post-tax profit	5.8
Share of other comprehensive profit	2.7
Dividends received	(8.5)
At 31 March 2013	**0.1**

The recoverable amount of investments is determined based on value-in-use calculations which are set out in note 15 of the financial statements.

Details of the Group's principal subsidiary and joint venture undertakings are set out in note 41.

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

	Assets		Liabilities		Income		Other comprehensive income/(loss)
	Non–current £m	Current £m	Non–current £m	Current £m	Revenue £m	Profit £m	£m
2013							
Lakeside Energy from Waste Holdings Limited	**73.8**	**19.5**	**(86.1)**	**(7.2)**	**25.2**	**5.8**	**2.7**
Viridor Laing (Greater Manchester) Holdings Limited	**175.2**	**39.5**	**(188.9)**	**(25.8)**	**63.6**	**–**	**–**
INEOS Runcorn (TPS) Holdings Limited	**95.0**	**22.3**	**(117.1)**	**(0.2)**	**1.3**	**–**	**–**
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)
INEOS Runcorn (TPS) Holdings Limited	76.0	8.2	(84.0)	(0.2)	–	–	–

Notes to the financial statements
Continued

21. Inventories

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Raw materials and consumables	**10.5**	9.0	**–**	–

22. Trade and other receivables – current

	Group		Company	
	2013 £m	2012 (Restated note 40) £m	**2013 £m**	2012 £m
Trade receivables	**212.4**	188.5	**–**	–
Less: provision for impairment of receivables	**(76.4)**	(67.0)	**–**	–
Net trade receivables	**136.0**	121.5	**–**	–
Amounts owed by related parties (note 45)	**11.0**	12.2	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**135.0**	90.8
Other receivables	**8.0**	13.0	**1.1**	0.7
Prepayments and accrued income	**112.7**	91.8	**0.2**	0.2
	267.7	238.5	**136.3**	91.7

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:

	2013 £m	2012 £m
Group		
Past due 1 – 30 days	**51.3**	37.3
Past due 31 – 120 days	**13.8**	13.0
More than 120 days	**115.6**	97.4

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:

	2013 £m	2012 £m
At 1 April	**67.0**	58.2
Provision for receivables impairment	**9.9**	9.2
Receivables written-off during the year as uncollectable	**(9.5)**	(7.1)
Cumulative amounts previously excluded from debt	**9.0**	6.7
At 31 March	**76.4**	67.0

23. Derivative financial instruments

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Derivatives used for cash flow hedging				
Non-current assets	**0.2**	–	**–**	–
Current assets	**0.6**	6.6	**–**	6.6
Current liabilities	**(18.0)**	(15.3)	**–**	–
Non-current liabilities	**(23.1)**	(26.8)	**–**	–
Derivatives used for fair value hedging				
Non-current assets	**30.8**	21.9	**–**	–
Current assets	**0.2**	0.8	**–**	–
Current liabilities	**(2.3)**	(1.3)	**–**	–
Non-current liabilities	**(6.9)**	(5.2)	**–**	–
Derivative deemed held for trading				
Current assets	**9.7**	2.3	**9.7**	2.3
Current liabilities	**(1.4)**	–	**–**	–
Non-current liabilities	**(1.5)**	–	**–**	–

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 hedging relationships was nil (2012 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 2013 54% of Group net borrowings were at fixed rate (2012 56%).

At 31 March 2013 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £1,135.0 million and a weighted average maturity of 4.0 years (2012 £855.0 million, with 4.0 years). The weighted average interest rate of the swaps for their nominal amount was 2.7% (2012 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. The weighted average interest rate of the swaps was 3.7%. This cross-currency interest rate swap matured during the year.

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 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 £7.4 million (2012 £2.3 million) fair value movement in the derivative has been recognised in net finance costs in the income statement.

Notes to the financial statements
Continued

23. Derivative financial instruments Continued

Valuation hierarchy

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

Level 2 inputs	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Assets				
Derivatives used for cash flow hedging	**0.8**	6.6	**–**	6.6
Derivatives used for fair value hedging	**31.0**	22.7	**–**	–
Total assets	**31.8**	29.3	**–**	6.6
Liabilities				
Derivatives used for cash flow hedging	**41.1**	42.1	**–**	–
Derivatives used for fair value hedging	**9.2**	6.5	**–**	–
Derivative deemed held for trading	**2.9**	–	**–**	–
Total liabilities	**53.2**	48.6	**–**	–

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		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Assets				
Derivative deemed held for trading	**9.7**	2.3	**9.7**	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).

24. Financial instruments at fair value through profit

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Financial assets at fair value through profit				
Current assets	**1.2**	0.5	**–**	–
Financial liabilities at fair value through profit				
Non-current liabilities	**(23.0)**	(16.7)	**–**	–

Financial instruments 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.

25. Cash and cash deposits

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Cash at bank and in hand	**86.6**	18.3	**58.4**	58.4
Short-term bank deposits	**159.0**	67.1	**159.0**	47.1
Other deposits	**388.9**	339.9	**181.5**	53.4
Total cash and cash deposits (note 39)	**634.5**	425.3	**398.9**	158.9

Group short-term deposits have an average maturity of one day.

Group other deposits have an average maturity of 134 days.

Group other deposits include restricted funds of £135.9 million (2012 £108.4 million) to settle long-term lease liabilities (note 28) and £7.7 million (2012 £14.2 million) relating to letters of credit.

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

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Cash and cash deposits as above	**634.5**	425.3	**398.9**	158.9
Bank overdrafts (note 28)	**(0.4)**	(10.5)	**–**	–
	634.1	414.8	**398.9**	158.9
Less: deposits with a maturity of three months or more (restricted funds)	**(143.6)**	(122.6)	**(1.4)**	(1.4)
	490.5	292.2	**397.5**	157.5

26. Trade and other payables – current

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Trade payables	**86.9**	87.2	**0.4**	0.1
Amounts owed to subsidiary undertakings	**–**	–	**0.1**	5.7
Amounts owed to joint venture (note 45)	**0.2**	7.0	**–**	–
Other tax and social security	**71.3**	41.2	**0.3**	0.3
Accruals and other payables	**118.8**	107.1	**6.9**	4.7
	277.2	242.5	**7.7**	10.8

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. Further disclosures have not been provided in accordance with IAS 37 paragraph 92.

Notes to the financial statements
Continued

27. Current tax liabilities/(recoverable)

	Group		Company	
	2013 £m	2012 (Restated note 40) £m	**2013 £m**	2012 £m
Current tax liabilities/(recoverable)	**67.0**	60.3	**18.9**	(2.6)

28. Borrowings

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Current				
Bank overdrafts	**0.4**	10.5	**–**	–
Short-term loans	**75.9**	253.2	**75.9**	253.2
European Investment Bank	**21.1**	21.1	**–**	–
Amounts owed to subsidiary undertakings (note 45)	**–**	–	**281.2**	281.2
	97.4	284.8	**357.1**	534.4
Obligations under finance leases	**41.2**	40.7	**–**	–
Total current borrowings (note 39)	**138.6**	325.5	**357.1**	534.4
Non-current				
Bank and other loans	**410.0**	139.3	**410.0**	139.3
Private placements	**162.3**	99.9	**162.3**	99.9
Bond 2040	**132.5**	132.3	**–**	–
RPI index-linked bond	**247.3**	240.3	**–**	–
Convertible bond	**120.4**	117.6	**120.4**	117.6
European Investment Bank	**210.4**	231.5	**–**	–
	1,282.9	960.9	**692.7**	356.8
Obligations under finance leases	**1,221.7**	1,243.5	**–**	–
Total non-current borrowings (note 39)	**2,504.6**	2,204.4	**692.7**	356.8
Total borrowings	**2,643.2**	2,529.9	**1,049.8**	891.2

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 3.1% (2012 3.2%).

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 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 and has been recognised in shareholders' equity in retained earnings.

South West Water Finance Plc issued a £150 million bond in July 2010 maturing in 2040 with a cash coupon of 5.875%.

The fair values of non-current borrowings were:

	2013		2012	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Group				
Bank and other loans	**410.0**	**410.0**	139.3	139.3
Private placements	**162.3**	**156.5**	99.9	92.3
Bond 2040	**132.5**	**175.1**	132.3	157.5
RPI index-linked bond	**247.3**	**166.7**	240.3	159.5
Convertible bond	**120.4**	**145.9**	117.6	161.7
European Investment Bank	**210.4**	**189.5**	231.5	205.8
	1,282.9	**1,243.7**	960.9	916.1
Obligations under finance leases	**1,221.7**	**1,053.3**	1,243.5	1,088.1
	2,504.6	**2,297.0**	2,204.4	2,004.2
Company				
Bank and other loans	**410.0**	**410.0**	139.3	139.3
Private placements	**162.3**	**156.5**	99.9	92.3
Convertible bond	**120.4**	**145.9**	117.6	161.7
	692.7	**712.4**	356.8	393.3

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

The maturity of non-current borrowings was:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Between 1 and 2 years	**259.1**	130.3	**185.2**	74.6
Over 2 years and less than 5 years	**593.9**	432.9	**345.2**	182.3
Over 5 years	**1,651.6**	1,641.2	**162.3**	99.9
	2,504.6	2,204.4	**692.7**	356.8

The weighted average maturity of non-current borrowings was 22 years (2012 23 years).

Finance lease liabilities – minimum lease payments were:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Within 1 year	**56.6**	61.7	**–**	–
Over 1 year and less than 5 years	**291.0**	292.9	**–**	–
Over 5 years	**2,045.3**	2,216.5	**–**	–
	2,392.9	2,571.1	**–**	–
Less: future finance charges	**(1,130.0)**	(1,286.9)	**–**	–
Present value of finance lease liabilities	**1,262.9**	1,284.2	**–**	–

Notes to the financial statements
Continued

28. Borrowings Continued

The maturity of finance lease liabilities was:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Within 1 year	**34.0**	31.0	**–**	–
Over 1 year and less than 5 years	**170.1**	133.9	**–**	–
Over 5 years	**1,058.8**	1,119.3	**–**	–
	1,262.9	1,284.2	**–**	–

Included above are accrued finance charges arising on obligations under finance leases totalling £130.8 million (2012 £135.5 million), of which £14.3 million (2012 £12.6 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.

The period for repayment of these leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £52.3 million at 31 March 2013 (2012 £41.9 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.

The period for repayment of certain existing leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £83.6 million at 31 March 2013 (2012 £66.5 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 were:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Floating rate:				
Expiring within 1 year	**190.0**	247.5	**25.0**	127.5
Expiring after 1 year	**325.0**	411.0	**220.0**	141.0
	515.0	658.5	**245.0**	268.5

In addition the Group had, at 31 March 2013, undrawn uncommitted short-term bank facilities of £25.0 million (2012 £50.0 million) available to the Company or South West Water Limited.

29. Other non-current liabilities

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Amounts owed to subsidiary undertakings	**–**	–	**8.7**	8.7
Other payables	**77.9**	76.9	**–**	–
	77.9	76.9	**8.7**	8.7

Other payables include deferred income resulting from the adoption at fair value of assets transferred from customers in the water and sewerage segment.

30. 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 £2.8 million (2012 £2.7 million).

Defined benefit schemes
Assumptions
The principal actuarial assumptions at 31 March were:

	2013 %	2012 %
Expected return on schemes' assets	**4.3**	6.3
Rate of increase in pensionable pay	**3.4**	3.5
Rate of increase for current and future pensions	**3.4**	3.3
Rate used to discount schemes' liabilities	**4.3**	4.7
Inflation	**3.4**	3.3

For 2013/14 IAS 19 (Revised) Employee Benefits will be implemented which requires the expected return on schemes' assets to be the same as the rate used to discount liabilities.

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 as:

	2013	2012
Male	**25.0**	24.9
Female	**27.0**	27.0

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

	2013	2012
Male	**25.9**	25.8
Female	**28.3**	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%	+/– 6.6%
Rate used to discount schemes' liabilities	+/– 0.5%	+/– 9.2%
Inflation	+/– 0.5%	+/– 8.3%
Life expectancy	+/– 1 year	+/– 3.6%

Notes to the financial statements
Continued

30. Retirement benefit obligations Continued

The amounts recognised in the income statement were:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Current service cost	**(13.7)**	(12.9)	**(0.5)**	(0.8)
Past service cost	**(0.4)**	(1.0)	**–**	–
Total included in employment costs	**(14.1)**	(13.9)	**(0.5)**	(0.8)
Expected return on pension schemes' assets	**32.3**	32.7	**2.2**	2.2
Interest cost on retirement benefit obligations	**(28.6)**	(29.1)	**(2.0)**	(2.1)
Total included within net finance costs	**3.7**	3.6	**0.2**	0.1
Total charge	**(10.4)**	(10.3)	**(0.3)**	(0.7)

The actual return on schemes' assets was a profit of £69.0 million (2012 £32.0 million).

The amounts recognised in the statement of comprehensive income were:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Actuarial losses recognised in the year	**(15.1)**	(51.7)	**(1.6)**	(3.9)

The amounts recognised in the balance sheet were:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Fair value of schemes' assets	**580.4**	517.2	**39.4**	35.4
Present value of defined benefit obligations	**(690.1)**	(615.8)	**(48.1)**	(43.2)
Net liability recognised in the balance sheet	**(109.7)**	(98.6)	**(8.7)**	(7.8)

The schemes' assets were:

	2013		2012	
	Value £m	**Fund %**	Value £m	Fund %
Equities	**315.9**	**54**	269.9	52
Bonds	**185.1**	**32**	168.8	33
Diversified growth	**38.6**	**7**	–	–
Property	**36.2**	**6**	35.4	7
Other	**4.6**	**1**	43.1	8
	580.4	**100**	517.2	100

Other assets at 31 March 2012 represented principally cash contributions received from the Group towards the year-end which were invested during the subsequent financial year.

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

	2013 £m	2012 £m
Equities	**20.4**	17.8
Property	**2.7**	2.7
Bonds	**13.1**	11.8
Other	**3.2**	3.1
	39.4	35.4

The expected return on schemes' assets for 2012/13 was 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 reflected long-term rates of return experienced in the respective markets. Expected yields on fixed interest investments were based on gross redemption yields as at the balance sheet date.

In conjunction with its investment advisors, 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 in alternative asset classes which give the potential for diversification (currently property and diversified growth).

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

Movements in the net liability were:

	Group		Company	
	2013 £m	2012 £m	2013 £m	2012 £m
At 1 April	**(98.6)**	(85.8)	**(7.8)**	(6.8)
Income statement	**(10.4)**	(10.3)	**(0.3)**	(0.7)
Statement of comprehensive income	**(15.1)**	(51.7)	**(1.6)**	(4.0)
Employer contributions	**14.4**	49.2	**1.0**	3.7
At 31 March	**(109.7)**	(98.6)	**(8.7)**	(7.8)

Movements in the fair value of schemes' assets were:

	Group		Company	
	2013 £m	2012 £m	2013 £m	2012 £m
At 1 April	**517.2**	454.2	**35.4**	30.7
Expected return on schemes' assets	**32.3**	32.7	**2.2**	2.2
Actuarial gains/(losses)	**36.7**	(0.7)	**2.3**	0.2
Members' contributions	**1.2**	1.2	**–**	–
Benefits paid	**(21.4)**	(19.4)	**(1.5)**	(1.4)
Employer contributions	**14.4**	49.2	**1.0**	3.7
At 31 March	**580.4**	517.2	**39.4**	35.4

Notes to the financial statements
Continued

30. Retirement benefit obligations Continued

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

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
At 1 April	**(615.8)**	(540.0)	**(43.2)**	(37.5)
Service cost	**(14.1)**	(13.9)	**(0.5)**	(0.8)
Interest cost	**(28.6)**	(29.1)	**(2.0)**	(2.1)
Actuarial losses	**(51.8)**	(51.0)	**(3.9)**	(4.2)
Members' contributions	**(1.2)**	(1.2)	**–**	–
Benefits paid	**21.4**	19.4	**1.5**	1.4
At 31 March	**(690.1)**	(615.8)	**(48.1)**	(43.2)

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:

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Group					
Fair value of schemes' assets	**580.4**	517.2	454.2	402.4	276.4
Present value of defined benefit obligations	**(690.1)**	(615.8)	(540.0)	(510.3)	(342.4)
Net liability recognised	**(109.7)**	(98.6)	(85.8)	(107.9)	(66.0)
Experience gains/(losses) on schemes' assets					
Amount (£m)	**36.7**	(0.7)	5.3	65.7	(101.6)
Percentage of schemes' assets	**6.3%**	(0.1)%	1.2%	16.3%	(36.7)%
Experience gains/(losses) on defined benefit obligations					
Amount (£m)	**0.1**	(0.4)	0.8	2.3	34.8
Percentage of defined benefit obligations	**–**	(1.0)%	0.1%	0.4%	10.2%

The cumulative actuarial losses recognised in the Group statement of comprehensive income at 31 March 2013 were £172.6 million (2012 £157.5 million).

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Company					
Fair value of schemes' assets	**39.4**	35.4	30.7	37.3	29.6
Present value of defined benefit obligations	**(48.1)**	(43.2)	(37.5)	(49.0)	(36.9)
Net liability recognised	**(8.7)**	(7.8)	(6.8)	(11.7)	(7.3)
Experience gains/(losses) on schemes' assets					
Amount (£m)	**2.3**	0.2	(10.4)	6.3	(9.6)
Percentage of schemes' assets	**5.8%**	0.5%	(33.9)%	16.9%	(32.4)%
Experience (losses)/gains on defined benefit obligations					
Amount (£m)	**–**	(0.4)	14.0	0.4	1.6
Percentage of defined benefit obligations	**–**	(1.0)%	37.3%	0.8%	4.3%

The cumulative actuarial losses recognised in the Company statement of comprehensive income at 31 March 2013 were £12.7 million (2012 £11.1 million).

The last triennial actuarial valuation of the principal defined benefit scheme was at 31 March 2010. The Group paid no deficit recovery contributions to the main scheme during the year (2012 £35 million) since all payments up to 31 March 2015 under the existing schedule of contributions have been made. The Group monitors funding levels on an annual basis and expects to pay total contributions of around £14 million during the year ended 31 March 2014.

31. Deferred tax

Deferred tax is provided in full on temporary differences under the liability method using a tax rate of 23% (2012 24%).

Movements in deferred tax were:

	Group		Company	
	2013 £m	2012 (Restated note 40) £m	2013 £m	2012 £m
Liabilities/(assets) at 1 April	**277.3**	292.5	**(4.6)**	(4.2)
(Credited)/charged to the income statement	**(32.8)**	(2.8)	**2.6**	0.5
Credited to equity	**(1.5)**	(15.9)	**(0.3)**	(0.9)
Arising on acquisitions	**0.1**	3.5	**–**	–
Liabilities/(assets) at 31 March	**243.1**	277.3	**(2.3)**	(4.6)

Deferred tax assets have been recognised in respect of all temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

The majority of the Group's deferred tax liability is expected to be recovered over more than one year.

The majority of the Company's deferred tax asset is expected to be recovered over more than one year.

All deferred tax assets and liabilities within the same jurisdiction are offset.

The deferred tax balance has been reduced by a credit of £10.6 million to recognise the changes in the rate of corporation tax enacted on 17 July 2012 to reduce the rate from 1 April 2013 from 24% to 23%. This credit includes a credit of £12.7 million recognised in the income statement and a debit of £2.1 million recognised in the statement of comprehensive income. If the Government proposals contained in the Financial Bill 2013 to reduce the rate of corporation tax by a further 2% for the financial year 2014 and a further 1% for the financial year 2015 had been enacted at the balance sheet date, the impact would have been a further reduction of approximately £32 million.

Notes to the financial statements
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31. Deferred tax Continued

The movements in deferred tax assets and liabilities were:

Group

Deferred tax liabilities

	Accelerated tax depreciation			
	Owned assets £m	Leased assets £m	Other (Restated note 40) £m	Total (Restated note 40) £m
At 1 April 2011	305.6	16.4	20.4	342.4
Credited to the income statement	(11.7)	(0.6)	(2.9)	(15.2)
Arising on acquisitions	–	–	3.7	3.7
At 31 March 2012	293.9	15.8	21.2	330.9
(Credited)/charged to the income statement	(37.6)	–	2.0	(35.6)
Arising on acquisitions	0.1	–	–	0.1
At 31 March 2013	**256.4**	**15.8**	**23.2**	**295.4**

Deferred tax assets

	Provisions (Restated note 40) £m	Retirement benefit obligations £m	Other (Restated note 40) £m	Total (Restated note 40) £m
At 1 April 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)
Arising on acquisitions	(0.2)	–	–	(0.2)
At 31 March 2012	(8.1)	(23.6)	(21.9)	(53.6)
(Credited)/charged to the income statement	(0.6)	0.4	3.0	2.8
(Credited)/charged to equity	–	(2.0)	0.5	(1.5)
At 31 March 2013	**(8.7)**	**(25.2)**	**(18.4)**	**(52.3)**
Net liability:				
At 31 March 2012				277.3
At 31 March 2013				**243.1**

Company
Deferred tax assets

	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 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)
Charged to the income statement	0.1	2.5	2.6
Credited to equity	(0.3)	–	(0.3)
At 31 March 2013	**(2.0)**	**(0.3)**	**(2.3)**

Deferred tax credited/(charged) to equity during the year was:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Actuarial losses on defined benefit schemes	**2.0**	10.2	**–**	0.8
Cash flow hedges	**–**	5.8	**0.3**	0.1
Deferred tax on other comprehensive loss	**2.0**	16.0	**0.3**	0.9
Share-based payments (note 36)	**(0.5)**	(0.1)	**–**	–
	1.5	15.9	**0.3**	0.9

Notes to the financial statements
Continued

32. Provisions

	Environmental and landfill restoration (Restated note 40) £m	Other provisions £m	Total (Restated note 40) £m
Group			
At 1 April 2012	93.4	9.2	102.6
Charged to the income statement	4.5	5.9	10.4
Exceptional charges (note 6)	90.1	13.0	103.1
Landfill restoration (note 17)	8.4	–	8.4
Utilised	(12.2)	(1.0)	(13.2)
At 31 March 2013	**184.2**	**27.1**	**211.3**

The amount charged to the income statement includes £3.8 million (2012 £3.7 million) charged to finance costs as the unwinding of discounts in provisions.

The addition to landfill restoration provision of £8.4 million recognised in the year has been matched with an addition to property, plant and equipment (note 17).

The analysis of provisions between current and non-current is:

	2013 £m	2012 (Restated note 40) £m
Current	**40.6**	26.3
Non-current	**170.7**	76.3
	211.3	102.6

Environmental and landfill restoration provisions are incurred during the operational life of each landfill site and for a considerable period thereafter. The period of aftercare post-closure and the level of costs expected are uncertain and can vary significantly from site to site. Key factors are the type of waste, the speed at which it decomposes, the volume of leachate requiring treatment and regulatory requirements specific to the site. Environmental and landfill restoration provisions are expected to be substantially utilised throughout the operational life of a site and for landfill sites within 60 years of closure (2012 30 years). The provisions have been established assuming current waste management technology based upon estimated costs at future prices which have been discounted to present value.

Other provisions comprise principally of onerous contracts and restructuring provisions. Onerous contracts are provided for at the net present value of the operating losses of the onerous contracts and are to be utilised over the remaining period of the contract to which they relate. The restructuring provision relates principally to severance costs and will be utilised within one year.

33. Share capital

Allotted, called-up and fully paid

	Number of shares		
	Treasury shares	Ordinary shares	£m
Group and Company			
At 1 April 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 issued under the Scrip Dividend Alternative	–	2,542,187	1.0
Shares re-issued under the Company's Performance and Co-investment Plan	(493,217)	493,217	–
For consideration of £0.9 million, shares re-issued to the Pennon Employee Share Trust	(113,957)	113,957	–
For consideration of £0.4 million, shares re-issued under the Executive Share Option Scheme	(76,415)	76,415	–
For consideration of £3.3 million, shares re-issued under the Company's Sharesave Scheme	(843,280)	843,280	–
At 31 March 2013 Ordinary shares of 40.7p each	**2,105,836**	**364,657,522**	**149.2**

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	
			2013	2012
5 July 2005	270p	2008 – 2012	**–**	30
4 July 2006	358p	2009 – 2013	**38**	39
3 July 2007	522p	2010 – 2014	**11**	88
8 July 2008	517p	2011 – 2015	**75**	79
6 July 2009	386p	2012 – 2016	**406**	1,184
28 June 2010	431p	2013 – 2017	**563**	608
29 June 2011	536p	2014 – 2018	**502**	580
29 June 2012	588p	2015 – 2017	**746**	–
			2,341	2,608

Notes to the financial statements
Continued

33. Share capital Continued
i) Sharesave Scheme continued

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

	2013		2012	
	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	**2,608**	**437**	2,564	409
Granted	**779**	**588**	593	536
Forfeited	**(157)**	**494**	(123)	438
Exercised	**(843)**	**394**	(385)	405
Expired	**(46)**	**496**	(41)	439
At 31 March	**2,341**	**498**	2,608	437

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 731p (2012 656p). The options outstanding at 31 March 2013 had a weighted average exercise price of 498p (2012 437p) and a weighted average remaining contractual life of 2.1 years (2012 3.0 years).

The aggregate fair value of Sharesave options granted during the year was £0.8 million (2012 £0.9 million), determined using the Black-Scholes valuation model. The significant inputs into the valuation model at the date of issue of the options were:

	2013	2012
Weighted average share price	**735p**	670p
Weighted average exercise price	**588p**	536p
Expected volatility	**19.0%**	27.4%
Expected life	**3.4 years**	3.9 years
Risk-free rate	**0.4%**	1.4%
Expected dividend yield	**4.0%**	4.3%

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

ii) Performance and Co-investment Plan

Executive Directors and senior management receive a conditional award of Ordinary shares in the Company and are also required to hold a substantial personal shareholding in the Company. The eventual number of shares, if any, which vest is dependent upon the achievement of conditions of the plan over the restricted period, being not less than three years.

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

	2013		2012	
	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	**1,407**	**573**	1,559	550
Granted	**424**	**768**	454	698
Vested	**(493)**	**486**	(247)	637
Lapsed	**(16)**	**486**	(359)	586
At 31 March	**1,322**	**669**	1,407	573

The awards outstanding at 31 March 2013 had a weighted exercise price of 669p (2012 573p) and a weighted average remaining contractual life of 1.2 years (2012 1.3 years).

The aggregate fair value of awards granted during the year was £1.9 million (2012 £2.0 million) determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2013	2012
Weighted average share price	**768p**	698p
Expected volatility	**19.0%**	27.4%
Risk-free rate	**0.4%**	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:

	2013		2012	
	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	**427**	**602**	459	557
Granted	**120**	**754**	175	725
Vested	**(93)**	**473**	(202)	608
Lapsed	**(25)**	**473**	(5)	522
At 31 March	**429**	**680**	427	602

The awards outstanding at 31 March 2013 had a weighted average exercise price of 680p (2012 602p) and a weighted average remaining contractual life of 1.3 years (2012 1.5 years). The Company's share price at the date of the awards ranged from 572p to 754p.

The aggregate fair value of awards granted during the year was £0.9 million (2012 £1.2 million), determined from market value. No option pricing methodology is applied since dividends paid on the shares are receivable by the participants in the scheme.

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

34. Share premium account

	£m
Group and Company	
At 1 April 2011	9.2
Adjustment for shares issued under the Scrip Dividend Alternative	(1.2)
At 31 March 2012	8.0
Adjustment for shares issued under the Scrip Dividend Alternative	(1.0)
At 31 March 2013	**7.0**

Notes to the financial statements
Continued

35. Capital redemption reserve

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

	£m
Group and Company	
At 1 April 2011	144.2
At 31 March 2012	144.2
At 31 March 2013	**144.2**

36. Retained earnings and other reserves

	Own shares £m	Hedging reserve £m	Retained earnings £m	Total £m
Group				
At 1 April 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
Profit for the year	–	–	26.9	26.9
Other comprehensive loss for the year	–	(3.9)	(10.4)	(14.3)
Transfer from hedging reserve to income statement	–	2.9	–	2.9
Transfer from hedging reserve to property, plant and equipment	–	3.0	–	3.0
Dividends paid relating to 2012	–	–	(96.0)	(96.0)
Adjustment for shares issued under the Scrip Dividend Alternative	–	–	18.1	18.1
Credit to equity in respect of share-based payments	–	–	3.6	3.6
Deferred tax in respect of share-based payments	–	–	(0.5)	(0.5)
Charge in respect of share options vesting	0.4	–	(0.4)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(0.9)	–	–	(0.9)
Proceeds from treasury shares re-issued	–	–	4.6	4.6
At 31 March 2013	**(2.3)**	**(29.7)**	**501.1**	**469.1**

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 457,000 Ordinary shares (2012 433,000 Ordinary shares) held by the trust at 31 March 2013 was £2.8 million (2012 £3.1 million).

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 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
Profit for the year	–	185.7	185.7
Other comprehensive loss for the year	0.3	(1.4)	(1.1)
Dividends paid relating to 2012	–	(96.0)	(96.0)
Adjustment for shares issued under the Scrip Dividend Alternative	–	18.1	18.1
Credit to equity in respect of share-based payments	–	0.8	0.8
Proceeds from treasury shares re-issued	–	4.6	4.6
At 31 March 2013	**–**	**684.2**	**684.2**

37. Perpetual capital securities

	£m
Group and Company	
At 1 April 2011	–
At 31 March 2012	–
Issue of £300m 6.75% perpetual subordinated capital securities	294.8
At 31 March 2013	**294.8**

On 8 March 2013 the Company issued £300m perpetual capital securities. They have no fixed redemption date but the Company may, at its sole discretion, redeem all, but not part, of these securities at their principal amount on 8 March 2018 or any subsequent periodic return payment date after this.

The Company has the option to defer periodic returns on any relevant payment date, as long as a dividend on the Ordinary Shares has not been paid or declared in the previous 12 months. Deferred periodic returns shall be satisfied only on redemption or payment of dividend on Ordinary Shares, all of which only occur at the sole discretion of the Company.

Costs directly associated with the issue of £5.2 million are set off against the value of the issuance.

Notes to the financial statements
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38. Analysis of cash flows given in the statement of cash flows

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

Cash generated from operations

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Continuing operations				
Profit for the year	**26.9**	172.4	**185.7**	116.3
Adjustments for:				
Share-based payments	**3.6**	3.6	**0.8**	0.8
Profit on disposal of property, plant and equipment	**(1.8)**	(2.8)	**–**	–
Depreciation charge	**145.5**	145.6	**0.1**	0.1
Amortisation of intangible assets	**3.7**	1.4	**–**	–
Exceptional impairment of property, plant and equipment	**69.8**	–	**–**	–
Exceptional provision charge	**111.5**	–	**–**	–
Other non cash exceptional charge	**7.6**	–	**–**	–
Share of post-tax profit from joint ventures	**(5.8)**	(4.0)	**–**	–
Finance income	**(143.0)**	(119.3)	**(103.3)**	(59.7)
Finance costs	**184.4**	191.6	**94.0**	60.6
Dividends receivable	**–**	–	**(177.6)**	(117.5)
Taxation (credit)/charge	**(5.1)**	28.1	**1.1**	2.1
Changes in working capital (excluding the effect of acquisition of subsidiaries):				
Increase in inventories	**(1.5)**	(1.7)	**–**	–
(Increase)/decrease in trade and other receivables	**(27.7)**	(9.4)	**(195.1)**	25.0
Increase in service concession arrangements receivable	**(31.3)**	(17.9)	**–**	–
Increase/(decrease) in trade and other payables	**11.8**	(13.2)	**(10.3)**	(5.7)
Decrease in retirement benefit obligations from contributions	**(0.3)**	(35.3)	**(0.6)**	(3.1)
Decrease in provisions	**(7.2)**	(14.4)	**–**	–
Cash generated/(outflow) from operations	**341.1**	324.7	**(205.2)**	18.9

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

Total interest paid

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Interest paid in operating activities	**75.8**	74.5	**23.4**	22.7
Interest paid in investing activities (purchase of property, plant and equipment)	**13.6**	3.0	**–**	–
Total interest paid	**89.4**	77.5	**23.4**	22.7

39. Net borrowings

	Group		Company	
	2013 **£m**	2012 £m	**2013** **£m**	2012 £m
Cash and cash deposits	**634.5**	425.3	**398.9**	158.9
Borrowings – current				
Bank overdrafts	**(0.4)**	(10.5)	**–**	–
Other current borrowings	**(97.0)**	(274.3)	**(75.9)**	(253.2)
Finance lease obligations	**(41.2)**	(40.7)	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**(281.2)**	(281.2)
Total current borrowings	**(138.6)**	(325.5)	**(357.1)**	(534.4)
Borrowings – non-current				
Bank and other loans	**(1,072.5)**	(729.4)	**(692.7)**	(356.8)
Other non-current borrowings	**(210.4)**	(231.5)	**–**	–
Finance lease obligations	**(1,221.7)**	(1,243.5)	**–**	–
Total non-current borrowings	**(2,504.6)**	(2,204.4)	**(692.7)**	(356.8)
Total net borrowings	**(2,008.7)**	(2,104.6)	**(650.9)**	(732.3)

Notes to the financial statements
Continued

40. Acquisitions

On 5 July 2012 the entire issued share capital of JWT Holdings Limited (renamed Viridor Waste (Atherton) Holdings Limited) was acquired by Viridor Waste Management Limited for a cash consideration of £6.6 million. The acquisition has been accounted for using the acquisition method. Provisional goodwill arising of £4.8 million has been capitalised.

On 8 October 2012 Viridor Waste Management Limited acquired the entire issued share capital of Pulp Friction Limited (renamed Viridor (Erith) Limited) and the trade and assets of SBS Paper LLP, a related business, for a cash consideration of £8.5 million. The acquisition has been accounted for using the acquisition method. Provisional goodwill arising of £7.7 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.

Fair values on acquisition	JWT Holdings £m	Pulp Friction £m	SBS Paper LLP £m	Total £m
Property, plant and equipment	2.4	1.0	0.4	3.8
Receivables	2.1	1.2	–	3.3
Cash and cash deposits	0.1	0.2	–	0.3
Payables	(1.1)	(1.6)	–	(2.7)
Taxation – current	(0.5)	–	–	(0.5)
Taxation – deferred	(0.1)	–	–	(0.1)
Leases	(1.1)	(0.4)	–	(1.5)
Net assets acquired	1.8	0.4	0.4	2.6
Goodwill	4.8	3.9	3.8	12.5
Total consideration	6.6	4.3	4.2	15.1
Satisfied by:				
Cash	6.6	4.3	4.2	15.1
Cash and cash deposits acquired	(0.1)	(0.2)	–	(0.3)
Net cash outflow arising on acquisition	6.5	4.1	4.2	14.8
Revenue for the period since acquisition to 31 March 2013	2.5	5.2	–	7.7
Loss before tax for the period since acquisition to 31 March 2013	(1.0)	(0.4)	–	(1.4)
Directly attributable costs included in other operating expenses	0.2	0.4	0.1	0.7

If all the acquisitions had occurred on 1 April 2012 Group revenues for the year would have been £1,207.7 million and profit before tax and exceptional items for the year would have been £197.4 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 2012 the accounting for the following acquisitions was provisional:
- JWS Churngold Limited (renamed Viridor (Lancashire) Limited)
- Veolia's trade waste collection interests in Cornwall and North Devon
- Community Waste Holding Limited (renamed Viridor (Community Recycling MKH) Limited)

Completion of the accounting for the acquisitions has resulted in a decrease to goodwill of £0.6 million, an increase to other intangible assets of £4.5 million, an increase in property, plant and equipment of £0.8 million, an increase in trade and other receivables of £0.1 million, an increase in current tax payable of £0.6 million, an increase in deferred tax of £3.5 million and an increase of £0.7 million in provisions.

41. Principal subsidiary, joint venture and associate undertakings at 31 March 2013

	Country of incorporation, registration and principal operations
Water and sewerage	
South West Water Limited[1]	England
South West Water Finance Plc	England
Source Contact Management Limited	England
Source Collections Limited	England
Waste management	
Viridor Limited[1]	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
Viridor Resource Management Limited	England
Viridor Waste Kent Limited	England
Viridor Oxfordshire Limited	England
Viridor EfW (Runcorn) Limited	England
Viridor Waste (Landfill Restoration) Limited	England
Viridor Waste (Atherton) Holdings Limited	England
Viridor Waste (Atherton) Limited	England
Viridor Waste (Somerset) Limited	England
Viridor (Erith) Limited	England
Viridor Waste (Thames) Limited	England
Viridor Waste (Greater Manchester) Limited	England
Viridor Parkwood Holdings Limited[2]	British Virgin Islands
Viridor Polymer Recycling Limited	England
Viridor Trident Park Limited	England
Viridor (Glasgow) Limited	Scotland
Viridor (Lancashire) Limited	England
Other	
Peninsula Insurance Limited[1,3]	Guernsey

[1] Indicates the shares are held directly by Pennon Group Plc, the Company
[2] The company carries out its operations in England and is resident in the UK for tax purposes
[3] Captive insurance company established with the specific objective of financing risks emanating from within the Group

The subsidiary undertakings are wholly-owned and all shares in issue are Ordinary shares. All companies above are consolidated in the Group financial statements.

Notes to the financial statements
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41. Principal subsidiary, joint venture and associate undertakings at 31 March 2013 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
Joint ventures			
Lakeside Energy from Waste Holdings Limited	1,000,000 A Ordinary shares	–	
	1,000,000 B Ordinary shares	100%	
Lakeside Energy from Waste Limited			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.			
Associates			
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.			
The Group's economic interest in INEOS Runcorn (TPS) Holdings Limited is 37.5%, as returns from the investment are based on holdings of B1 and B2 Ordinary shares.			

42. Operating lease commitments

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
The future aggregate minimum lease payments under non-cancellable operating leases are:				
Within 1 year	**9.4**	8.8	**–**	–
Over 1 year and less than 5 years	**28.3**	26.1	**–**	–
Over 5 years	**77.8**	75.5	**–**	–
	115.5	110.4	**–**	–

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.

43. Contingent liabilities

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	**–**	–	**297.1**	359.9
Performance bonds	**116.2**	117.4	**116.2**	117.4
Other	**6.9**	6.9	**6.9**	6.9
	123.1	124.3	**420.2**	484.2

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.

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.

In connection with the application of the audit exemption under Section 479C of the Companies Act 2006 the Company has guaranteed all the outstanding liabilities as at 31 March 2013 of certain of its subsidiaries: Pennon Power Limited, Exe Continental and Viridor Waste 2 Limited since these companies qualify for the exemption.

44. Capital commitments

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Contracted but not provided	**391.2**	545.8	**–**	–

45. Related party transactions

During the year Group companies entered into the following transactions with joint ventures and associate related parties which are not members of the Group:

	2013 £m	2012 £m
Sales of goods and services		
Viridor Laing (Greater Manchester) Limited	**83.0**	80.4
Purchase of goods and services		
Lakeside Energy from Waste Limited	**10.9**	10.7
Dividends received		
Lakeside Energy from Waste Holdings Limited	**8.5**	–

Notes to the financial statements
Continued

45. Related party transactions Continued

Year-end balances

	2013 £m	2012 £m
Receivables due from related parties		
Viridor Laing (Greater Manchester) Holdings Limited (loan balance)	**45.4**	40.3
Lakeside Energy from Waste Holdings Limited (loan balance)	**9.7**	10.0
INEOS Runcorn (TPS) Holdings Limited (loan balance)	**25.0**	22.3
	80.1	72.6
Viridor Laing (Greater Manchester) Limited (trading balance)	**9.6**	7.6
Lakeside Energy from Waste Limited (trading balance)	**1.2**	1.0
	10.8	8.6
Payables due to related parties		
Viridor Laing (Greater Manchester) Limited (trading balance)	**–**	7.0
Lakeside Energy for Waste Limited (trading balance)	**0.2**	–

The £80.1 million (2012 £72.6 million) receivable relates to loans to related parties included within receivables and due for repayment in instalments between 2013 and 2033. Interest is charged at an average of 13.0% (2012 14.0%).

Company
The following transactions with subsidiary undertakings occurred in the year:

	2013 £m	2012 £m
Sales of goods and services (management fees)	**9.3**	8.4
Purchase of goods and services (support services)	**0.5**	0.5
Interest receivable	**25.2**	19.6
Dividends received	**177.6**	117.5

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

Year-end balances

	2013 £m	2012 £m
Receivables due from subsidiary undertakings		
Loans	**628.2**	439.8
Trading balances	**8.8**	1.9

Interest on £128.7 million of the loans has been charged at a fixed rate of 4.5% and on £199.4 million at a fixed rate of 6.0% (2012 £204.3 million, 4.5% and £29.6 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 2014 to 2018. During the year there were no provisions (2012 nil) in respect of loans to subsidiaries not expected to be repaid.

	2013 £m	2012 £m
Payables due to subsidiary undertakings		
Loans	**281.2**	281.2
Trading balances	**14.4**	14.4

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

Five-year financial summary

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Income statement					
Revenue	**1,201.1**	1,233.1	1,159.2	1,068.9	958.2
Operating profit before exceptional items	**246.3**	268.8	260.9	266.3	250.8
Net finance costs before exceptional items	**(53.9)**	(72.3)	(76.7)	(81.6)	(92.2)
Share of profit in joint ventures	**5.8**	4.0	4.3	1.1	0.8
Profit before tax and exceptional items	**198.2**	200.5	188.5	185.8	159.4
Net exceptional items before tax	**(176.4)**	–	–	–	–
Taxation credit/(charge)	**5.1**	(28.1)	(16.9)	(44.3)	(69.6)
Profit for the year	**26.9**	172.4	171.6	141.5	89.8
Dividends proposed	**103.8**	96.0	88.2	79.6	73.4
Earnings per share (basic):					
From continuing operations					
Earnings per share	**7.4p**	48.1p	48.4p	40.4p	25.8p
Deferred tax before exceptional items	**(3.4)p**	(0.8)p	(6.1)p	0.4p	11.1p
Exceptional items (net of tax)	**38.6p**	–	–	–	–
Earnings per share before exceptional items and deferred tax	**42.6p**	47.3p	42.3p	40.8p	36.9p
Declared dividends per share	**28.46p**	26.52p	24.65p	22.55p	21.00p

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Capital expenditure					
Acquisitions	**14.8**	29.2	25.1	9.3	3.4
Property, plant and equipment	**410.1**	257.4	199.0	192.2	231.8
Balance sheet					
Non-current assets	**3,845.5**	3,592.5	3,347.6	3,189.4	3,036.3
Net current assets	**379.3**	11.8	335.7	162.1	40.5
Non-current liabilities	**(3,160.5)**	(2,782.2)	(2,903.8)	(2,688.6)	(2,476.2)
Net assets	**1,064.3**	822.1	779.5	662.9	600.6
Number of employees (average for year)					
Water and sewerage business	**1,354**	1,335	1,196	1,191	1,227
Waste management	**3,180**	3,148	3,012	2,853	2,154
Other businesses	**50**	46	44	43	41
	4,584	4,529	4,252	4,087	3,422

Shareholder information

Financial Calendar

Financial year-end	31 March
Twenty-fourth Annual General Meeting	1 August 2013
Ex-dividend date for 2013 Final dividend	7 August 2013*
Record date for 2013 Final dividend	9 August 2013*
2013 Final dividend payable	4 October 2013*
2013/14 Half yearly financial report announcement	November 2013
2014 Interim dividend payable	April 2014
2014 Preliminary results announcement	May 2014
Twenty-fifth Annual General Meeting	July 2014
2014 Final dividend payable	October 2014

Scrip Dividend Alternative timetable*

Ordinary shares quoted ex-dividend	7 August 2013
Record date for final dividend	9 August 2013
Posting of Scrip dividend offer	23 August 2013
Final date for receipt of Forms of Election/Mandate	16 September 2013
Posting of dividend cheques and share certificates	3 October 2013
Final dividend payment date	4 October 2013
First day of dealing in the new Ordinary shares	4 October 2013

*These dates are subject to obtaining shareholder approval at the 2013 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2013.

Shareholder Analysis at 31 March 2013

Range of shares held	Number of shareholders	% of total shareholders	% of Ordinary shares
1 - 100	2,465	10.66	0.02
101 - 1,000	9,596	41.51	1.40
1,001 - 5,000	9,472	40.97	5.54
5,001 - 50,000	1,257	5.44	3.94
50,001 - 100,000	74	0.32	1.50
100,001 - Highest	254	1.10	87.60
	23,118	**100.00**	**100.00**
Individuals	19,380	83.83	8.09
Companies	209	0.91	2.43
Trust companies (pension funds etc)	12	0.05	0.02
Banks and nominees	3,517	15.21	89.46
	23,118	**100.00**	**100.00**

Major Shareholdings

The position on 31 March 2013 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 was as follows:

Ameriprise Financial Inc	9.68%
Pictet Asset Management SA	7.02%
AXA Investment Managers SA	4.96%
Invesco Ltd	4.72%
Legal & General Group Plc	3.69%
Norges Bank	3.06%

No changes to the above interests in the issued share capital of the Company were disclosed to the Company between 31 March 2013 and 25 June 2013 (being a date not more than one month prior to the date of the Company's Notice of Annual General Meeting) except for the following:

i) on 17 May 2013 Norges Bank notified the Company that on 16 May 2013 its interests in the issued share capital of the Company had fallen below the 3% threshold;

ii) on 22 May 2013 RARE Infrastructure Limited notified the Company that as at 2 May 2013 it held 18,325,407 Ordinary shares in the Company representing 5.06% of the issued share capital of the Company at that date.

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 2013 Annual General Meeting to the payment of a final dividend for the year ended 31 March 2013, full details of the Scrip Dividend Alternative, including how to join, will be sent out to shareholders on 23 August 2013. The full timetable for offering the Scrip Dividend Alternative is given on page 144.

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 www.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 www.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 email 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 www.capitashareportal.com. Shareholders who register an email preference will not receive a paper proxy form. Instead they will receive an email alert advising them of general meetings of the Company, with links to the Notices of Meetings and annual and half yearly financial reports.

The Pennon website
Pennon's website www.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 RNS 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 www.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 www.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 www.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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www.pennon-group.co.uk

To view our online annual report:
www.pennonannualreport.co.uk/2013

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