

Bringing resources to life



Founded in 1989, Pennon has been driven by its strategic vision to become a leader in UK infrastructure, delivering for the benefit of customers, communities and the environment.

2019/20 has been a landmark year for Pennon, culminating in the announcement in March 2020 of the proposed sale of Viridor. The transaction recognises the strategic value that has been created over many years. Going forward, Pennon will continue to pursue operational excellence and growth within the UK water industry.

The COVID-19 pandemic is an unprecedented challenge for all. Throughout the Pennon Group with key worker status the majority of our operations have continued and we have successfully focused on supporting our customers and employees through these difficult and uncertain times.

 Find out more on pages 2 and 34

Integrated reporting

Our business touches the lives of many stakeholders, from customers, employees, investors and suppliers, to our communities and regulators.

Reflecting the integrated nature of our business, we have integrated our reporting on financial, economic, social and environmental aspects of our performance and how they contribute to long-term value creation. In preparing the integrated report, we have referred to the principles of the International Integrated Reporting Council's <IR> Framework.

Find out more about Pennon

Corporate website

www.pennon-group.co.uk

Annual report

www.pennon-group.co.uk/annualreport2020

Our vision:

Bringing resources to life

Our values



Trusted

We do the right thing for our customers and stakeholders



Responsible

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



Collaborative

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



Progressive

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

Strategic priorities



Leadership in UK infrastructure



Cost base efficiency



Sustainable growth

Our businesses (2019/20)

During 2019/20 Pennon provided services in waste management, water and wastewater, and water retail services through three businesses: Viridor, South West Water and Pennon Water Services.

Water and wastewater



Find out more starting on page 42

Water retail services



Find out more on page 48

Waste management



Find out more on page 49



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COVID-19: staying resilient during a global pandemic

In 2020 the impact of the coronavirus pandemic was felt across the world.

At Pennon Group, our people – many of whom are designated key workers – have been working hard to ensure services to customers and communities are maintained despite the challenging circumstances. Their health, safety and wellbeing remains our top priority.

South West Water

In order to continue to provide the level of service customers expect while ensuring their safety and that of employees, South West Water enacted its contingency planning. In line with Government guidance, and in coordination with regulators, industry and supply chain colleagues, this included the implementation of new working processes for frontline staff, additional safety precautions on sites, remote working support, regular engagement with the region's local resilience forum, and a range of employee relations measures to support employees.

Viridor

Similarly, at Viridor, additional measures were implemented to prioritise the health and welfare of employees and customers and reduce the risk of any exposure to the virus. While household waste recycling sites were temporarily closed, the committed and hard-working teams from Scotland to Cornwall have continued to collect and process waste and materials from households and businesses, including the NHS.

Across the Group, from frontline workers to back office functions, we recognise and thank our people for their ongoing efforts during COVID-19.





Pennon is focused on the responsible and sustainable provision of essential utility services and environmental infrastructure.

Innovation, new technologies and a holistic approach underpin our commitment to delivering service improvement and long-term value.



Strategic report

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Note on the 2019/20 strategic report:

The following strategic report is focused on performance reporting for the 2019/20 financial year, which includes the activities of Viridor. Sections and statements relating to the future are focused solely on the water side of the business – South West Water (including Bournemouth Water) and Pennon Water Services.

Our continuing business activities

We aim to provide an outstanding level of service to the customers and communities we serve, while protecting the environment and creating value for our shareholders.

Water and wastewater

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

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

 Find out more starting on page 42

Water retail services

Pennon Water Services are business water specialists providing water retail services for business customers' water management needs.

 Find out more on page 48



Water treatment works

Treating water to high standards to ensure it is clean, safe and reliable.



Raw water reservoirs/water resources

Ensuring an available and sufficient supply of raw water collected from rivers, reservoirs and a small number of boreholes.



Upstream catchment

Managing water in the landscape alongside landowners and partner agencies.

Waste management (discontinued operations)

Throughout 2019/20 Viridor remained at the forefront of the resource sector in the UK, transforming waste into energy, high-quality recyclates and raw materials. The sale of Viridor is anticipated to complete in early summer 2020.

 Find out more starting on page 49

Agreed sale of Viridor for

£4.2bn

(net proceeds of c.£3.7bn)

Enterprise value of £4.2 billion equates to 18.5 times EBITDA multiple (based on Viridor's 2018/19 adjusted EBITDA of £225.4 million).





Surface water management

Managing surface water drainage and reducing the risk of flooding.



Drinking water mains network

Managing an extensive network to deliver an uninterrupted supply of drinking water to households and businesses.



UK-based call centre

For household and business customers (South West Water and Pennon Water Services).



Customer support

Ensuring high-quality services are maintained and responding quickly to any issues.



Wastewater mains network

A resilient and reliable network of sewers to take wastewater from properties to our treatment works.



Improved bathing and shellfish water quality

Supporting local communities and businesses.



Wastewater treatment works

Ensuring treated wastewater is returned to the environment safely.



Bio-resources

Making the most of resources – turning sludge by-products into high-quality bio-resources.

Highlights of the year

Continuing Group + Viridor

Robust finance

Continuing Group + Viridor

Revenue

£1,390m

2018/19: £1,478m (-6.0%)

EBITDA underlying

£563m

2018/19: £546m (+3.1%)

Profit before tax underlying

£288m

2018/19: £280m (+2.6%)

Profit before tax including non-underlying items

£302m

2018/19: £260m (+15.8%)

EPS underlying⁽¹⁾

61.7p

2018/19: 57.8p (+6.7%)

Effective interest rate[^]

3.5%

2018/19: 3.6% (-1pts)

Dividend

43.77p

2018/19: 41.06p (+6.6%)

EPS statutory – continuing operations[^]

27.7p

2018/19: 38.2p (-27.5%)

EPS statutory – continuing and discontinued operations

47.7p

2018/19: 51.1p (-6.7%)

Capital investment[^]

£339m

2018/19: £396m (-14.3%)

Continuing Group

Revenue – continuing operations

£637m

2018/19 restated: £633m (+0.6%)

EBITDA underlying – continuing operations

£365m

2018/19: £367m (-0.5%)

Profit before tax underlying – continuing operations

£183m

2018/19: £192m (-4.5%)

Profit before tax statutory – continuing operations

£193m

2018/19: £201m (-4.1%)

EPS underlying – continuing operations⁽¹⁾

35.2p

2018/19: 36.7p (-4.1%)

Highlights of the year

Solid performance in 2019/20

in line with management expectations

Expected revenue reduction reflecting

- transition of Viridor's Greater Manchester contract
- water business weather-driven demand reduction

Efficient financing

3.5%
average interest rate

Good cost control


momentum in efficiency
3.6%
overall cost reduction in South West Water



Strong operating cash flow performance supporting continued capital investment, accelerated pensions and responsible tax contributions

Dividend per share up +6.6% to 43.77p

Cumulative return on regulated equity (RoRE) over K6 (2015-20) at 11.8%

 See page 45 for further information

Alternative performance measures (APMs)

Measures with this symbol [^] are defined in the alternative performance measures section of the annual report on pages 191 to 194.

(1) Underlying earnings are presented alongside statutory results as the Directors believe they provide a more useful comparison on business trends and performance. Note 6 to the financial statements provides more detail on non-underlying items.

Sustainable operations

Continuing Group + Viridor

Total low-carbon energy generation⁽²⁾

1,816GWh

2018/19: 1,617GWh (+12.3%)

Lost time injury frequency rate (LTIFR)⁽³⁾

0.90

2018/19: 1.37 (down 34%)

Continuing Group operations

Drinking water quality
Bournemouth Water

99.99%

2018: 100.00% (-0.01pts)

Bathing water compliance
(‘sufficient quality’ or higher)

98.7%

2018: 98.7% (unchanged)

Drinking water quality
South West Water

99.98%

2018: 99.99% (-0.01pts)

Leakage (megalitres per day)
South West Water

84

2018: 84 (unchanged)

Viridor operations

Total waste material inputs (tonnes)

6.7m

2018/19: 6.8m (-0.1m)

Average ERF availability⁽⁴⁾

90%

2018/19: 91% (-1 pt)

Waste recycled and recovered (tonnes)

5.5m

2018: 4.9m (+0.6m)



Avonmouth ERF in commissioning

LTIFR reduced by **34% to 0.9**

Created 191 new graduate and apprenticeship development opportunities across the Group




Commitment to recycling resulting in **£65 million** PRF and refurbished MRF supported by 10-year local authority contract

New Deal business plan for K7 (2020-25)
South West Water well positioned for new K7 regulatory period



WaterShare delivering **c.£140 million** of outperformance for sharing with customers

 See pages 35 and 69 for further information

- (2) Gigawatt hours, being an amount of energy equivalent to delivering 1 billion watts of power for a period of one hour.
- (3) LTIFR for employees and agency staff per 200,000 hours worked.
- (4) Weighted by capacity. Includes joint ventures at 100%, excludes Glasgow Recycling and Renewable Energy Centre (GRREC) due to different technology.

Chairman's statement



I would like to thank our people for their incredible hard work and dedication to providing our vital services. They have continued to deliver for our customers and communities day in and day out in the most challenging circumstances. Thank you.



Sir John Parker
Chairman

This has been a significant year in the history of the Pennon Group, and it has been a particularly busy one for the Board. In 2019/20, we delivered strong financial performance and operational progress as we approached the commencement of the new K7 (2020-25) regulatory period for South West Water.

This performance has continued in the face of the COVID-19 crisis, throughout which the Group has proved resilient despite the range of operational and other challenges it has presented. On this point, I want to acknowledge our employees for their resilience and commitment throughout the year. In extraordinary times you need extraordinary people and it gives me huge pride when I think about our people across the Group, and in our supply chain, who have continued to deliver for customers and communities.

I also want to thank all those employees who have supported our frontline teams to be able to continue delivering, learning to work collaboratively together in new and different ways.

Viridor strategic value realised, well positioned for future growth in water

Over recent years, the Board has closely monitored the market value of the Group and its component parts. It has been clear for some time that the fundamental value of Viridor was not adequately reflected in Pennon's share price. Against this background, the Board concluded that it was an appropriate time to commence a strategic review of the Group. This was announced in September 2019, which ultimately led to a series of inbound approaches to acquire the Viridor business.

Pennon announced on 18 March 2020 the proposed sale of Viridor to KKR for an enterprise value of £4.2 billion. The Board carefully considered the wider implications of the deal and the impact on all key stakeholders and agreed unanimously that the transaction was in the best interests of shareholders and employees across the Group.

The share price rose 42% from the announcement of the strategic review to the announcement of the sale and Pennon was promoted to the FTSE 100. The transaction recognises the full strategic value that Pennon has developed and nurtured in Viridor over many years and accelerates the realisation of that value for shareholders. The European Commission has given merger clearance and Pennon's shareholders have given their approval. The sale is expected to complete in early summer. The Board intends to use the £3.7 billion of net cash proceeds to reduce Pennon's company borrowings and pension deficit, make a return to shareholders, and retain some funds for future opportunities.

We are extremely proud to have grown Viridor into a key industry player with strong credentials as a leader in engineering excellence, pioneering new technologies, and as a vocal champion in tackling environmental challenges particularly around the use of plastics. Our shared heritage – between the water and waste subsidiaries – has given the Group a unique mix of strategic insight and operational expertise while shaping our holistic approach to the management of natural resources. This gives us a valuable knowledge base with which to enter a new period in the Group's history.

Leakage Technician
Mel Ryan checking for
rural leaks during the
lockdown period in April



Thank you to our people

In these extraordinary times, I would like to thank all our employees across the Group for their incredible hard work and dedication.

The Group has been tested in ways we would never have previously imagined but it gives me great pride that we have been able to adapt so successfully to the many challenges. This would not have been possible without the tremendous efforts of all our people, many of whom are classified by Government as key workers in our society. I thank them all for maintaining and delivering high-quality services during this difficult period and I wish our Viridor employees a fond farewell and good fortune under their new ownership.

Robust performance

This has been an important year for Viridor operationally, as the most recent ERFs at Glasgow, Beddington and Dunbar move through their ramp-up phases. The construction at Avonmouth ERF is progressing and commissioning is underway. Recycling is on a growth trajectory with the new plastics processing facility at Avonmouth under construction. Viridor will continue to serve its customers and communities delivering vital public services under new ownership.

South West Water finished the K6 (2015-20) regulatory period with a sector-leading return on regulated equity and the successful conclusion of the 2019 price review process (PR19). As a result, South West Water began the K7 regulatory period as the only company to have achieved fast-track status for its business plan in two consecutive five-year price reviews.

This recognition from Ofwat, our water industry regulator, was a welcome endorsement of the efforts put in by the South West Water leadership team over these plan periods. The board and management of South West Water made a great effort to introduce an even higher level of technology and innovation into the business plan and we look forward to seeing the benefits this will deliver for customers, enabling us to reduce bills at a faster rate than peers.

Health & safety is at the heart of the Group

The Group has an ambitious road map for health & safety, focused largely on our HomeSafe programme. This has yielded a range of encouraging and improving trends.

Yet, despite our efforts, we sadly lost two colleagues during the year as a result of tragic accidents in Viridor operations: Mick at the Earls Barton, Northamptonshire facility and Mark at a customer's premises in Bovey Tracey, Devon. Our thoughts are with their families, friends and colleagues as we continue to work with the Health and Safety Executive in relation to these sad events.

Our HomeSafe initiative is designed to deliver the highest standards of health & safety performance and enjoys high visibility and support across our operations. However, we have taken further steps to place even greater emphasis on this including further training, system upgrades and root cause analysis. The longer-term HomeSafe strategy has ambitious targets, which we are determined to achieve and is subject to independent review, which will help us achieve our goal to be the health & safety leader in the UK water and waste industries within this new K7 regulatory period.

Sustainability is our strategy

Last year the Board endorsed a new long-term sustainability strategy with clear objectives and three-year targets across nine sustainability focus areas. Over the course of this year, we have made good progress towards these targets through implementing our detailed Group-wide action plans. We continue to invest and focus management efforts on further improvements to environmental performance at South West Water.

In 2019/20, we further reduced the number of serious and significant pollution incidents down to one Category 2 event, building on our 2018/19 performance which was the best in the 2015-20 regulatory period. We expect our substantial investments and measures to ensure further reductions across all wastewater pollution categories to meet our ambitious targets.

Our water resources position recovered from the previous dry year and we have met our leakage target every year since targets were introduced over two decades ago.

Transparent and engaged

Last year we welcomed the changes to the UK Corporate Governance Code requiring companies to better understand the views of key stakeholders and report how their interests have been considered and taken into account. In addition, the Board is now required to report, through the section 172 statement, on the broad range of factors we consider as part of discharging our duty to promote Pennon's success for the benefit of our shareholders as a whole. Our section 172 statement can be found on page 121. This move to increase transparency fully aligns with our values and we continue to develop strong relationships with our full range of stakeholders.

We constantly engage with our people and seek their views. Our employees are key to our successes and achievements and provide vital services to our customers and communities. We have increased the frequency of our Big Chat over the year, providing employees the opportunity to hear from and ask questions of Directors, we have enhanced our Employee Voice and Engagement Forums and seen further improvements in our Group-wide employee survey results.

Chairman's statement

continued



Using technology & innovation to enhance customer service

In July 2019 we were pleased to receive confirmation that Research England would be providing £10 million support for the Centre for Resilience in Environment, Water and Waste (CREWW) – a joint venture between ourselves and the University of Exeter.

With up to £20 million funding from South West Water, CREWW will conduct world-leading research into the provision of safe and resilient water services in the UK and overseas. Central to its focus will be how to manage our natural resources to ensure there is sufficient water to cope with population growth, the pressures of climate change, and improving resilience to the potentially devastating effects of flood, drought and emerging pollutants. CREWW will accommodate state-of-the-art, specialist laboratory facilities, and designated space to encourage collaborative research between academics and experts from the water industry and will draw on Exeter's world-leading expertise across a wide range of disciplines to develop innovative new solutions that benefit the environment, global societies and the economy.

Sustainability focus area



See sustainability strategy on page 20

“

With up to £20 million funding from South West Water, CREWW will conduct world-leading research into the provision of safe and resilient water services in the UK and overseas.

”

Sir John Parker
Chairman

We work hard to build strong relationships with our customers and to deliver excellent services. The 2020-25 business plan is all about empowering customers and offering a New Deal. A striking feature of this New Deal is an innovation called WaterShare+, which builds on our established WaterShare financial mechanism for sharing outperformance with our customers. Through WaterShare+, we will go even further, offering eligible South West Water customers a shareholding in Pennon Group in 2020, along with a greater say in how South West Water is run through a separate customer annual general meeting. The Board wholeheartedly supports this bold and imaginative initiative.

Promoting diversity

The Board promotes equality and diversity in the workplace. We remain committed to the search for Board candidates being conducted and appointments being made on merit, range of relevant experience and with adequate consideration given to the benefits of gender and ethnic diversity.

The latest Hampton-Alexander Review: FTSE Women Leaders (November 2019) listed Pennon 24th in its FTSE 250 rankings for women on boards and in leadership, compared with 85th last year. Key to our success this year has been the recent appointment of Non-Executive Director, Claire Ighodaro. As a result, the Board's female headcount increased to three with our diversity at board level now standing at 42.9%.

Pennon is a member of the 30% Club, a forum with a goal of achieving a minimum of 30% women on FTSE 350 boards by 2020.

Developing and retaining talent

In 2018, we announced our new vision – bringing resources to life – with its strong supporting values of trusted, collaborative, responsible and progressive. Good work has continued this year in further embedding these values across the Group.

Great people make great organisations and developing and retaining talent is integral to the Group's future success. Overcoming competition for top talent in the marketplace is a priority for the Group. Alongside our management trainee scheme at Viridor, we have extended our graduate recruitment across the Group in 2019/20 supporting our pool of internal talent. We have continued to invest in apprenticeships and are particularly proud of our apprenticeship scheme which started 191 new apprentices through this route in 2019/20. This now brings our three-year total to 575 apprenticeships across Pennon.

Balancing returns and investment

The Board has evaluated the Group's dividend for 2019/20 in light of the COVID-19 crisis and has concluded that it is appropriate for Pennon to deliver on its dividend commitment. The Group has significant cash and liquidity of £1.6 billion and has not needed to take any Government support measures. The vast majority of Pennon shareholders are pension funds, charities, employees, customers and other retail holders who rely on this income. Pennon's dividend has been supported by the growth in Viridor's earnings and we have shared our success with customers through South West Water's innovative WaterShare mechanism with £140 million of total cumulative benefits identified since 2015 and shared through bill reductions, service improvements and reinvestment. This will continue with our 2020-25 WaterShare+ scheme.



For 2019/20, the Board has recommended a final dividend of 30.11 pence per share, subject to shareholder approval at the Annual General Meeting on 31 July 2020. Together with the interim dividend of 13.66 pence per share, this will result in a total dividend of 43.77 pence per share, an increase of 6.6% from last year. This is in line with our dividend policy for 2010-20 of retail price index (RPI) +4% growth per annum, which has been achieved while investing more than £3.6 billion in our businesses over the past 10 years.

Board and leadership

We were pleased to welcome Claire Ighodaro to the Board in September 2019. Claire's extensive range of boardroom experience and her background in finance, across both regulated and non-regulated industries, is a great asset to the Group and complements the broad range of skills on the current Board. We ensure that our Board has a broad skill set and deep experience.

Sadly, we will say our farewells to Lord Matthew Taylor and Martin Hagen, who have both served on the South West Water board for some 10 years, in order to provide continuity through to the K7 regulatory period. Both have rendered exemplary service and deserve our heartfelt thanks. We thank them for their commitment over many years and wish them all future success.

Outlook

The sale of Viridor is targeted to complete in summer 2020 and the Pennon Board will then oversee the operating companies of South West Water and Pennon Water Services and also perform a holding company role in managing and allocating the funds from the Viridor sale.

Pennon will continue to be a UK-focused water infrastructure group, comprising South West Water and Pennon Water Services. South West Water is focused on providing services in the most efficient and sustainable way possible. Innovation, new technologies and a holistic approach underpins our commitment to delivering service improvement and long-term value. South West Water serves its customers and communities and continues to be committed to the highest standards of environmental performance. Work is already underway to deliver the commitments in the business plan focusing on cost-base efficiency, operational performance, customer service and sustainable growth.

The crystallisation of the Viridor sale is equivalent to 22.66 pence per share of the recommended 2019/20 dividend. This implies a Continuing Group dividend (after excluding Viridor) of 21.11 pence per share.

The Board intends to use the c.£3.7 billion of net cash proceeds to reduce Pennon's company borrowings and pension deficit, retain some funds for future opportunities, and make a return to shareholders. Details of additional returns to shareholders from the sale of the Viridor business will be announced in due course.

Pennon's dividend policy for 2020-25 for the rebased Continuing Group will be growth of CPIH +2% per annum, from an implied Continuing Group dividend for 2019/20 of 21.11 pence per share. The shift from the existing policy of linking the growth in dividend from RPI to CPIH reflects the change in the regulatory model for South West Water and assumes continued alignment in regulatory growth.

The rebased dividend reflects the sector-leading position of the Continuing Group, with expectations for outperformance on financing and totex supporting the sustainable dividend growth policy.

Sir John Parker
Chairman

Business model

Our business model is designed to deliver sustainable shareholder value by providing high-quality environmental infrastructure and customer services. From 2020 onwards, following the proposed sale of the waste management business, Pennon will be solely focused on delivering excellence in the UK water sector.

What we do...

Our core businesses

Water and wastewater

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

 See pages 42 to 47 for further information

Water retail services

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

 See page 48 for further information

...the strengths we rely on

Our strengths

The best people

The talent, commitment and hard work of our people is the foundation of our success. As a responsible employer, we are focused on employee retention, training and development, productivity and, above all, an unwavering commitment to health, safety and wellbeing.

Effective governance

A strong governance framework provides oversight and support to Group businesses including robust decision-making and performance management processes.

High-quality assets

We invest in the construction of world-class facilities and plants that use state-of-the-art technology. We engage the best people to maintain and operate our fleet of assets, to ensure we always maximise returns.

Efficient financing

The strength of our proposition, and investor confidence in our performance and reputation, means we are well funded with efficient long-term financing.

Environmental stewardship

We invest in the maintenance and improvement of our services, operations and assets and constantly seek more sustainable ways of working to protect, enhance and reduce our impact on the natural environment.

Strong relationships with our suppliers

We work closely with our suppliers and take the steps necessary to ensure their performance meets our expectations. We expect them to uphold our standards, align with our policies, protect human rights and promote good working conditions.

Well-managed risk

Comprehensive and fully embedded risk management processes assist us in identifying and managing risks and opportunities to deliver the Group's strategy and objectives.

Underpinned by our values



Trusted

We do the right thing for our customers and stakeholders



Collaborative

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

...delivering our strategy

Our long-term priorities

1

Leadership in UK infrastructure

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

See page 17 for further information

2

Cost base efficiency

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

See page 18 for further information

3

Sustainable growth

We actively seek opportunities to invest for growth, whether through investment to increase our asset portfolio, initiatives to expand our customer base, or partnerships with other organisations.

See page 19 for further information

...to create value

Value created for our stakeholders

Customers

80.3pts

new measure – CMex⁽¹⁾

Investors

+6.7%

earnings per share increased to 61.7p⁽²⁾

People

23,223

formal training days

Community

98.7%

149 bathing waters out of 151 classified as 'sufficient' or better⁽³⁾

Environment

659km

total km of river improved during 2015-20

(1) As measured by the new customer experience score (CMex) based on the methodology for the next regulatory period 2020-25 which has been piloted during 2019/20.

(2) Before non-underlying items and deferred tax. See note 6 on page 152 for more details.

(3) 125 beaches (82.8%) classified as 'excellent'.



Responsible

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



Progressive

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


Strategic progress

Our strategic objectives are set and monitored through a rolling long-term strategic planning process. This takes into account potential risks and our sustainability drivers.

Pennon continues to strive towards the following long-term strategic priorities.

Our priorities have always been applicable to both water and waste but Pennon will be focusing solely on water going forwards:

- 1 Leadership in UK water infrastructure**
- 2 Cost base efficiency**
- 3 Sustainable growth**

 For information on how our strategic priorities are linked to remuneration targets, see page 95



Strategic priority

1

Pre 2020

Leadership in UK water and waste infrastructure

Performance against objectives 2019/20

- Improved Employee Trust Index score in 2019/20
- Outperformance of the regulatory contract for the 2015-20 period achieving c.80%⁽¹⁾ of business plan commitments. Several initiatives already underway as part of the fast-tracked 2020-25 business plan
- Ongoing improvement in customer satisfaction following investment in enhancing the customer journey, improved response times to issues, digital improvements, and training and development of our people

(1) Financial ODIs exceeded, met or within regulatory tolerances.

- High levels of performance and availability maintained for ERF portfolio
- Maximising value from our infrastructure business through strong performance across business divisions alongside efficiency improvements
- Sector-leading performance across both water and waste management
- Environmental performance improved in a range of areas in the water business including the expansion of catchment management programmes and an increased proportion of energy from renewable sources. National Environment Programme commitments on river water quality for the 2015-20 regulatory period completed in both service areas. High bathing water standards retained.

KPIs

Fast-track

Status for business plan

90%

Overall customer satisfaction

90%

ERF availability

63%

Employee trust score

Sustainability drivers

- **Health, safety and wellbeing** – investing in and protecting our people to ensure we have a skilled, diverse, engaged and motivated workforce to deliver our strategy
- **Environmental leadership** – integral to our water business's regulatory contract
- **Natural capital stewardship** – delivering solutions for society is core to our strategy and helps to address the challenge of depleting natural resources.

Risks and uncertainties

Our aspiration to be a leader in the sectors in which we operate could be affected by the occurrence of certain events, many of which have reputational consequences:

- An avoidable health & safety incident
- Legal, regulatory or tax non-compliance
- Poor customer service
- Business interruption or operational failure
- Failure or increased cost of a capital project
- Loss or corruption of data as a result of a cyber attack.

2020 onwards

Leadership in UK water infrastructure

Near-term objectives (2020 onwards)

- Deliver marked improvements in focus areas for environmental performance. This includes the implementation of the new pollutions strategy and ongoing investment in wastewater upgrades
- Deliver on WaterShare+ benefits to customers

- Continue to deliver high-quality drinking water, minimising supply interruptions and achieving demonstrable reductions in the amount of water lost through leakage
- Target industry-leading customer service performance including improved customer satisfaction
- Continue to improve scores for employee satisfaction and trust.

Strategic progress
continued

Strategic priority



Pre 2020

Leadership in cost base efficiency

Performance against objectives 2019/20

- South West Water continues to deliver sector-leading totex outperformance, with £297 million cumulative efficiencies over the 2015-20 regulatory period
- Continuing to drive efficiencies across all areas of the Group

- Continuing to deliver cost-efficient, long-term financing – 3.5% average interest rate – among the lowest in the sector
- Continued reduction in Viridor indirect costs.

KPIs

11.8%

Cumulative RoRE in K6

£288m

Underlying profit before tax

£297m

Cumulative totex outperformance 2015-20

3.5%

Interest rate – efficient financing

Sustainability drivers

- **Community investment and benefit** – minimising disruption and inconvenience for communities means we also minimise the cost to the business
- **Resource and energy efficiency** – the use of solar photovoltaics to power our facilities, and other energy saving initiatives, help us to reduce our own demand for electricity from the grid while maximising the energy generated from our core operations
- **Responsible supply chain** – value for money secured through robust procurement practices and sustainable supply chains.

Risks and uncertainties

- Risks that could impact our ability to deliver efficiencies include:
- Operational failures that result in rectification costs
 - Changes in law or regulation that require additional expenditure to fund implementation and ongoing compliance
 - An increase in customer bad debt, resulting in additional debt collection costs
 - Failure to recruit, retain and develop people with the appropriate skills.

2020 onwards

Leadership in cost base efficiency

Near-term objectives (2020 onwards)

- Deliver sector-leading totex outperformance throughout the K7 period (2020-25)
- Ensure ongoing sector-leading efficiency savings, including through the identification of new technologies, systems upgrades and overall performance improvement

- Continue to deliver cost-efficient, long-term financing
- Ensure the efficient transition of the waste business under new ownership following the proposed Viridor sale.

Strategic priority

3

Pre 2020

Driving sustainable growth

Performance against objectives 2019/20

- Strategic value being realised through the proposed sale of Viridor
- Opportunities for further growth, including initiatives to expand our customer base or form partnerships with other organisations being identified
- Building on the progress made in K6 by making headway with the K7 New Deal plan that meets the needs and priorities of South West Water's customers and other stakeholders
- £65 million investment in new plastics processing facility under construction
- Continuing to build scale and efficiency in the non-household retail market through Pennon's water retail business, Pennon Water Services
- Completion of construction on the Mayflower water treatment works. The works has entered commissioning and, pending any restrictions due to the ongoing COVID-19 situation, will begin supplying customers with drinking water from summer 2020 onwards
- Adoption of water and wastewater services for the Isles of Scilly successfully completed.

KPIs

+6.7%

growth in EPS

£245m

Finance aligned to Sustainable Financing Framework

69

Sustainalytics score

Fair Tax Mark

Reaccreditation

Sustainability drivers

- **Quality services and satisfied customers** – delivered with an increased focus on improving the customer experience
- **Good governance and high standards of business conduct** – ensuring our people are rewarded appropriately and exhibit the right behaviours to enable us to achieve long-term, sustainable growth.

Risks and uncertainties

Our ability to deliver sustainable growth could be impacted by:

- Unfavourable economic conditions
- Poor customer service
- Loss of market share as a result of regulatory reform and increased competition
- Difficulties in recruiting, retaining and developing people with the right skills to help our businesses grow and prosper.

2020 onwards

Driving sustainable growth

Near-term objectives (2020 onwards)

- Identify opportunities for growth within the water sector
- Further LTIFR reductions
- Support sustainable growth in the regions served through the provision of value-for-money services and championing regional growth initiatives
- Development of the CREWW (Centre for Resilience in Environment, Water and Waste) innovation centre to provide industry-wide learnings to ensure sustainable best working practice
- Deliver the 2020-25 New Deal business plan for the benefit of customers and stakeholders
- Continue to provide high-quality workplaces, training and development to support employment and communities
- Capitalise on opportunities for growth and expansion in the non-household retail market through the water retail business, Pennon Water Services
- Deliver on sustainable supply chain objectives.

Sustainability at the heart of the business

Built around our environmental, social and governance (ESG) framework, our sustainability strategy helps us to focus on the positive impact we can have on the communities we serve, and on the environment that we rely on. It supports the creation of value – financial, social and environmental – for our shareholders and stakeholders.



We have set clear long-term objectives and three-year targets to enable clear monitoring and continuous improvement of our performance in each of our nine sustainability focus areas. These cover the areas of greatest significance and materiality to our businesses, and range from key global issues of carbon reduction, biodiversity and natural capital stewardship, to local community benefits, employee wellbeing and development, and ensuring good governance, quality services and customer satisfaction.

Our environmental focus areas include:

- Demonstrating leadership – in carbon management and climate change adaptation, and in regulatory compliance and pollution prevention
- Proactively protecting and enhancing healthy places, habitats and biodiversity in our operational areas, especially working in partnership with wildlife trusts and other stakeholders
- Showing leadership in natural capital management and resource productivity.

Environmental improvement programmes and contributing activities include:

- 100% of Viridor and South West Water’s sites and operations covered by ISO 14001 environmental management system accreditation
- Active land stewardship on three special areas of conservation, two special protection areas and nine sites of special scientific interest; with nine SSSI Water Industry Environment Programme schemes approved by Natural England and the Environment Agency
- 25 biodiversity enhancement opportunities identified on priority operational sites
- Priority habitats restoration and management programmes, including blanket bog, purple moorgrass and culm grassland
- Five-year biodiversity plan launched, focusing on: county wildlife sites; fish passage and protection measures; natural flood management; river improvements; peatland restoration; and tree planting
- 48,400 trees planted in 2019/20 – strong contribution to our 100,000 trees commitment.
- Building natural capital – South West Water land holdings in Dartmoor and Exmoor National Parks will be prioritised for active management, as well

as 14 sites in areas of outstanding natural beauty (Cornwall, East Devon, Tamar Valley and the Blackdown Hills).

Our social focus areas and objectives include:

- Net gain in our social capital through positive investment and support for local communities, including sponsorship, supply chain partnerships, education services and employee volunteering
- Aiming for the highest standards of health, safety and employee wellbeing in our workplaces
- Achieving a diverse and productive workforce, reflecting the communities in which we operate, and developing and upskilling our employees through structured programmes and opportunities.

Social capital improvement programmes and contributing activities include:

- New Deal plan for 2020-25 to ensure 2025 customer bills are lower than in 2010, and to include extra steps to eliminate water poverty
- Ongoing work with Citizens Advice and social housing associations to support vulnerable customers
- >25,500 customers are on a support tariff and >35,000 customers have benefited from one of our other support schemes
- Ongoing Love Your Loo, Think Sink and water efficiency campaigns to prevent blockages and promote good practice, including c.1,300 subsidised or free water butts distributed
- Supporting Refill Southwest: providing hydration stations at public events, permanent community Refill points and distributing reusable water bottles.

Our governance focus areas and objectives include:

- Engaging with our customers, clients and stakeholders, aiming to exceed their expectations, supporting vulnerable customers, and continuously improving our services
- Enabling sustainable supply chain practice and partnerships including human rights, equal opportunities and positive social and environmental values and outcomes
- Strong and transparent governance and a sustainable finance framework, enabling investment, innovation and sustainable growth.

Good governance improvement programmes and regional contributing activities include:

- Building trust via quarterly WaterShare+ panel meetings in public and a customer annual general meeting from 2020
- Serving a population of 2.2 million
- c.5,300 regional jobs supported via our supply chain, and c.£600 million GVA to Cornwall, Devon and Dorset economies
- Continued participant in the Back the Great SouthWest campaign and its regional growth prospectus
- Ongoing support for the Mayflower 400 initiative, including supporting local social enterprises and promoting Plymouth, Britain’s Ocean City.

A clear, strategic and long-term approach to sustainability enhances our business performance, strengthens our resilience, protects our ongoing licence to operate via regulatory compliance and is an integral element of our risk management processes.

Our contribution to the UN Sustainability Development Goals (SDGs)

We continue to encourage our customers, suppliers, employees and other stakeholders to familiarise themselves with the 17 SDGs, or Global Goals, and see how we can all contribute towards them.

We have assessed and mapped our sustainability focus areas to the SDGs that are most relevant to us. While we have been committed to measuring our sustainability performance against our own three-year targets, we have also begun the process of assessing the SDG targets and KPIs to enable future detailed reporting against them, as appropriate.



THE GLOBAL GOALS

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

Environment

Resource efficiency and natural capital stewardship



Headline target:

measurable natural capital gain and improved resource efficiency across relevant operational areas and projects

KPI:

- 3% year on year improvement from a 2019/20 baseline

Performance:

- 2 methodology approved, baseline assessment underway. Completion summer 2020



Healthy places and habitats



Headline target:

measurable biodiversity net gain on our relevant operational sites and projects

KPI:

- 5% biodiversity net gain across sites with biodiversity management plans

Performance:

- 1 sites confirmed and baseline assessments complete



Environmental leadership



Headline targets:

implement Group climate change & carbon strategy defining contribution to a low carbon economy. Embed compliance culture ensuring positive and measurable environmental impact and regulatory compliance

KPI:

- B-rated CDP Climate disclosure
- zero serious/major or significant environmental incidents

Performance:

- 1 improved CDP Climate B rating achieved. KPI to be replaced by approved carbon reduction targets
- 2 single Category 2 incident recorded by Environment Agency



Social

Community investment and benefit



Headline target:

measurable community benefit and social capital gain in relevant operational areas and projects

KPI:

- 3% year on year improvement from a 2019/20 baseline

Performance:

- 2 methodology approved, baseline assessment underway. Completion summer 2020



Health, safety and wellbeing



Headline target:

continual improvement in overall health, safety and wellbeing achieved through implementation of our HSSA strategy and its core KPIs

KPI:

- LTIFR at 0.5 by end of 2024/25

Performance:

- 3 target formally on track, however the sad loss of two Viridor colleagues at Earls Barton and Bovey Tracey is acknowledged, and investigations into both continue



Skills, diversity and development



Headline target:

continual improvement in employee diversity, skills and engagement

KPI:

- increase % of female employees in the Group from 21% in 2019 to 25% by 2022.
- achieve 65% Trust Index score by 2021/22

Performance:

- 1 female employees rose to 23%
- 1 Trust Index score rose to 63% in 2019



Governance

Quality services and customer satisfaction



Headline target:

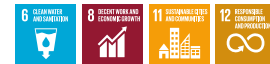
continual improvement in levels of customer satisfaction and service quality, and defined methods to support vulnerable customers

KPI:

- 2% year on year increase from a 2019/20 baseline

Performance:

- 1 methodologies established and baseline complete



Responsible supply chain



Headline target:

adopt defined sustainability principles within procurement and contract management processes, building resilience across our supply chain

KPI:

- 100% compliance with sustainable procurement policy by end 2021/22

Performance:

- 1 supply chain rationalisation and segmentation ongoing. Onboarding compliance process continues



Good governance enabling investment, innovation and sustainable growth



Headline target:

transparent approach to good governance, responsible business and sustainable investment through continuous improvement in ESG performance

KPI:

- upper quartile scores in our peer group for external ESG disclosure assessments.

- 25% of total finance raised within the Pennon Sustainable Finance Framework

Performance:

- 1 improved CDP Climate and Water ratings achieved
- 1 29% achieved (£245 million raised through the Sustainable Finance Framework of a total £840 million)



Focus area performance

1 Currently on track and forecast to achieve KPI/target within reporting period

2 Currently not on track but forecast to be retrievable with identified actions in order to meet KPI/target within reporting period

3 Currently not on track and forecast to not meet KPI/target within reporting period

Priority programmes 2019/20

We chose three important priority programmes for 2019/20 and have made accelerated progress in these key leadership programmes:

- Plastics
- Biodiversity
- Sustainable finance

Priority programmes 2020/21

Prior to the strategic review, we chose three new priority programmes which offer opportunities to accelerate progress in important aspects within our sustainability strategy focus areas. We will report on our progress towards these commitments in our next annual report.

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



Sustainable transport, travel and smarter working

Implementing a consistent approach to working policies and practice in these areas can help to improve: health & safety performance; employee wellbeing; productivity; business efficiency; our reputation; and environmental awareness, as well as helping to reduce GHG emissions. It will contribute to targets in our core strategies.



Circular workplace

Our commitment to the principles of a more circular economy includes delivering sustainability practices in the workplace. We want to inspire change at work and in everyday life – improving waste, water and energy efficiency. This should deliver both cost savings and opportunities for education and engagement in our sustainability strategy and wider sustainability issues by employees.



Community benefit and social value

We aim to provide measurable positive investment and support for our communities through a combination of: services and supply chains; sponsorship, partnerships and donation programmes; community liaison; education and outreach; and employee volunteering. We have conducted a baseline social capital impact assessment to help better target our community investment activities and maximise value and benefit to both the company and communities.



Plastics

We assessed and identified opportunities under each of the five Pennon plastics programme commitments. Our achievements include actions to:

Further develop innovative infrastructure

- Investment in polymers recycling technology at Masons MRF and Glasgow
- South West Water further investment in biobead containment.

Commission, support and enable targeted research and development

- Active polymers R&D support including micro-plastics
- Joint research into solutions to reprocess micro-plastics including biobeads with opportunity identified to recycle micro-plastics into e.g. fence posts
- Working with universities, including PhD projects, to explore plastics reprocessing and treatment opportunities.

Collaborate with our clients, partners and suppliers

- Continued engagement with UK Plastics Pact and Innovate UK's Smart Sustainable Packaging Plastics initiative, and partnership with Nurdle, a CIC, to help clean coastal micro-plastic hotspots
- Hosted South West Rubbish to Resource event to boost regional plastics recycling
- Extended BeachCare partnership programme with Keep Britain Tidy.

Enable and deliver dynamic campaigning

Campaigns and projects to change behaviours to reduce the amount and impact of plastic waste and increase recycling, including:

- Year of Green Action volunteering initiative throughout 2019
- Keep Britain Tidy's plastic initiatives
- Love Your Loo campaign preventing flushing of plastic products
- Award-winning Right Stuff, Right Bin recycling campaign continued
- Continued participation in Refill South West campaigns.

Engage and inspire our employees

Aim to reduce, recycle and replace plastics used in our offices and operations, and help clean-up our beaches, rivers and local environments, including:

- Nine volunteering litter pick events including Taunton's Big Litter Pick
- Sponsorship and launch of Nurdle's micro-plastics South West beaches clean-up programme at Croyde Beach.

Pennon's UK plastics programme contributes to the following UN SDGs.



Sustainability focus area





Biodiversity

We established a biodiversity task & finish group to assess and identify progress opportunities in each operating business in relation to our biodiversity strategy.

This has helped Viridor and South West Water biodiversity teams to align across the Group, share knowledge and best practice, and build on work already established. Achievements this year include:

- Viridor and South West Water each identifying 25 sites and developing plans to measure biodiversity net gain using Defra's version 2.0 metric
- Habitat volunteering by employees including tree planting, guard removal and hedge laying with our partners The Somerset Wildlife Trust and The South West Lakes Trust
- South West Water's commitment to plant 100,000 trees by 2030 working with The Wildlife Trusts, Woodland Trust and Friends of the Earth
- Restored 5,713 acres of habitat through South West Water's Upstream Thinking programme, exceeding Ofwat's ODI target of 3,212 acres
- Progress by South West Water in the second year of its peatland restoration Three Moors Project
- Appointment of 28 site guardians to report on invasives, biosecurity and biodiversity as part of South West Water and South West Lakes Trust's invasive species programme, and extended management of invasive non-native species on South West Water operational assets to 64 sites
- Eight Viridor sites maintaining Wildlife Trusts Biodiversity Benchmark accreditation
- New Viridor partnerships with the Berkshire, Buckinghamshire and Oxfordshire Wildlife Trusts and work with Thames Water to protect and enhance the local biodiversity at Beddington
- Partnering with beekeepers to allow beehives to be located at five of Viridor's closed landfill sites.

Pennon's biodiversity programme contributes to the following UN SDGs.



Sustainability focus area



Sustainable finance

At Pennon, we are proud to be the first UK corporate to launch a Sustainable Financing Framework. We issued a green long-funding finance lease, and were among the first to agree sustainability-linked impact loans and revolving credit facilities. Being a leading company in this area demonstrates that sustainability is truly at the core of our business. It incentivises sustainable behaviours by linking outcomes to the cost of servicing our finance.

The Group is at the forefront of sustainable finance and has adopted a holistic approach to incorporate all sustainable finance principles. We have signed a diverse range of sustainable finance products.

We developed a Group Sustainable Financing Framework. This enables the issuing of sustainable finance to support investment across the Group's activities in particular: pollution, prevention and control; sustainable water and wastewater management; and climate change adaptation, resulting in environmentally and socially sustainable outcomes. We have worked closely with The Prince's Accounting for Sustainability Project (A4S) to set the standard for sustainable financing frameworks.

Over the year we have raised £245 million of finance aligned to the Sustainable Financing Framework, representing approximately 29% of our total finance raised. Cumulatively, since the introduction of the framework we have raised £840 million.

Activities contributing towards the Sustainable Financing Framework:

- Mayflower water treatment works
- ERFs
- South West Water customer engagement
- HomeSafe
- Sustainable procurement policy
- Upstream Thinking programme
- Peatland restoration programme
- Avonmouth plastics recycling centre.

Our first annual allocation and Sustainable Financing Framework impact report was issued in September 2019 with the first funds from the green reserve account allocated to South West Water's sustainable investment in 2019/20.

Pennon's Sustainable Financing Framework contributes to the following UN SDGs.



Sustainability focus area



Market and regulatory overview

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



Water sector

The water industry serves more than 50 million household and business customers in England and Wales, who are supplied with drinking water and have their wastewater taken away and treated.

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

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

Our competitive environment comprises the water and wastewater companies in England and Wales. As well as the competitive environment with our UK water peers, we benchmark customer service against other providers in the region and the UK. As a FTSE 100 publicly-listed company, other infrastructure companies are competitors from an investor (equity and debt) perspective.

Water companies (2019)⁽¹⁾



Source: Ofwat.gov.uk

(1) Hafren Dyfrdwy acquired by Severn Trent in 2016.

Our approach

South West Water is focused on demonstrating leadership within the water sector, pioneering new technologies and methods to improve customer service, efficiency and resilience while working closely with industry peers, as appropriate, and the supply chain to identify and implement best working practice across all areas of the business.



Regulatory framework

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

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

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

Key water industry regulators (2019)



Our approach

South West Water has mature and robust processes to ensure compliance with regulatory requirements.

We engage with our regulators at all levels and are committed to ensuring trust and transparency within these relationships.



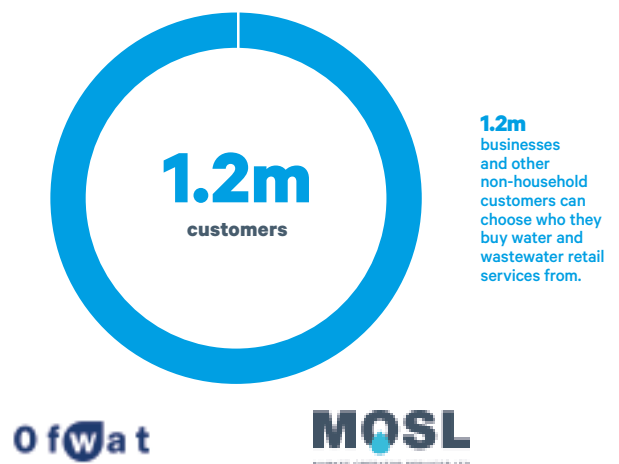
Non-household retail market

The non-household retail market allows up to 1.2 million businesses and other non-household customers across the country to choose which retailer they buy water and wastewater services from.

The non-household market operates through a controlled portal operated by Market Operator Services Limited. It has required the separation of the wholesale and retail arms of water businesses.

Pennon Water Services was established to manage the non-household retail business for Pennon via a retail venture with South Staffordshire plc.

Market choice and regulators (2019)



Our approach

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

Our stakeholders

The sector we operate in is high profile with a wide stakeholder group.

We are committed to listening, engaging and reflecting our stakeholders’ needs and priorities in our business plans and operations.

The work we do delivers a wide range of benefits to a variety of stakeholders, creating long-term sustainable value.

Our engagement approach involves regular dialogue that is timely and open, building meaningful relationships based on trust and transparency.

We use a wide range of methods to reach our stakeholders, ranging from formal independent research, focus groups and workshops to real-time conversations.

We engage with our stakeholders in order to understand their needs and priorities, which in turn shape our strategy and social purpose:

Innovate and develop our business – by knowing how our business is experienced, perceived and understood by our stakeholders we learn how to improve

Identify our risk profile – an open and transparent approach helps us to see potential problems before they materialise

Build loyalty and satisfaction – engagement, particularly with employees, customers and investors, builds understanding and appreciation of our business

Develop advocates – strong stakeholder relationships mean we have more advocates helping us shape our reputation and the environment in which we operate

Our Board – takes into account stakeholders’ interests when making decisions (see our section 172 statement on page 121 and examples provided on page 73).



Our customers

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

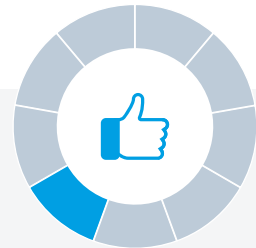
Our engagement approach

We engage regularly with our customers on service quality, cost of service, value for money and our strategy. This includes regularly conducting customer satisfaction surveys, holding focus groups, co-creation workshops and convening forums, providing ongoing feedback to our teams to recognise good service and make improvements where needed. With the introduction of WaterShare+ as part of the New Deal 2020-25 business plan, customers are being offered a tangible stake and a say in the business, including the opportunity to participate in a customer annual general meeting.

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

 Find out more on page 69

Quality services and satisfied customers



South West Water's customer satisfaction

90%

target: year on year increase in customer satisfaction scores

Viridor's customer satisfaction

80%

target: year on year increase in customer satisfaction scores

Pennon Water Service's customer satisfaction

91%

target: year on year increase in customer satisfaction scores

Our WaterShare customer panel meets quarterly

83%

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

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



Our people

Our employees are our greatest asset. We provide the opportunity for them to be engaged at multiple levels of the business and through a variety of two-way dialogue and feedback channels.

Our engagement approach

We continually engage and communicate with our people on their health, safety and wellbeing, our organisational culture, promoting diversity and inclusion, training and development. We use our annual employee trust and engagement survey as a mechanism to measure progress and obtain feedback. Our senior leaders meet once a quarter with established engagement forums where staff representatives discuss business challenges. We also recognise Trade Union partners in some areas of the Group and maintain an open dialogue with them. We hold regular Big Chat calls with employees, providing them with the opportunity to hear directly from the Pennon Executive and ask any questions they wish.

Find out more on pages 38 and 39

You can find our gender pay gap report online: www.pennon-group.co.uk/about-us/gender-pay-gap-report

Skills, diversity and development



LTIFR 0.90 is down

34%

from 2018/19. Target of 0.50 by 2025, which would make Pennon a health & safety sector leader in water and waste

Trust Index score

63%

+1pt on 2018/19. Target is to be Great Place to Work accredited

Engagement score

68%

maintaining our strong 2018/19 score

Female representation at Board level has increased to

42.9%

from 33.3% in 2018/19; ahead of our 2020 30% Club target

Eight STEM

partnerships delivered up from 2018/19

long-term target to increase the reach of our STEM and community education programme



Our communities

Our businesses operate in the heart of local communities, so we work closely with these stakeholders through regular liaison meetings and community events. Our education facilities and outreach programmes support environmental learning and our charity donation schemes support hundreds of good causes in communities where we operate.

Our engagement approach

We engage regularly with our communities on local projects and initiatives and hold regular community liaison groups around our sites. We also engage with our communities through print, digital and social media and use these channels to great effect with our behavioural change campaigns including Love Your Loo, and Think Sink! South West Water holds a Conservation and Recreation Forum twice a year to get input from a range of stakeholders including South West Lakes Trust, National Farmers Union, Dartmoor National Park and the Royal Yacht Association.

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

Find out more on pages 20, 40 and 47

Community investment and benefit



£6.4m

community investment across Pennon including £5.3 million to Viridor credits

98.7%

of bathing water classified as 'sufficient' or better maintaining last year's excellent performance. Our long-term target is 100%

c.2m

visitors to South West Water's reservoirs in line with 2018/19

173

beach cleans held through our BeachCare partnership removing 11.3 tonnes of waste

7,283

visitors to Viridor's 11 educational centres last year



Our environment

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

Our engagement approach

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

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

 Find out more on pages 20 and 23



Our suppliers

Our supply chain partners play a vital role in supporting sustainable growth and cost base efficiency across the business. Through rationalising and segmenting our supply chain partners to reflect either strategic, key, preferred or transactional relationships, we are developing an approach that maximises our engagement with each supply chain partner.

Our engagement approach

We have formal contracts and framework agreements with all supply chain partners that meet the appropriate balance between commercial, quality and sustainably focused delivery. Our e-procurement platforms support a structured, fair and transparent approach to supplier engagement and as a signatory to the EU Skills Accord we work collaboratively to support skills development and investment throughout the supply chain.

In 2018/19, we launched our sustainable procurement policy and supplier code of conduct.

Healthy places and habitats



1
Category 2 wastewater pollution incident, down from 2 in 2019

Net zero carbon

South West Water's commitment to achieve net zero carbon emissions by 2030

100,000
the number of trees we are committed to planting by 2030 supporting Water UK's commitment to plant 11 million trees

5,713
acres of habitat restored by our Upstream Thinking programme

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

Responsible supply chain



2021/22 target continued delivery of supply chain rationalisation to achieve a supply base of

c.3,000
suppliers to reflect a 59% decrease from the 2017/18 figure (c.4,400 suppliers)

We have engaged extensively with our SME suppliers who represent
over 80%
of our current supply chain. In 2018/19, we launched our sustainable procurement policy and supplier code of conduct

Following supplier segmentation and rationalisation, work with all suppliers to ensure

100%
compliance with the five objectives⁽²⁾ identified within our sustainable procurement policy by end 2021/22

Incorporated
sustainability-focused questions

⁽²⁾ see www.pennon-group/sustainability/responsible-supply-chain.



Our investors

We run an extensive investor relations programme ensuring debt and equity investors, shareholders, analysts and financial media are informed of our business strategy and key developments.

Our engagement approach

We engage regularly with our financial community including equity investors and debt providers on financial performance, strategy, risks and opportunities and macro themes. We hold roadshows across the UK, Europe and the USA each year in addition to conferences, investor and analyst briefings. In 2019, we hosted an event for analysts dedicated to Viridor's work in plastics recycling and its contribution to the circular economy – a key investment theme within the year. We also hold twice-yearly results presentations and CFO updates and we continue to provide trading updates between results.



Our regulators

We have an open dialogue and meet regularly with our regulatory bodies: Ofwat, the Department for Environment, Food & Rural Affairs (Defra), the Environment Agency, Drinking Water Inspectorate and the Health and Safety Executive (HSE) to ensure that our business plans address their priorities and concerns.

Our engagement approach

We engage regularly with all our regulators on our business plans, strategy, performance, risks and opportunities and delivery for customers. We attend regular meetings, provide reports and reviews, respond to consultations and join workshops, to ensure trust and transparency within these relationships.



Environmental leadership



Good governance enabling investment, innovation and sustainable growth

50.4%

of our shareholder register met over 2019/20

90

meetings and calls were held

11

roadshows were held and **eight** conferences attended

29%

of finance raised under Pennon's Sustainable Financing Framework against a target of 25%

2019 Sustainalytics score

69

down from 72 in 2018, target of year on year improvement

2019 FTSE4Good score

3.6

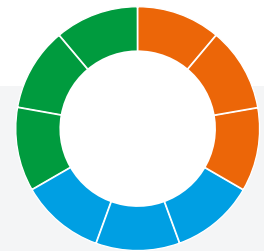
out of 5

Our policy makers

Engaging with national and local Government, MPs and Peers, Local Enterprise Partnerships, the HSE, HM Revenue & Customs (HMRC), the Department for Business, Energy & Industrial Strategy (BEIS) and Defra, we have a good ongoing dialogue with policy makers and stakeholders who influence and shape our social contract.

Our engagement approach

We regularly discuss our strategy, performance and risks and opportunities with policy makers and key opinion formers. We engage through a regular meeting programme, briefings, round tables, consultation responses, and through trade bodies including Water UK and British Water.

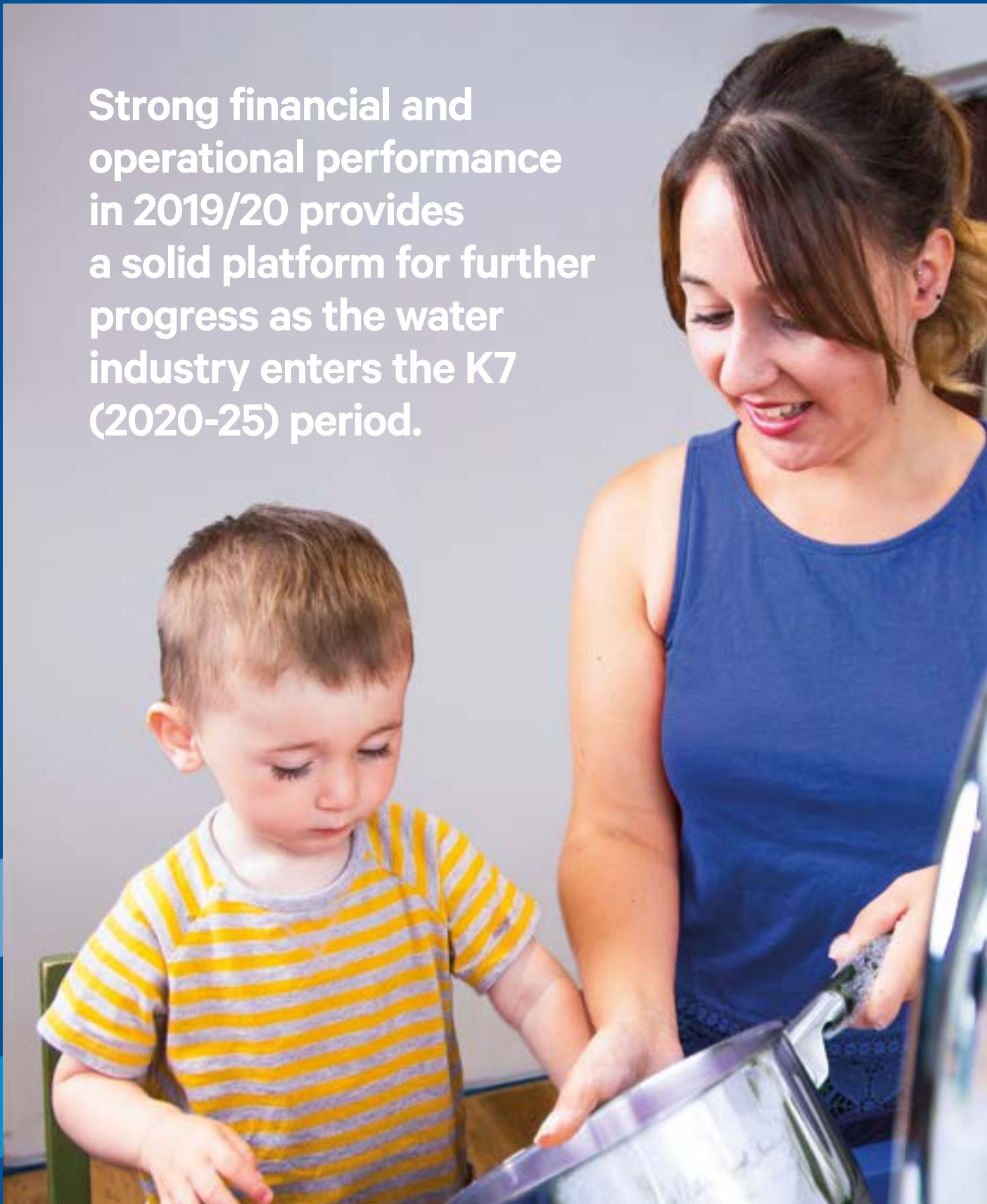


ESG

139

meetings and site visits held in 2019/20, a 26% increase on 2018/19

Strong financial and operational performance in 2019/20 provides a solid platform for further progress as the water industry enters the K7 (2020-25) period.





Strategic report

Group performance

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Chief Executive Officer's review



Our focus on sustainability continues to underpin the activities Pennon undertakes and the way in which we undertake them.



Chris Loughlin
Chief Executive Officer

The past year has been pivotal for Pennon Group; a year significant for the decisions taken, the progress made, and the challenges overcome, not least those relating to the impact of COVID-19 on our business activities in the latter part of the year.

The announcement of the proposed sale of Viridor marks an evolutionary step in the Group's history and the realisation of the strategic value created following almost three decades of successful acquisition and growth in the waste sector. Meanwhile in the water side of the business, we reached the end of the K6 (2015-20) period in an extremely confident position, having once again delivered strong financial results and excellent operational performance across key business areas.

I am pleased to report that Pennon Group has continued to carry out its business in a manner which reflects our core values of trusted, responsible, collaborative and progressive. 2019/20 has seen the ongoing implementation of the sustainability strategy we announced last year, further work to embed our HomeSafe culture of health & safety across our businesses, and the continued delivery of efficiencies for the benefit of our customers and shareholders. This continues to be achieved through a combination of innovation, investment in new technologies and the pioneering of cost-effective sustainable solutions.

Committed to health & safety

The health & safety of our people remains paramount and we were shocked and saddened by the tragic loss of two colleagues at Viridor during the past year. We continue to cooperate with the investigations being led by the Health and safety Executive following the separate incidents at Earls Barton in Northamptonshire and in Bovey Tracey, Devon. Our thoughts and sympathies remain with the loved ones of Mick and Mark.

Pennon's focus and emphasis on health & safety continues unabated, recognising that we should all expect to go to work and come home safely at the end of each day. While our headline performance target – LTIFR – improved by 34% compared with the previous year, our ambition for zero harm remains and we have further stretched our performance expectations for 2020/21.

The Board remains fully committed to HomeSafe.

This includes independent review and benchmarking in order to identify areas for further improvement, as we work towards our ambition to become the health & safety leader in the industries we operate within.

Tackling COVID-19

The development of the coronavirus crisis in March 2020 presented the Group with a variety of challenges, not least the logistical and technical challenge of ensuring social distancing among frontline workers.

Ensuring the health, safety and wellbeing of our people has been our primary focus throughout. Drawing on our strong resilience and crisis management plans, complemented by our HomeSafe health & safety philosophy (see page 40), we took timely and effective action in order to ensure services could continue to be provided to our customers as necessary, in a safe manner, and in line with Government guidelines.

For our water customers we took steps to ensure those facing difficult financial circumstances would be provided with support in the most appropriate way. This included automatically extending social tariffs and payment plans and proactively identifying and contacting those customers most in need. Following the announcement of 'stay at home' guidance on 23 March we introduced a dedicated priority services register for those self-isolating. We also immediately implemented a range of additional measures and processes to prevent any risk of contracting or spreading the virus while carrying out essential work in the community. Core services were successfully maintained with non-essential services gradually reinstated once it was safe to do so.

I am pleased to report that, across the Group, our employees responded incredibly well, adapting to the situation as it developed with superb flexibility. No employees in the Group were furloughed. New working processes, cleaning regimes, adjusted shift patterns and restrictions on non-essential visits to treatment works and other non-essential activity were introduced, while those able to work from home were supported to do so. We successfully ensured the right personal protective equipment (PPE) and workplace protections were in place and made the most of technology and digital platforms to ensure good lines of communication between teams.

In addition to working closely with our industry peers, we supported colleagues in the emergency services, NHS and local authorities on a variety of initiatives to protect public safety and wellbeing. One example was the donation of an incident support vehicle to East Cornwall Primary Care Network for use as a temporary consulting room.

Furthermore, at industry level, and in my capacity as Chairman of British Water, it was encouraging to see increased collaboration between the leading water organisations to support the sector during the pandemic with British Water, Energy & Utility Skills, the Future Water Association, Waterwise, Water UK and UK Water Industry Research all working together in partnership.

The impact of COVID-19 has tested the Group's resilience and we are proud to have risen to the challenge.

I would like to personally thank our employees for their adaptability and devotion to getting the job done under challenging circumstances.

At the same time, we send our deepest sympathies and a message of support to all of those at Pennon and beyond who have been affected personally by this unprecedented situation.

Delivering for customers and communities

Focused on delivering for customers and communities while dedicated to the principles of strong financial control, sound administration and good governance, South West Water has made considerable progress throughout the K6 period while remaining at the forefront of efficiency within the sector.

The company achieved £297 million of total expenditure (totex) outperformance by 2020, outperforming its regulatory contract to achieve a cumulative sector-leading RoRE (return on regulated equity) of 11.8%, delivering outperformance in outcome delivery incentives (ODIs) to secure a net reward every year.

Colliford Reservoir,
Cornwall



Resilient water resources

2019 was South West Water's 23rd consecutive year without water restrictions despite a relatively dry start to the year and the exceptionally hot and dry weather of 2018. Bournemouth Water's track record of no water restrictions was also successfully maintained. South West Water's careful management of resources ensured sufficient supplies throughout summer 2019.

Ahead of the winter, precautionary work was undertaken to prepare a pumped storage scheme for Roadford reservoir in mid-Devon. However, the second half of the year was abnormally wet with monthly rainfall between August 2019 and January 2020 more than 130% of the long-term average – an event only seen in one in 25 years.

South West Water is currently well placed in terms of its water resources position and we continue to work closely with customers and other stakeholders to encourage water efficiency. We are also engaged with the South West regional strategic water resources group.

In 2019/20 South West Water's water resources management plan was approved by the Department for Environment, Food & Rural Affairs (Defra). The plan sets out how the company intends to maintain the balance between supply and demand for water over the next 25 years.

Chief Executive Officer's review continued



Isles of Scilly

In 2014, Defra launched a consultation on the introduction of water and sewerage legislation applying to the Isles of Scilly. As the level of investment required to improve the services and infrastructure to meet new standards would have been well beyond what the islands' small number of bill payers could collectively afford, a water company operating on a similar basis to UK mainland regions was the Government's preferred option to deliver future services.

South West Water assessed the condition of the water and wastewater infrastructure on the islands before submitting a business plan for the Isles of Scilly to Ofwat. Following licence amendments the company took over responsibility for serving the five inhabited islands on 1 April 2020.

As part of South West Water's 2020-25 business plan, a programme of investment has been developed, designed to ensure legislative compliance, environmental benefits and resilience improvements. These will, in turn, support the local economy and contribute to island life.

Residents have been contacted and partnerships developed with the Council of the Isles of Scilly, Duchy of Cornwall and Tresco Estate to support the roll-out of operations across the Islands.

£140 million cumulative benefits have been identified for WaterShare during 2015-20 – the innovative mechanism introduced by South West Water at the start of the period for the sharing of outperformance between customers and shareholders.

At an operational level, drinking water quality remains near perfect in both the South West Water and Bournemouth Water service areas. The careful management of resources, particularly following the unusually dry weather of 2018, ensured there were no water restrictions placed on customers in 2019, leakage levels were successfully kept in line with target once again and South West Water outperformed its target for minimising supply interruptions. Complaints about the taste and appearance of drinking water were reduced to their lowest ever level⁽¹⁾ and overall customer satisfaction remained high, reflecting substantial investment in customer service improvements during the period.

On the wastewater side of the business, targeted investment continues to be made in improving South West Water's performance within wastewater treatment, the prevention of flooding and pollution control. The latter continues to require additional focus, and we were disappointed to narrowly miss our target of zero serious (Categories 1 & 2) pollution incidents by 2020, due to a single Category 2 incident.

A revised pollution strategy is now in place and we are confident this will further reduce the risk of any incident occurring.

“

The impact of COVID-19 has tested our resilience and we are proud to have risen to the challenge.

”

Strong foundations laid at Viridor

We are proud of the progress made at Viridor in recent years and 2019/20 was no exception. Robust operational and financial performance was achieved across the various business divisions with market conditions in residual waste and recycling remaining favourable.

In addition to the ramp-up of the energy recovery facilities (ERFs) at Glasgow, Beddington and Dunbar, the commissioning of the £252 million resource recovery centre in Avonmouth during 2020 marks a major milestone in Viridor's growth trajectory. A flagship site, Avonmouth will divert about 320,000 tonnes of non-recyclable waste away from landfill and is being complemented by the adjacent construction of a new cutting-edge £65 million plastic recycling plant (announced in May 2019). Reflecting Pennon's commitment to working in ever-more sustainable ways, this use of energy from non-recyclable waste to power

(1) South West Water region only.

plastic recycling will effectively create a South West recycling powerhouse and has established a blueprint for additional sites of this type going forward. Read more on page 49.

Having focused on core waste infrastructure in recent years, the revaluation of Viridor and proposed sale following the strategic review recognises the strategic value that Pennon has developed and nurtured in the waste business over many years and accelerates the realisation of that value for our shareholders.

I would like to take this opportunity to thank the leadership team at Viridor for their professionalism and dedication throughout the past year. As a Group we have come a long way together and I wish them every future success.

Launch of the New Deal

As the only water company to have achieved fast-track status for two consecutive price reviews, South West Water entered the K7 (2020-25) period on 1 April 2020, having already moved forward with a number of key initiatives in support of its New Deal 2020-25 business plan.

The company will continue to invest significantly to improve services, including the delivery of the largest programme of environmental improvements in 15 years.

At the same time customer bills will be reduced – the plan will see the average bill in 2025 being lower than it was in 2010, and extra steps taken to eliminate water poverty.

Furthermore, the plan – which was informed by the company's largest ever programme of customer engagement – marks a shift from customer engagement to customer empowerment.

Through WaterShare+ eligible customers are being given the option of a tangible stake through equity shares in Pennon, and the ability to hold South West Water to account through a customer annual general meeting and quarterly public meetings.

The New Deal is designed to redefine the relationship between the water company and its customers and was welcomed by the regulator, Ofwat, as 'setting a new standard' in the industry.

For the 2020-25 period, specific comparative service and environmental targets will be measured consistently across the whole industry on an annual basis and South West Water remains well-placed to make further progress in key business areas.

Highlights of the plan include two new water treatment works for the Bournemouth Water area, targeted water quality improvements in the South West, an ambitious leakage transformation project (see page 46), accelerated investment to further reduce the risk of pollution, and a range of technological upgrades to improve monitoring and response times across the company's drinking water and wastewater networks.

Sustainable future

Our focus on sustainability continues to underpin the activities Pennon undertakes and the way in which we undertake them. Following the launch of the Group's sustainability strategy in 2018/19 (see pages 20 and 21) we have deepened the integration of sustainability into all areas of business decision-making; from those taken within our core operations and services, to our approach to longer-term Group strategy and finance.

In every aspect of our business we remain committed to conducting our activities in a way which optimises business, societal and environmental value. This includes nurturing and developing our people as we focus on being a high-quality employer and a great place to work (see pages 38 to 41).

Outlook

In a changing world, with new challenges at local and global level, we are confident in our ability to adapt and develop for the benefit of customers and shareholders alike.

The ongoing strategic review, the decisions taken regarding the sale of Viridor, and the progress made within the water side of the business during 2019/20 gives us a strong platform to move forwards with our strategic priorities and the ambitious plans we have set out in the New Deal business plan.

With that in mind, I would like to thank all Group employees for their hard work over the past year and, in particular, for their enduring resilience during recent, testing times. From new apprentices to experienced professionals across all business functions, everyone plays a vital role in helping deliver the high-quality, value-for-money services our customers and stakeholders depend upon.



Chris Loughlin
Chief Executive Officer

Supporting customers in vulnerable circumstances

We remain committed to providing support for customers in vulnerable circumstances and, as part of the New Deal business plan, we have committed to reducing bills and tackling water poverty.

In 2019/20 we continued to support customers through a range of industry-leading affordability measures, including the WaterCare+ scheme, which assists those with affordability or debt issues. More than 35,000 have now been supported through one or more of the schemes available and over 25,500 are on a support tariff. Work also continues to support customers through our water efficiency campaigns and initiatives.

Recognising the potential economic impacts of both COVID-19 and Brexit, we continue to review and assess the most appropriate ways in which to provide extra support to those who need it.

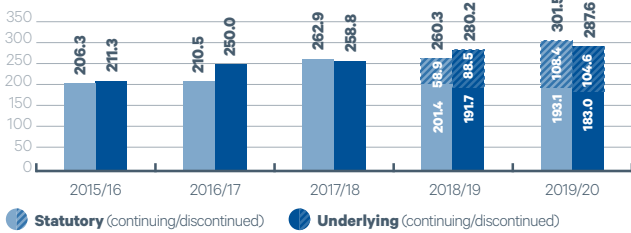


Key performance indicators

Annual⁽¹⁾

Operational

Profit before tax (£m)

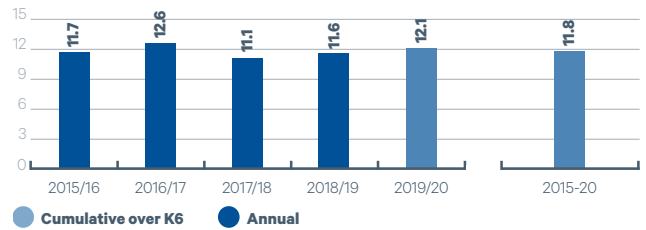


Alignment to strategy

1 2 3

For more information and discussion of our performance during the year see the Report of the Chief Financial Officer, pages 50 to 57.

Return on regulated equity (RoRE) (%)



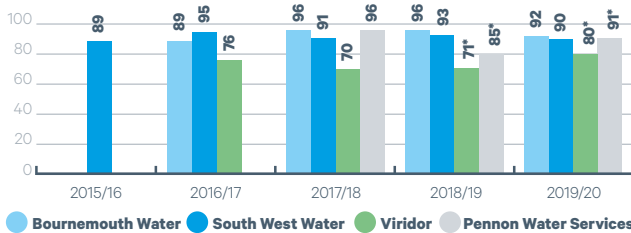
Alignment to strategy

1 2 3

For more information and discussion of our performance during the year see Our operations, Water and wastewater, pages 42 to 46.

Sustainable business

Customer satisfaction with overall service (%)



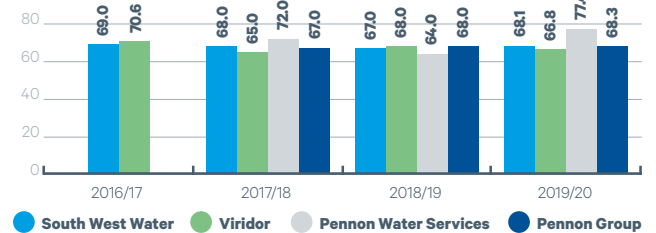
Alignment to strategy

1 3

For more information and discussion of our performance during the year see Our operations, pages 42 to 47.

* Basis of measurement for Viridor changed during the year. Pennon Water Services based on Trust Pilot score.

Employee engagement (%)⁽²⁾



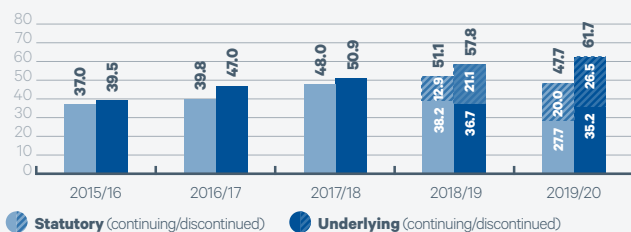
Alignment to strategy

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For more information and discussion of our Group-wide employee survey see Our people, page 38.

Long-term⁽¹⁾

Earnings per share (pence)

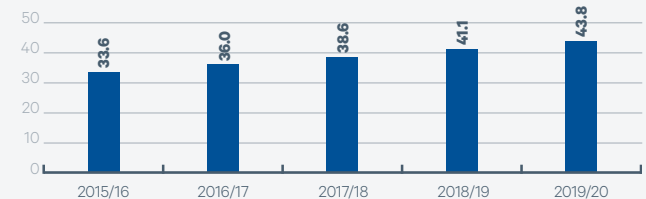


Alignment to strategy

1 2 3

For more information and discussion of our performance during the year see the Report of the Chief Financial Officer, pages 50 to 57.

Dividend per share (pence)

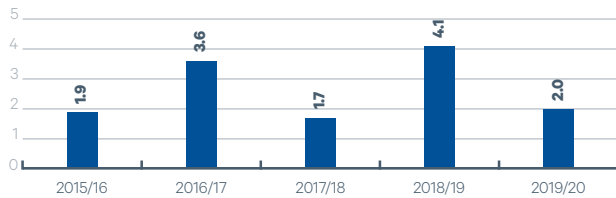


Alignment to strategy

1 2 3

For more information and discussion of our performance during the year see the Report of the Chief Financial Officer, pages 50 to 57.

ODI net rewards (£m)



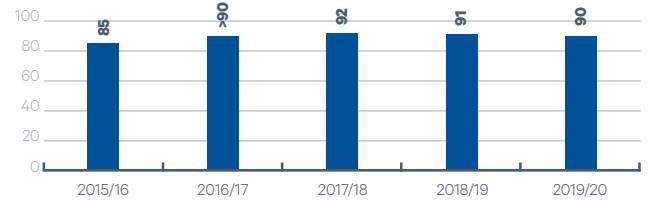
Alignment to strategy

1 3



For more information and discussion of our performance during the year see Our operations, Water and wastewater, page 45.

ERF availability (%)⁽³⁾



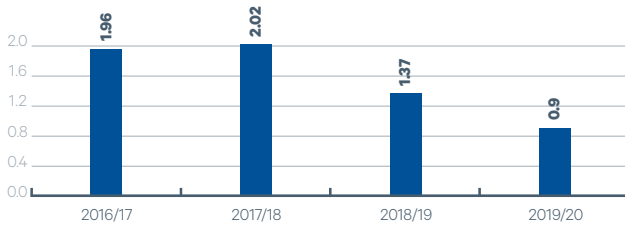
Alignment to strategy

1 3



For more information and discussion of our performance during the year see Our operations, Waste management, page 49.

Health & safety (LTIFR)⁽⁴⁾



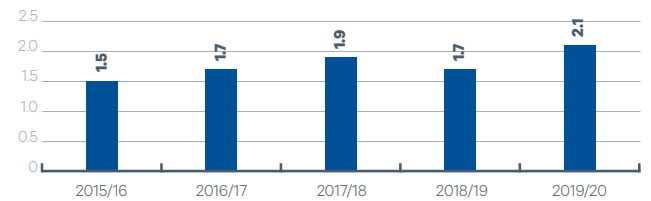
Alignment to strategy

1 2 3



For more information and discussion of our approach to health & safety during the year see the Chairman's statement, page 10, the Chief Executive Officer's review, page 32 and Our people, page 40.

GHG emissions (million tCO₂e)⁽⁵⁾



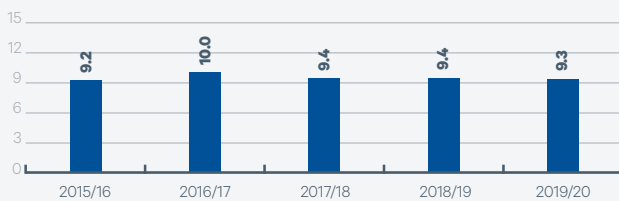
Alignment to strategy

1 3



For more information and discussion of our performance during the year see the Directors' report, pages 116 to 119.

Return on capital employed (RoCE) (%)



Alignment to strategy

2 3



New metric introduced for the LTIP in 2017.

Our strategic priorities

1

Leadership

2

Cost base efficiency

3

Sustainable growth

Our KPIs are aligned to our three strategic priorities.



For more information on our strategic priorities see pages 16 to 19.

- (1) For further information on the relevance to Executive Directors' remuneration see pages 94 and 107 to 109.
- (2) In 2017/18 we introduced a Group-wide employee survey, which changed the methodology for calculating employee engagement.
- (3) Weighted by capacity. Includes joint ventures at 100%, excludes GRREC due to different technology.
- (4) Lost time injury frequency rate (LTIFR) for employees and agency staff per 200,000 hours worked.
- (5) Gross Scope 1 & Scope 2 emissions – million tonnes carbon dioxide equivalent (location-based).

Our people

Talented, empowered people working safely to deliver for our customers and communities.

Becoming a great place to work

We are committed to engaging employees in our strategy and the important role they play in delivering it. We know companies with high trust cultures enjoy better financial results.

Research shows best workplaces outperform the market by 2 to 3% a year over a 25-year period. They have strong leadership, a talented workforce, are more collaborative and more innovative.

This was the third year we asked employees how it feels to work for Pennon using Great Places to Work Best Workplace Survey™. We were pleased to see our highest ever response rate of 83%, an 11% improvement on last year and an improved Trust Index© score of 63%. This is significantly higher than the national average of 53%. We also maintained our strong engagement score of 68%. These results show that we are well on the journey of embedding the Group's HR strategy and demonstrate that we are continuing to make progress in living our values and being recognised as a UK Best Workplace™.

The 2019 Great Place to Work survey asked employees to comment on a wide range of topics including communication and involvement, job security, culture, diversity, recognition, strategy, talent management, teamwork and wellbeing, as well as work environment and processes.

We have made improvements on all the key focus areas of last year, which were communicating our strategy and direction, values and ethics and reward, demonstrating that living by our values is making an impact. For 2020/21, we have decided to focus on: teamwork and collaboration; healthy working environment; and line manager communication and involvement.

The Group's highest scoring categories for 2019 included diversity at 84% favourable, line management at 75% favourable, and empowerment and accountability at 73% favourable.

We also undertake 'pulse surveys' during the year as an additional way to get employee feedback and have used this method to get feedback on health & safety, home working during COVID-19 and our consultation on modernising our pension arrangements.

Incorporating employees' views

Under the Financial Reporting Council's updated code of standards, companies are now required to explain how they are incorporating employee views in Board decisions. We welcome this.

We have continued to develop and evolve our staff forums across the Group to ensure employees are represented and have opportunities to understand and feed into discussions on matters that impact them and the work they do.

Employee forums

The Viridor Employee Voice Forum is now well established, with 50 representatives from each area of the business. Representatives work with the Viridor leadership regarding all aspects of the business and attend both functional and national Voice Forum events. This year, members were invited to attend the Senior Leadership Forum in November so that they were able to share with colleagues what was being discussed at a senior level. We invest in training of our representatives, for example how to understand behaviours using the DiSC (dominance, influence, steadiness and compliance) method.

The South West Water Employee Engagement Forum has been running for two years in its current format and has become an established group of employees who meet regularly to create a two-way communication between senior managers of the Group and employees. This forum also helps to influence and support business changes, including being the employee voice in the recent pension consultations, and ensures that our employees are front and centre for all that we do.

Our Speak Up whistleblowing policy continued to operate throughout 2019/20, providing another engagement channel. Speak Up helps to create an open, transparent and safe working environment, where workers feel able to speak up and are supported if they do so. Further information can be found on page 83.

The Pennon Big Chat continued throughout 2019/20 increasing in frequency from four to six updates in the year. It is now in its third year and allows all employees across Pennon Group the opportunity to put any question direct to the Pennon Executive; this initiative has been well received by employees. Discussions always start with a focus on health & safety; other topics on the Big Chat have included, progress on the Group's Strategic Review, how we are managing through COVID-19 and sharing of the engagement results and progress on actions.

Diversity and equal opportunities

Changing the diversity landscape across an organisation the size and scale of Pennon needs awareness and action at all levels, and requires a cultural shift as well as targeted activity. Building a sustainable, agile and diverse workforce is a key pillar of our HR strategy. We have taken steps to make progress in this area which continues to be led at Board level. Across Pennon, the workforce comprises almost 5,000 employees with a gender split of 77% male and 23% female, a 2% increase in the proportion of female employees during the year. Our permanent workforce is supported by around 1,200 temporary and agency employees throughout the year.

We have reviewed the Group's recruitment practices and are now able to monitor diversity in all Group job applications. The Group now also uses a software gender decoder tool which allows us to check all our job advertising for masculinity to reduce the potential risk of alienating female applicants. In addition, we have refreshed our equal opportunities forms to be included in all onboarding packs. The new version allows us to report on sexual orientation, gender identity, ethnicity and disability and to include in annual reporting.

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

According to the latest Energy & Utility Skills demographics, 5% of the sector identifies as BAME. Pennon stands at 2.7%, which is similar to 2.8% last year. This is a self-reported figure and is believed to be under-reported.

Our gender pay gap

This is the third year where employers in Great Britain with more than 250 staff have been required by law to publish their gender pay gap on their own website and on a government website. The current national average gender pay gap is 17.3% for all employees.

The aggregated Pennon Group gender pay gap for 2019 is 4.1%, which is an increase of 1.4% from 2018. Viridor has a gender pay gap of 7% and at South West Water it is 5%. The main driver for the Group increase is the move to standardise pay review cycles across the Group to 1 April each year. This change largely impacted Viridor, which has a higher proportion of male workers, therefore moving their pay review date from 1 June and affecting calculations for this year.

In Pennon, the number of female employees within the upper-middle quartile has grown significantly from 215 to 262 and in the upper quartile from 191 to 375, indicating that the pipeline of female talent is growing.

According to Energy & Utility Skills, across the water industry workforce 20% are identified as female, which places South West Water, at 29%, slightly ahead of the sector. The waste and resource management workforce is 15% female and Viridor, at 18.7%, is also ahead of the sector.

The Board promotes equality of opportunity and diversity across all areas, including gender and ethnicity. The Group has more to do in this area which remains a key focus – see the Nomination Committee report on page 90 for further details.

Training and development

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

We continue to embrace apprenticeships and since 2017 we have started 575 new apprenticeships across the Group. This increased by 191 during the past year, including 39 existing Viridor employees who began a team leader apprenticeship to improve their management and leadership capabilities. Find out more online at www.southwestwater.co.uk/careers/apprenticeships.

Our current graduate programme consists of 58 graduates across four cohorts with our next intake scheduled for September. To date, nine of those graduates have been offered permanent roles as they complete their structured programme of development and experience across the Group.



Our people strategy supports our sustainability goals

We are part of the 30% Club mentoring programme, which is a global campaign by CEOs and chairs to actively increase gender diversity at board and senior levels within organisations. Our participation in the 30% Club has increased during 2019/20 and three of our senior leaders are now actively mentoring future women leaders. We also have three mentees who joined the programme in 2019. The plan is to expand this to 20 members in 2020, demonstrating our commitment to investment in future female leaders.

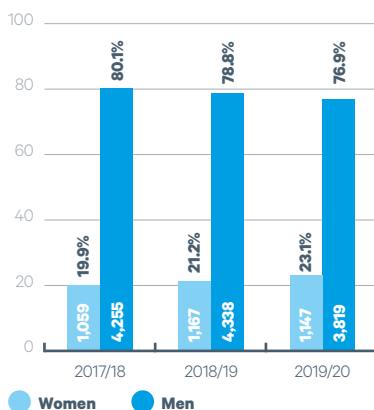
Sustainability focus area



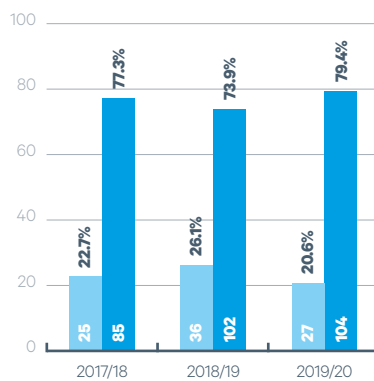
See sustainability strategy on page 20.

Gender diversity as at 31 March

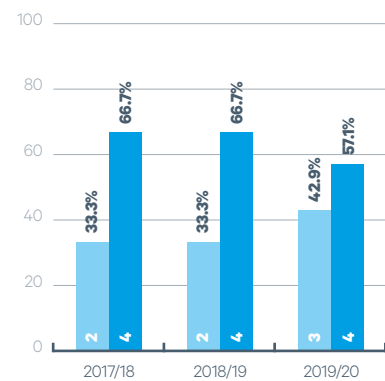
Employees



Senior management



Board



Our people continued



Community

Pennon has a significant community and educational programme across the regions where we operate. Viridor has 11 educational centres which welcomed 7,283 visitors last year, in addition to delivering 186 outreach events, involving 44,841 people in our communities. South West Water has seven learning and education centres.

Last year, our multi award-winning science, technology, engineering and mathematics (STEM) projects included mentoring 60 students and hosting 25 work experience placements.

We are a leading sponsor of Go4Set across Scotland enabling 210 student teams to tackle 10-week STEM projects using business management techniques. We also continue to collaborate with seven local educational establishments to inspire young people through our long-term STEM projects.

We have been a lead partner in the South Devon University Technical College since it opened in 2016. This specialist school has a curriculum focused on careers in water, engineering and the environment and South West Water provides work experience and real-life challenge projects.

Sustainability focus area



See sustainability strategy on page 20.

Our MBA apprenticeship programme was first launched in 2017 in partnership with Cranfield University, with two small cohorts of delegates. In 2018, we extended the MBA apprenticeship nationally across the business in partnership with Exeter University. The programme has been designed to focus on our core business functions and situational analysis of the organisation. With a 100% success rate, the first cohort with Cranfield University have now achieved their MBA and passed end-point assessment with a merit or above.

Within our second cohort we anticipate a further 100% success rate. Our partnership with Exeter University continues to grow with 14 employees undertaking their MBA and a further four being nominated for our next intake.

Our Group-wide turnover rate in 2019/20 was 18.05%. While this is a small increase on last year, it remains at a healthy level for the Group, enabling us to attract new talent during the year.

Responsible employer

We continued to live our values and demonstrate we are a responsible employer during the year. Pennon has maintained its membership of the Slave-Free Alliance, which is part of Hope for Justice, the global anti-slavery charity. Our membership demonstrates our commitment to the highest employment standards for both our direct employees and those within our supply chain. We also continue to be a signatory of the Social Mobility Pledge, the cross-party campaign to improve social mobility in the UK established by the Rt Hon Justine Greening MP. This pledge reflects our social commitments through our partnerships with local schools, our open door approach to visitors and our provision of work experience opportunities. Our head office and customer call centre are based in Exeter, providing jobs and investment to the local community.

Human rights

We are fully supportive of the principles set out in the UN Declaration of Human Rights and the Group ethics policy outlines the high standards of employment practice with which everyone in Pennon Group is expected to comply. The Group also supports the International Labour Organization's core conventions for the protection and safety of employees wherever they may work throughout the Group. These standards are also embedded in our sustainable supply chain and documented in our procurement policy and code of conduct for supply chain partners.

Health & safety (H&S)

The Group's flagship health & safety programme, HomeSafe, was the focus of much attention and roll-out in 2019/20, with the substantial completion in Viridor and South West Water, and the extension to Pennon shared services at the start of 2020. As well as face-to-face training delivery, which has now reached over 3,300 staff, a further three HomeSafe e-learning packages were deployed across the Group, the most recent of which was targeted at mental wellbeing. This flexible method of online learning will continue into 2020 with the development of a further module focused on security and resilience.

Following the introduction of the HomeSafe 2025 strategy, which was signed off in 2018, a comprehensive range of activities have been delivered and progressed, including: upgraded supplier H&S assurance; mental wellbeing pilots in South West Water and Viridor; a Group-wide substance misuse policy; and the procurement of an online incident investigation and root cause analysis system.

The introduction of our new incident management system (PIMS) in April 2019 has delivered improved reporting capabilities and data capture, allowing trend analysis, severity-based reporting and a strengthened incident investigation and review process. All lost time injuries and high potential incidents are subject to a higher level of investigation, with the latter subject to independent investigation and formal incident review panel. This is designed to establish accountability, causation, action and ultimately drive learning across our business operations

Significantly, Viridor was certified to ISO 45001:2018 in July 2019, and South West Water made substantial progress towards certification to the same standard, which is expected by the end of 2020. These improvements, coupled with enhancements to H&S new starter induction, new Group standards, and improvements to our health surveillance arrangements, are putting us firmly on track to achieve our ambition of 0.50 lost time injury frequency rate⁽¹⁾ (LTIFR) by 2025.

LTIFR remains the Group's primary measure of injury performance and is subject to year-on-year target setting. In this review period, the Group achieved an LTIFR of 0.90 against a target of 1.09, a reduction of 34% when compared to the previous year. To achieve a broader balance of H&S metrics across the Group, we introduced further key performance indicators focused on occupational

ill-health, scores from our employee engagement survey, safety visit impact assessments, and safety observations raised and closed. Baseline results from these metrics will be used to set targets in the forthcoming period.

We will continue to pursue our HomeSafe 2025 strategic themes and activities this year, which will realise further progress in areas including: task risk assessment; supervisor training and competence; occupational monitoring; and crisis management.

Measuring our 2025 strategy effectiveness

The Group continues to measure progress carefully and Pennon's Sustainability Committee monitors the five key performance indicators set in March 2019. These include the core H&S measure as well as targets on leadership, occupational ill-health, hazard removal and the engagement score from the annual Great Place to Work survey. We will also arrange independent benchmarking of its approach and outcomes.

(1) A lost time injury is defined as any work-related injury that results in a person being unfit for work on any day beyond the day of the incident. Lost time injuries are expressed as a frequency rate (LTIFR) per 200,000 working hours.

Resource efficiency

In November 2019, Group IT needed to attract and appoint a wide range of specialist IT staff as a result of the new IR35 legislation. We promoted our brands through a variety of online media and encouraged applications from candidates who needed flexible working hours or location to attract the widest possible pool.

Candidates highly rated our recruitment process – 75% of responses rated their experience as very good or excellent. We used an innovative platform to digitally screen the 1,100 applications we received.

The resourcing project, led by Group Recruitment, was successful with hires for the majority of positions. All hires were directly sourced, which gave us the opportunity to increase our female representation in Group IT and also to bring in our own employees to replace contractors, with the aim of securing a more sustainable, long-term resource.

Non-financial information statement

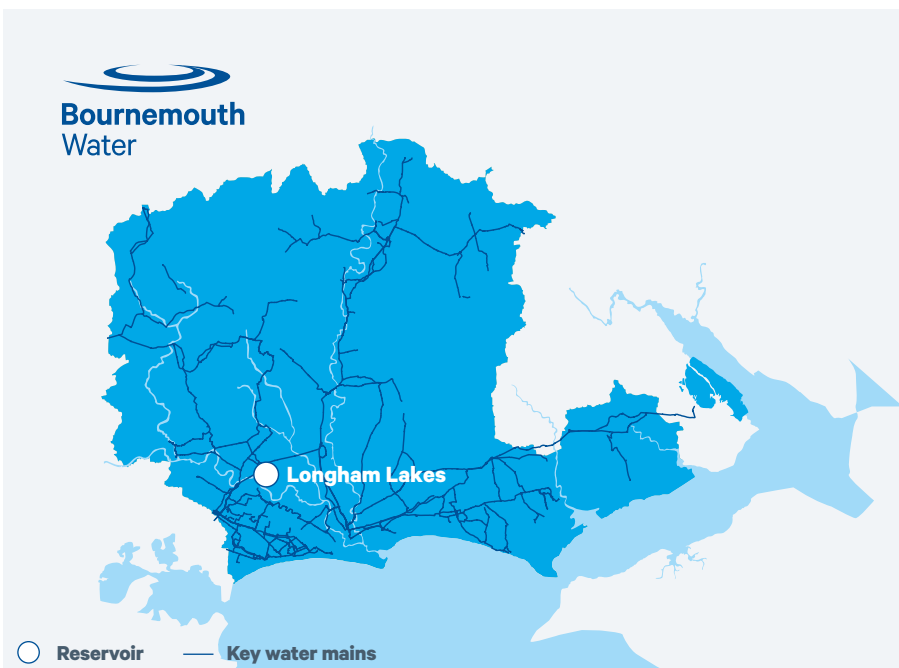
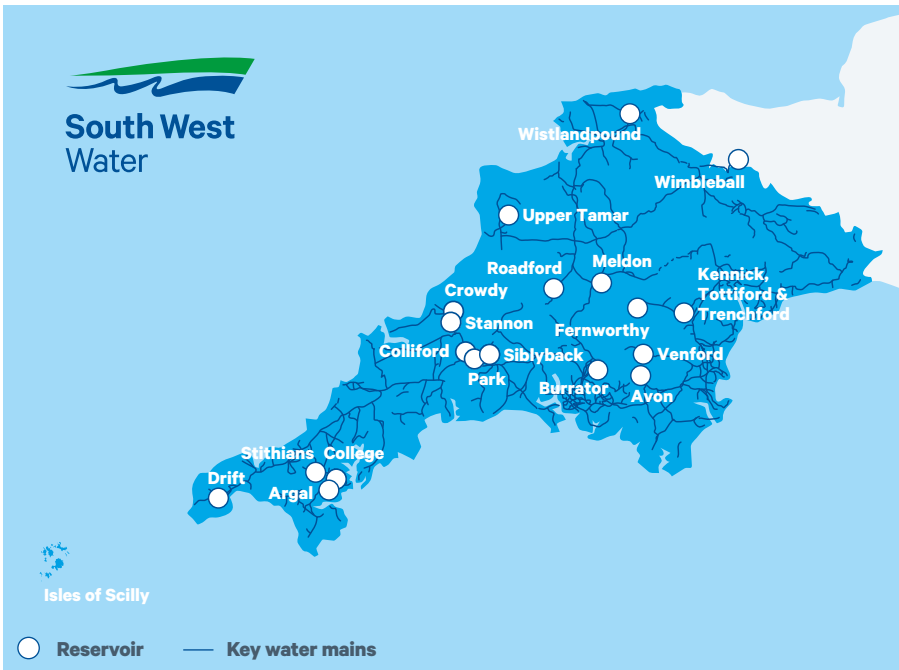
The following table summarises the information required by section 414CB Companies Act 2006, and/or indicates where this information can be found within the annual report. Due diligence is carried out on all of our suppliers, and all are required to adhere to our code of conduct for supply chain partners.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

	Description of policies	Policy outcomes	Principal risks and risk management	KPIs
Environmental matters	Our social and environmental policy seeks to ensure that we pursue activities that conserve, protect and enhance the natural environment. Environmental compliance is monitored as part of the regulatory framework within which the business operates.	The policy underpins the environmental improvement programmes set out on page 20.	Environmental non-compliance may lead to non-delivery of regulatory outcomes and performance commitments – see page 66.	See pages 21 and 37.
Employees	We have a wide range of employment policies that are designed to protect and support our workforce. The key features of these policies are disclosed on page 116 and as follows: <ul style="list-style-type: none"> Health, safety and wellbeing (page 40) Diversity, respect and inclusion (pages 38 and 91) Code of Conduct (page 83) 	The policies seek to achieve the highest workplace standards, as explained on page 20 and an engaged workforce, as reported on page 38.	Risks relating to health & safety and employees, and their mitigations, are set out on pages 64 and 66.	See pages 21 and 36 to 37.
Social matters	Our social and environmental policy requires us to undertake our activities in a way that minimises potential adverse effects on society and has a positive impact on the local economy. Our community relations and investment policy enables strong and clear governance for making positive community investments which create value and benefit both for the community and the businesses.	The policies support the social capital improvement programmes set out on page 20 and the activities reported on page 40.	A number of our principal risks would impact our communities if they occurred, for example: business interruption, poor operating performance and cyber risks. See pages 65 to 67 for further information.	See pages 21 and 36.
Respect for human rights	Pennon's Code of Conduct (described on page 83) confirms our respect for human rights throughout our operations and our anti-slavery & human trafficking policy requires the implementation and enforcement of systems and controls to ensure modern slavery is not taking place anywhere within our own business or in our supply chain.	We will not tolerate human rights abuse or modern slavery in any form and have developed processes and procedures to manage the risk of potential non-compliance (see page 116).	We explain the risks relating to non-compliance with laws and regulations and their mitigations on page 63.	We have a zero tolerance approach across the Group and within our supply chains.
Anti-corruption and anti-bribery	A description of our policy on anti-bribery and anti-corruption (including due diligence and enforcement procedures) is provided on page 83.	The policy's outcomes are explained on page 83.	We explain the risks relating to non-compliance with laws and regulations and their mitigations on page 63.	We have a zero tolerance approach to bribery and corruption.

Our operations

Water and wastewater

As we reach the end of the K6 (2015-20) period South West Water remains well positioned to forge ahead with its ambitious New Deal business plan for the next five-year period having once again made good progress across all business areas during 2019/20.



Highlights of the year

2.2
million total
population served

23
raw water reservoirs

650
wastewater
treatment works

17,515
km wastewater
mains network

18,370
km of drinking water
mains network

1,501
employees

34
drinking water
treatment works

151
bathing waters
and 24 shellfish waters

Excellence in drinking water

On the drinking water side of the business South West Water continued to deliver outstanding quality tap water in both service areas, achieving 99.98% and 99.99% in the South West and Bournemouth regions respectively.

Careful management of resources, particularly following the unusually dry weather of 2018, ensured there were no water restrictions placed on customers in 2019, leakage levels were successfully kept in line with target and the company outperformed its target for minimising supply interruptions.

Furthermore, in the South West Water area, contacts about the taste and appearance of drinking water were reduced to their lowest ever level.

Throughout the 2015-20 period South West Water has delivered major investment in our drinking water assets and networks, exploiting the use of technology and innovation in areas such as network modelling, to improve the efficiency and sustainability of our operations.

This included the start of a c.£10 million investment in new granular activated carbon (GAC) disinfection treatment processes at our College water treatment works. We also carried out extensive refurbishment work on our drinking water mains networks.

In 2019/20, the flagship Mayflower drinking water treatment works in Plymouth also went into commissioning and is due to enter operations in summer 2020. The first of its kind in the UK, the Mayflower is now undergoing rigorous performance testing and will provide the blueprint for future treatment facilities in the Bournemouth Water area.

Meeting customers' needs and expectations

South West Water's strategy is designed to prevent issues and problems arising, thereby avoiding the need for customers to contact us. However, when a customer does need to make contact, every effort is made to resolve the matter as quickly and as professionally as possible.

In recent years South West Water has radically improved the level of service its customers receive.

In addition to investing in team development, training and internal systems the company has taken a proactive approach to customer communications and made use of digital platforms, data analysis and 'co-creation' to improve the customer experience.

Having already surpassed its 2020 target for customer service, as measured by the service incentive mechanism (SIM), South West Water continued to improve its service offering in 2019/20. For the new regulatory period, a new customer experience metric (CMex) has been introduced, and we have been focused on these changes in our delivery plans this year.

This included improving the website to increase self-service options; making digital actions easier through clearer online messages and improved navigation; and increasing webchat to provide customers with answers quickly and increase first time resolution.

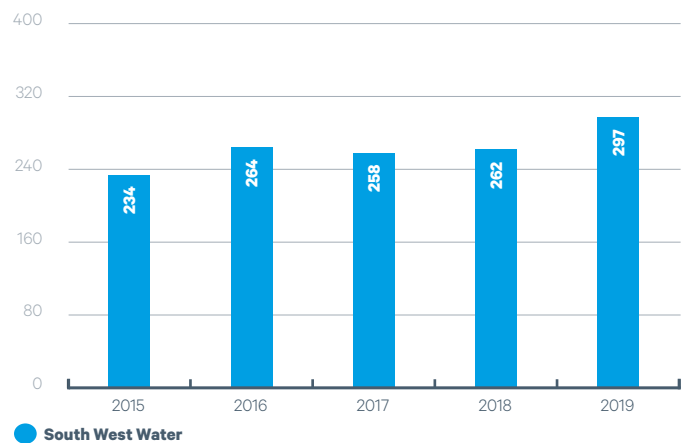
Delivering services which reflect the priorities that matter most to our customers has resulted in complaints to South West Water reducing by 16.7% this year, that is 56.5% since 2015/16. Bournemouth Water complaints have also reduced by 66.7% in this time.

Providing value for money services remains central to all of South West Water's business activities and in cases in which customers struggle to pay their bills a range of additional support measures are available. To date, >35,000 customers have received support from one of our support schemes including WaterCare+ which assists those with affordability or debt issues, and >25,500 customers are currently on a support tariff.

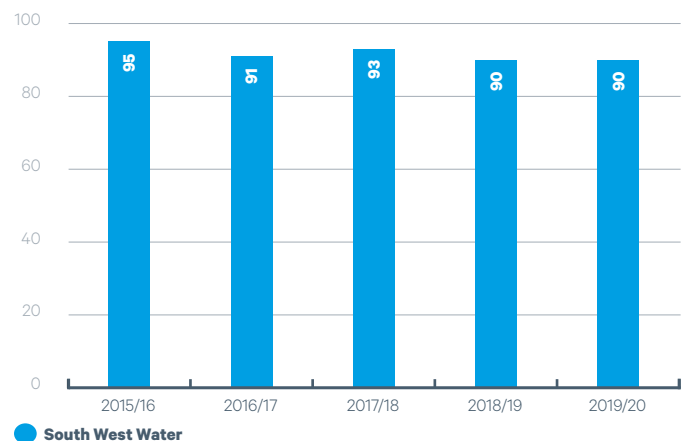
Customer satisfaction with overall service remains high. In 2019/20 South West Water achieved its 2020 committed performance target of customer satisfaction at 90% and there was further improvement in the percentage of customer contacts resolved first time across both drinking water and wastewater operations.

Furthermore, during the COVID-19 pandemic South West Water has successfully maintained the vast majority of its services, having taken swift and responsive action to ensure critical operations and essential services, particularly for vulnerable customers, would be unaffected.

Pollutions (Categories 1-4)⁽¹⁾



Customer satisfaction with overall service (%)



Investment in wastewater improvements

During 2015-20, South West Water set itself ambitious targets to improve wastewater services, reduce the risk of pollution and prevent sewer flooding.

Despite having maintained our best-ever results for wastewater treatment and reduced internal sewer floodings by 12% over K6, South West Water narrowly missed its 2020 targets in each of these performance areas.

While this is disappointing, targeted action plans are in place in order to build on the significant progress made up to this point.

Similarly, following a concerted effort to reduce the risk of pollution through a range of initiatives and investments, we have seen a year-on-year reduction in the number of serious (Categories 1 & 2) incidents since 2015.

Our target of zero by 2020 was missed due to a single Category 2 incident in 2019.

(1) Category 1-4 wastewater pollutions.

Our operations

Water and wastewater continued

Alternative water supplies

Recognising the vital importance of ensuring the reliability of customers' drinking water supplies, South West Water has invested in the recruitment of a dedicated alternative water supplies team, tasked with responding quickly and effectively to any network issues.

A key component of the company's strategy to tackle supply interruptions during 2020-25, the 18-strong team is being supported with a significant investment in new equipment and technology.

This includes state-of-the-art response vehicles with pumping capabilities and the capacity to be plumbed into the mains network in order to maintain supplies during mains bursts or when planned work is being undertaken.

The company has also invested in its ability to carry out large scale water deliveries, with two new lorry units capable of carrying bulk supplies of bottled water or portable water tanks.

The investment in this dedicated resource means South West Water will be better able to deliver large volumes of water to areas at risk of supply interruption. It also ensures that the impact of supply interruptions on customers can be minimised even during the most challenging of circumstances.

With respect to the less serious pollution incidents (Categories 3 & 4) we recognise that this is a challenging area for South West Water and we are fully committed to tackling these issues during the 2020-25 period.

As such we have implemented an accelerated pollution plan. This includes:

- The implementation of a dedicated pollutions task force
- Significant increases in resources for sewer cleansing and pumping station inspection/maintenance
- Strengthening our incident response capability.

Furthermore, we are investing in improved root cause analysis, developing asset specific plans for treatment works, networks, and pumping stations, enhancing our customer campaigns to help reduce blockages and driving a culture change within the organisation.

In May 2019 South West Water was fined £44,000 plus costs for a 2017 pollution offence caused by a blocked sewer at South Sands, Salcombe. The company has invested £2.9 million since 2013 to address saline and sand ingress in the Salcombe area, to minimise the risk of this type of incident. On 1 April 2019, the Environment Agency accepted an Enforcement Undertaking from South West

Water to make a payment of £385,000 to the Westcountry Rivers Trust in relation to a pollution incident in Widewell Woods, Plymouth in 2016.

Health & safety

Our success as a company relies on the health, safety and wellbeing of our employees. Following the launch of the long-term HomeSafe strategy across the Pennon Group in September 2018 we have been implementing a range of measures and initiatives to protect our teams and support their physical and mental health. HomeSafe has been given greater visibility across our operations and engagement with the training programme has been high.

In 2019/20, there were 11 RIDDOR incidents in the South West Water area and zero RIDDOR incidents in the Bournemouth Water area.

The primary causes of such incidents in 2019/20 were slips, trips and falls and manual handling issues. Management actions are ongoing to improve performance.

A core aim of HomeSafe is to improve our key safety measure known as LTIFR (lost time injury frequency rate) from the 1.5 recorded for 2018/19 to 0.50 by 2025. This would place South West Water in the top quartile of the industry.

Following the implementation of the Group's HomeSafe programme the LTIFR across South West Water reduced to 1.27 in 2019/20 and we are therefore on track to reduce this to 0.50 by 2025, as well as reducing the number of RIDDOR incidents.

Protecting the environment

The major investment South West Water has made in measures to help protect bathing and river water quality continues to support the region's high standards in each of these areas and the company continues to work closely with partner organisations and landowners to manage water and wastewater in a more sustainable and holistic way.

Bathing water quality results for Devon and Cornwall were once again extremely high in 2019/20 which saw the largest proportion (82.8%) of bathing waters meeting the 'excellent' criteria since this more stringent standard came into effect in 2015.

All but two met the 'sufficient' standard and neither of these failures were related to the performance of South West Water's assets.

Other environmental work during 2019/20 included the completion of South West Water's 2015-20 programme of river water quality upgrades and the ongoing expansion of the company's award-winning catchment management schemes – Upstream Thinking and Downstream Thinking.

Through the former, South West Water has worked to improve the water quality at 1,604 farms located upstream of water reservoirs and river abstractions.

The company has also restored 10,655 acres, (4,312 hectares) of moorland, culm grassland and other semi-natural habitats in this period.

This benefits raw water quality and biodiversity while reducing flood risk.

Environmental programme 2020-25

As part of its 2020-25 business plan, South West Water is launching its largest environmental programme in 15 years, recognising that a healthy environment is vital for the long-term sustainability of the services we provide to customers. This includes targeting the following:

- Zero serious pollutions
- Lowest number of minor pollutions in the industry
- Industry-leading wastewater compliance
- Improving and maintaining the number of high-quality bathing and shellfish waters
- Further 15% reduction in leakage levels with no overall incremental expenditure increase or impact on customer bills (see page 46)
- Protecting our river systems and expanding our industry-leading catchment-based programmes
- The delivery of long-term drainage and wastewater management plans.

Sector-leading outperformance

In 2019/20, South West Water once again delivered sector-leading financial performance maintaining a cumulative RoRE of 11.8% since the start of K6.

This industry-leading performance comprises 6.0% as the base return, 2.6% totex savings and efficiencies, with 0.3% reflecting a net reward on ODIs. The remaining 2.9% reflects the difference between actual and assumed financing costs using a cumulative forecast retail price index over K6 of 2.8%, consistent with the way we calculate our innovative WaterShare mechanism. Cumulatively, this WaterShare RoRE outperformance is broadly consistent with the approach adopted by Ofwat.

Total expenditure savings

During 2019/20, we continued to deliver cost efficiencies and delivered £297 million of savings over K6.

ODI rewards

Operational performance resulted in a net ODI reward of £2.0 million (£13.3 million cumulatively over K6), reflecting an annual equivalent RoRE outperformance of 0.3%.

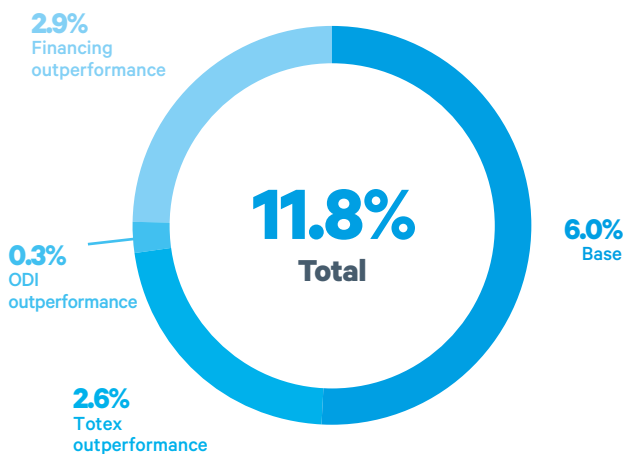
Wholesale services

Since the opening of the non-household retail market in April 2017, South West Water has successfully engaged with 21 different retailers.

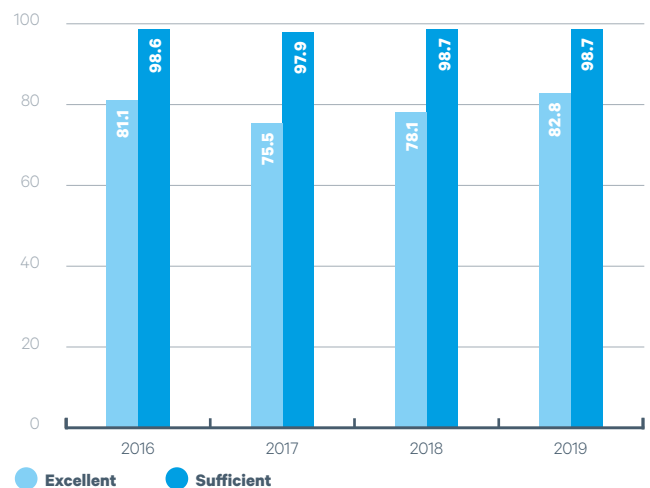
Our wholesale service desk continues to operate effectively. During the COVID-19 pandemic we took proactive steps to ensure close lines of communication were kept with retailers. All were contacted individually to discuss how operations would be changing and to understand their needs during the period, including their processes for identifying vacant premises due to the pandemic. Site visits were temporarily deferred and we were involved in discussions with Water UK regarding the guidance being provided to businesses regarding return to work.

(2) New standards introduced in 2015 under the EU's revised Bathing Water Directive. The classifications are 'poor quality', 'sufficient quality' (the new minimum standard), 'good quality' and 'excellent quality' (the new guideline standard).

Cumulative K6 RoRE



Bathing water compliance⁽²⁾ (%)



Our operations

Water and wastewater continued

Leakage transformation project

In 2019/20 South West Water once again met its target to maintain leakage levels at a maximum of 84 megalitres per day. Performance commitment levels in the Bournemouth area were also met.

Recognising that leakage is a high priority for customers, South West Water has undertaken a leakage transformation programme in readiness for targeting a 15% reduction in leakage levels across our South West Water and Bournemouth Water regions by 2025.

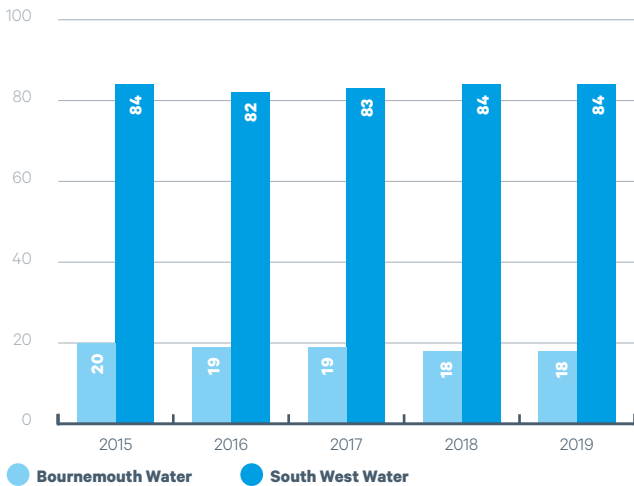
The greater deployment of 'lift and shift' acoustic loggers and fixed network sensors across our network is improving real time visibility, the targeting of leak detection activity and the productivity of leakage detection teams.

Alongside pressure management of the network, the enhancements made during 2019/20 provide a strong platform to deliver sustained levels of leak reductions over the longer term.

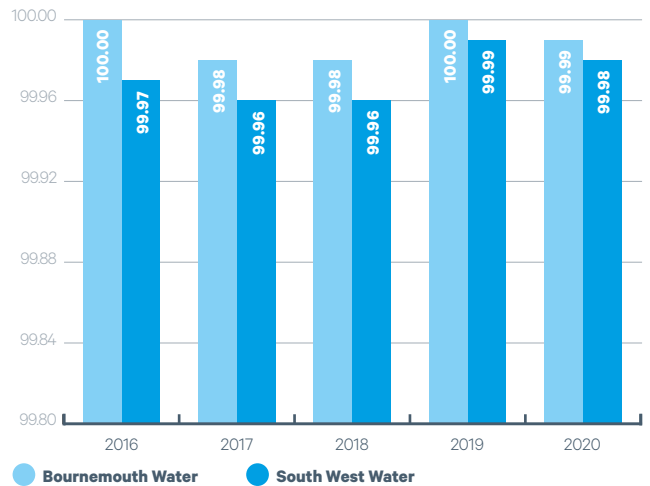
South West Water also continues to actively collaborate with other water companies to ensure best practice is shared for the benefit of all customers.



Leakage megalitres per day



Drinking water quality mean zonal compliance (%)



Our community

As well as providing essential water services, South West Water supports the area's economic sustainability, supporting the employment of some 5,300 people either directly or indirectly through our supply chain.

Working with partners and through our own events we fundraise and support community activities, conservation and wildlife programmes and environmental education campaigns.

Sponsorship and campaigns

As part of our 2015-20 business plan South West Water is committed to spending a minimum of £80,000 on community sponsorship and charitable donations.

In 2019/20 the company provided c.£200,000 worth of support for local charities and organisations.

South West Water's strategy is to link our sponsorship and charity support to initiatives which have clear links with our core business activities, such as protecting the environment, biodiversity and health and wellbeing.

Over the past year this included sponsorships for:

- South West Coast Path
- Devon Wildlife Trust
- Cornwall Wildlife Trust
- Surf Life Saving GB
- Beach Schools South West
- Environment Plymouth
- Devon Youth Games Trust.

In addition to our ongoing support for WaterAid – the water industry charity – we also provided £46,000 of charitable donations, including to the following:

- Cornwall Air Ambulance Trust
- Devon Air Ambulance Trust
- Age UK Devon
- Age UK Cornwall & The Isles of Scilly
- The Devon & Cornwall Food Association (DCFA)
- RNLI.

Furthermore, South West Water's wastewater team continued to fund the BeachCare programme with Keep Britain Tidy, which organises and coordinates voluntary, community-based beach cleans across the South West peninsula.

Support for education

South West Water's community team directly engaged with more than 2,300 primary schoolchildren about the water cycle in classrooms and school assemblies, including through Scouts and Guides groups.

Through Bournemouth Water's partnership with Dorset-based educational charity Life Education Wessex, curriculum-based Waterwise presentations and materials on the water cycle and water efficiency were delivered to 48 schools in the Bournemouth Water area, reaching more than 4,500 pupils.

Community access, conservation and recreation

Our reservoirs are managed for environmental improvements and for the benefit of our customers and communities through our partnership with South West Lakes Trust.

During the year we welcomed more than two million people to our recreational estate across both service areas. Around 72,000 people took part in organised recreation activities including sailing, windsurfing and kayaking. A further 5,000 participants have learnt new skills at the sites through the Trust's heritage and environmental education programme.

South West Water's dedicated community team also attended 34 high-footfall events including the Devon County and Royal Cornwall Shows, various regattas, food and drink and other community festivals and events.

We also continue to take part in the Heritage Open Days initiative. In 2019 we opened eight operational water and wastewater sites to the public, hosting behind-the-scenes tours for a total of around 400 people.

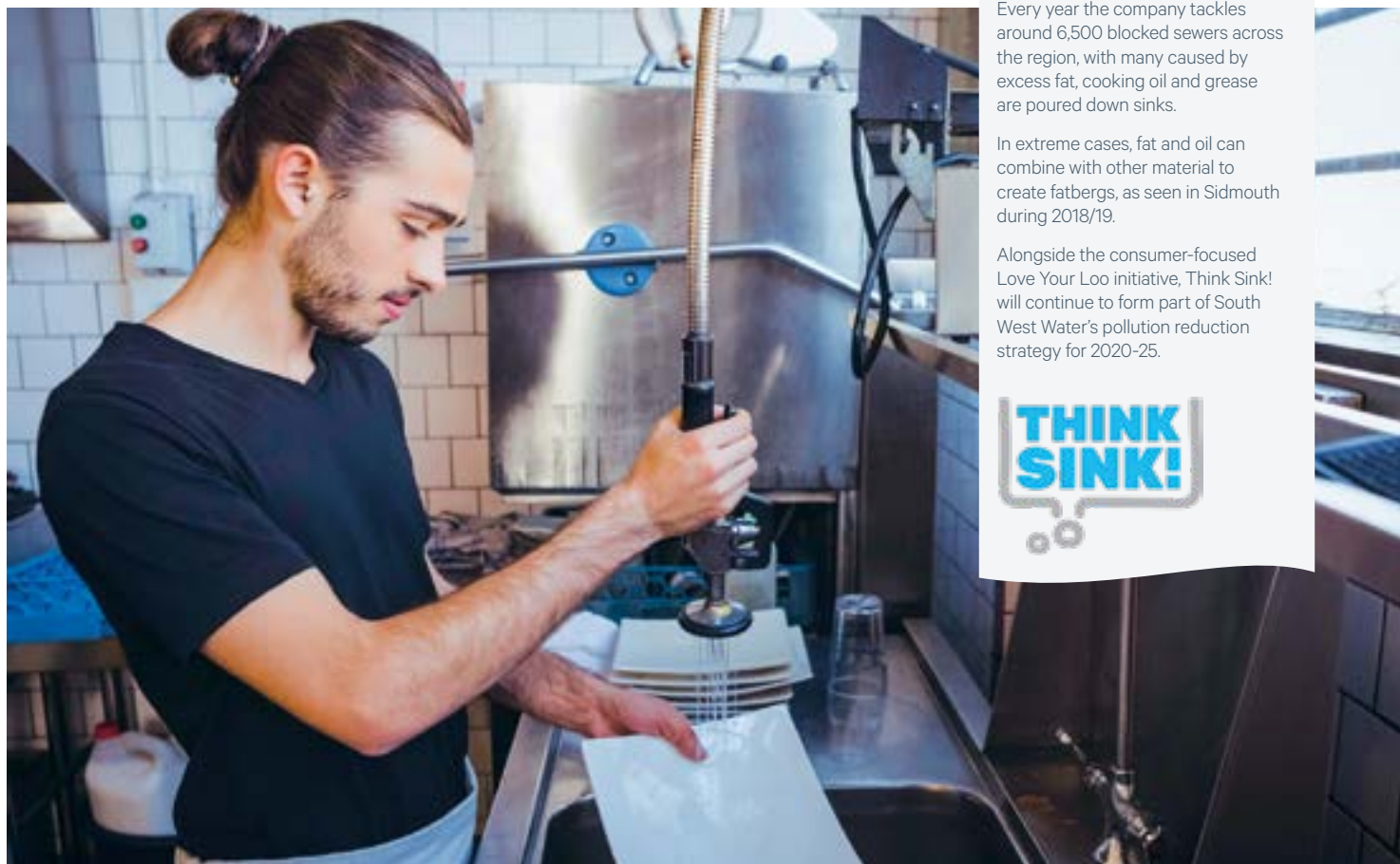
Think Sink!

Throughout 2019/20 South West Water continued the region-wide roll-out of its Think Sink! campaign reminding businesses and food service establishments of their responsibilities regarding the proper disposal of fat, oil, grease and food waste.

Every year the company tackles around 6,500 blocked sewers across the region, with many caused by excess fat, cooking oil and grease are poured down sinks.

In extreme cases, fat and oil can combine with other material to create fatbergs, as seen in Sidmouth during 2018/19.

Alongside the consumer-focused Love Your Loo initiative, Think Sink! will continue to form part of South West Water's pollution reduction strategy for 2020-25.



Our operations

Water retail services

Pennon Water Services continues to deliver excellent service to its customers and against its strategic objectives, doubling prior year earnings before interest, tax, depreciation and amortisation through strong growth in its strategic sectors and efficiencies delivered by investments in IT, process and its people.

Pennon Water Services service performance is part of a customer-centric approach which runs as a thread throughout the year and underpins its competitive advantage and reputation with key market influencers such as brokers interacting on behalf of clients. Across its brands Pennon Water Services customers rate it very highly with a score of 9.1 out of 10 through the independent review site Trustpilot, an increase on an already strong customer assessment of 8.5 out of 10 in the prior financial year. This trend continues into its customer complaint performance with a 41% drop in total written complaints and an upper quartile position in the market. Furthermore, improvements in its market compliance scores demonstrate its focus upon regulatory standards and measures with a top three market performance score for the full financial year among companies with more than 5,000 supply points.

The business has also shown strong resilience amid continuing market challenges affecting retailers, including poor market data, low customer awareness and low margins which have rendered large parts of the business switching market inert.

Focused on health & safety

Safety remains a top priority with Pennon Water Services demonstrating this along with its resilience and flexibility in March by its ability to quickly isolate 100% of its staff during the global outbreak of COVID-19. Mental health support was provided to employees while working in isolation to maintain the strong sense of team and cohesive culture which pervades the business. All employees were able to function fully within a home environment with its IT infrastructure, including customer call handling, operable remotely. This enabled Pennon Water Services to provide support and advice to its customers in a difficult time personally and professionally while protecting its employees, their families and the communities it serves.

Securing long-term partnerships

Pennon Water Services strategy of acquiring and retaining long-term partnerships in key sectors continues to succeed. 100% of all tendered customer contracts signed since the market opened on 1 April 2017 have been renewed. By tendering, customers have demonstrated a desire to switch supplier to find the best market value and service and in working with Pennon Water Services they have opted to stay with the business to take advantage of its customer-centric approach and advice. This is, in part, demonstrated by the renewal rate but also by the strong growth in the value of non-retail services delivered by Pennon Water Services in the past 12 months. Its customers have benefited from services such as leakage detection and repair, infrastructure and installation projects, alternative water sources and consultation services.

A sustainable approach

Community and sustainability remain important to Pennon Water Services. It continues to help global communities build and thrive by championing access to clean drinking water through the charity WaterAid while locally supporting beach cleans and helping businesses to use water more efficiently. Installation of boreholes and projects designed to allow businesses to recycle water back into their business process help to reduce network demand and support a more resilient water future for us all. At the heart of its support for business and communities are its people and, through work with Great Places to Work, Pennon Water Services has measured improvements to its employee engagement scores which also compare favourably to top performing companies in the UK.

Outlook

Further consolidation of the UK retail market and difficult trading conditions, exacerbated by COVID-19, continue to create a challenging environment which will flow into financial year 2021. While the full impact of COVID-19 on the non-household sector as a whole is yet to be fully understood, Pennon Water Services remains well placed to deliver against its long-term strategic objectives, growing organically and able to take advantage of opportunities to further consolidate the market for economies of scale should they arise.

100%

of new tendered contracts renewed

£51m

value of national customer contracts served



Source for Business

Source for Business[®] is the national trading brand of Pennon Water Services covering both England and Scotland.

 www.sourceforbusiness.co.uk


Source
for Business

(1) Pennon Water Services serves national customers through the Source for Business brand, additionally it operates regionally as South West Water Business, South Staffs Water Business, Bournemouth Water Business and Cambridge Water Business.

Our operations

Waste management

Viridor continued to perform strongly during 2019/20, with robust operational and financial performance across its business divisions. With its focus on operational excellence and ongoing efficiency Viridor has delivered continued progress in targeted growth areas. As it moves under new ownership, it is at the forefront of the resource sector in the UK, transforming waste into energy, high-quality recyclates and raw materials.

Health & Safety

Viridor continues to focus on health, safety and wellbeing, and during the year substantially completed the roll-out of the first phase of HomeSafe, resulting in over 2,700 employees trained since introducing HomeSafe in 2018. This, coupled with the development of a new management system, certification to ISO 45001:2018 and the completion of our mental wellbeing pilot, has contributed to a 43% reduction in our LTIFR compared with 2018/19.

Optimising ERF performance

There was strong growth in energy recovery with operational ramp-up at Glasgow, Beddington and Dunbar ERFs. Availability across the ERF operational portfolio (including joint ventures) was at 90%⁽¹⁾ for the fourth consecutive year.

The latest ERF at Avonmouth is now in commissioning and on track for operational ramp up in 2020/21.

Viridor announced its proposal to build a new ERF at Ford, West Sussex, in partnership with Grundon Waste Management, our joint venture partners at Lakeside ERF. The new facility will be built adjacent to Viridor's existing MRF.

As the UK market fundamentals for ERFs provide a solid foundation for growth, Viridor continues to progress a pipeline of options for two further ERFs.

Momentum in recycling to support a circular economy

The UK Government's Resources and Waste Strategy for England continues to provide positive momentum for the recycling sector, particularly in plastics, as producers focus on including more recycled content in their products.

Construction is progressing at the Avonmouth plastics processing facility.

Our high-quality recycled plastic offers manufacturers alternatives to sourcing virgin stock and has resulted in significant contracts with major manufacturers including Unilever, Proctor & Gamble and Klockner Pentaplast. Viridor continues to progress additional plastics processing facilities at its Ardley and Dunbar ERFs and has run stakeholder engagement events ahead of formal planning applications. This investment in UK plastics processing will help reduce Viridor's exposure to international markets and help develop a more sustainable waste value chain.

Our emphasis on producing high-quality recyclates contributed to an increase in recycling revenue per tonne to £118 from £115 per tonne in the prior year.

We have incurred higher costs in producing the right quality recycle. Global paper markets continued to be challenging, as the markets for high-grade export paper recycle effectively closed. Incorporating high-grade paper into the mixed paper streams saw paper price reductions, although Viridor's risk share mechanisms provided some protection in the volatile markets.

Landfill & landfill gas

Viridor continues to operate eight landfill sites flexibly to adapt to market need. The volume of landfill gas declined, but investment in new infrastructure and engines meant this decline was at a lower rate than experienced in previously years. Strong pricing from hedging activities and renewables pricing helped support overall performance.

Joint ventures outperform their original targets

The TPSCo joint venture (between Viridor and Inovyn) has performed strongly during the year with availability again in excess of 90%. Operational and financial performance at our Lakeside ERF (a 50:50 joint venture with Grundon Waste Management) also exceeded expectations for both processing waste and power generation.

Contracts

Viridor continued to work closely with local authorities and completed the transition of the Greater Manchester Waste Disposal Authority contract to another operator in May 2019 with minimal impact to Viridor earnings. Significant volumes of waste from this contract have been secured into our key assets.

Total waste material inputs

Total waste inputs dropped slightly to a total of 6.7 million tonnes (6.8 million tonnes in 2018/19). Within this there have been declines within landfill and recycling & other, offset by increases to ERFs. Landfill decline follows on from the closure of two sites during last year. Recycling & other has been impacted by the end of the Greater Manchester contract (May 2019) and increased focus on quality in the recycling market. Within ERF, inputs have increased due to full year operation of three new ERF sites (Beddington, Dunbar and Glasgow).

Enhancing environmental performance

Viridor's regulatory compliance performance for the calendar year 2019 improved in comparison with 2018. No Category 1 or 2 non-compliances (England and Wales), or significant or major non-compliances (in Scotland) were reported.

Highlights of the year

11

energy recovery facilities (ERF) including one in commissioning

500,000

potential homes powered by energy produced by our portfolio

34,000

customers across the UK

>200

recycling, energy recovery and waste management facilities

6.7

million tonnes of waste materials input

5.5

million tonnes of material recycled or recovered

(1) Weighted by capacity. Includes joint ventures at 100%, excludes GRREC due to different technology.

Report of the Chief Financial Officer

Financial review



We have delivered solid underlying performance through our sustainable approach to operations. This has resulted in a successful close to the K6 regulatory period for South West Water and the realisation of strategic value through the sale of Viridor.

Financially, Pennon is well positioned to manage the current COVID-19 situation with the Continuing Group's robust balance sheet, appropriate gearing levels and healthy liquidity.



Susan Davy
Chief Financial Officer

Overview

We have delivered a solid financial performance in 2019/20, in line with management expectations.

Our businesses provide essential services to local communities. We have a responsibility to deliver these well and our customers depend on our ability to operate in a sustainable way. Our approach ensures alignment with our values: trusted, responsible, collaborative and progressive.

We are at the forefront of sustainable financing through our successful financing framework and were the first water and waste company to achieve the Fair Tax Mark accreditation, which demonstrates transparency and best practice across the Group.

The COVID-19 pandemic impacts from March 2020 have posed unprecedented challenges to all businesses and the Group took timely and effective action to ensure essential service delivery has been maintained in line with Government guidelines.

While no business is immune to the impacts of COVID-19, the financial impact for the Group for 2019/20 has been in respect of recoverability of amounts owed by customers. A non-underlying charge of £90 million has been recognised across the Group in respect of expected credit losses (ECLs) arising from the disruption of COVID-19 in the year to 31 March 2020. During lockdown South West Water has seen a change in customer demand with a decline in wholesale demand from businesses (c.20%), particularly those within the hospitality and retail sectors, with c.84% of our household customers on a meter, we have experienced net increased residential demand of c.5% as people remain at home during this period. We continue to monitor these impacts closely, however any net shortfall in household and non-household demand in future years would be recovered through existing regulatory mechanisms.

The extent of the impact of COVID-19 on the UK economy remains uncertain with the risk of ECL from business and commercial customers increasing during and following lockdown. However, cash collections in April and May have remained relatively robust and Pennon Water Services has not taken advantage of wholesaler regulatory support through deferral of any payments at this stage.

In recent years, the strong collections performance for household customers, and use of our social tariff and support schemes, has successfully reduced our bad debt costs. We believe these support measures and our continued focus on collections will help mitigate the financial impacts of COVID-19.

The significant local authority contracted position in Viridor provides resilience to the underlying business, with strong ERF performance mitigating the volume impact from commercial & industrial customers in collections, landfill and recycling.

The essential nature of the services we provide and our sustainable financing strategy leaves the Group well positioned with strong funding and liquidity to weather the current uncertainty resulting from COVID-19. Cash and committed facilities of £1.6 billion were in place at 31 March 2020. £840 million of new or renewed finance was raised in 2019/20, including £245 million of funding for South West Water through the Sustainable Financing Framework.

On 18 March 2020, the Group announced the sale of Viridor to Kohlberg Kravis Roberts & Co. L.P. (KKR) equating to an enterprise value of £4.2 billion. The sale was approved by shareholders on 28 May 2020, European Commission merger clearance has been received and we are finalising the last condition precedent ahead of an expected completion in early summer. The sale will provide expected net cash proceeds to the Group of £3.7 billion realising significant strategic value from the sustainable investment that has been made in Viridor over the last 30 years.

As a result, Viridor's financial performance has been shown as discontinued operations in these financial statements with the assets and liabilities of Viridor being shown as assets held for sale at the balance sheet date.

Given the significant contribution of Viridor to the Group's results for the entire 2019/20 financial year, pro forma results for the whole Group including continuing and discontinued operations have been presented alongside the statutory results in the income statement.

On a pro forma basis, Pennon Group has again delivered a solid set of underlying results, robust cash flows, strong liquidity with a sound balance sheet position underpinned with low cost, flexible and sustainable funding. This supports our 2019/20 dividend growth of 4% above RPI. Underlying⁽¹⁾ earnings per share from continuing and discontinued operations rose by 6.7% from 57.8p to 61.7p, reflecting a 3.1% increase in underlying

EBITDA and a 2.6% increase in underlying profit before tax. The earnings growth for 2019/20 has been driven by our energy recovery facilities (ERF) portfolio expansion and a strong focus on cost control, benefiting both customers and shareholders. Pennon remains focused on ensuring it is well placed to capitalise on emerging opportunities.

Statutory earnings per share from continuing and discontinued operations fell by 6.7% from 51.1p to 47.7p in the main driven by a £41 million non-underlying deferred tax charge relating to the Government's decision not to go ahead with the planned reduction in the headline corporation tax rate from 19% to 17%.

While revenues marginally increased for the Continuing Group, the impact of lower wholesale water revenues on margins reduced EBITDA. As such, underlying earnings per share from continuing operations fell by 4.1% reflecting a 0.5% decrease in underlying EBITDA and a 4.5% decrease in underlying profit before tax. Statutory earnings per share from continuing operations reduced to 27.7p with the change in tax rate being the major contributor to the non-underlying charges.

During the year our effective interest rate on average net debt remained relatively low at 3.5% (2018/19 3.6%). One of our key financial objectives is to ensure we maintain strong liquidity and have access to the most efficient and effective funding to support our capital investment programme and, at 31 March 2020, the Group continued to have a strong funding position with £1.6 billion of cash and committed facilities.

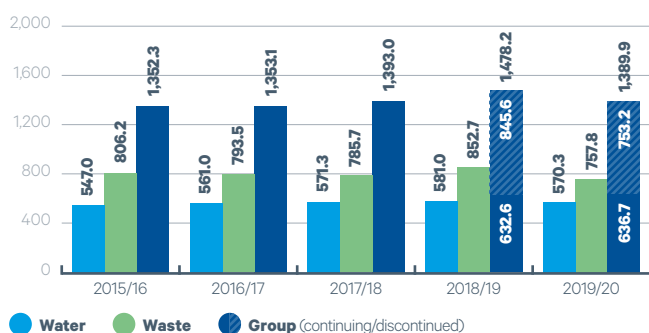
South West Water has outperformed in the K6 (2015-20) regulatory period delivering a sector-leading outperformance as measured by the return on regulated equity (RoRE). Totex outperformance of £297 million over the K6 regulatory period, together with the delivery of £13.3 million net ODI awards and outperformance in our cost of financing has resulted in a cumulative RoRE for K6 of 11.8%.

Throughout our operations we align the interests of investors and customers in sharing the financial benefits of good performance. In South West Water, our long established WaterShare mechanism offers customers extra investment in service enhancements or lower bills. We are also pleased to announce that £20 million is available to give back in this coming year. Shareholders approved in principle last year to give customers the option of receiving Pennon shares in 2020, aligning customers and investors more closely. This scheme will be launched subject to secondary approval from investors at the July Annual General Meeting (AGM).

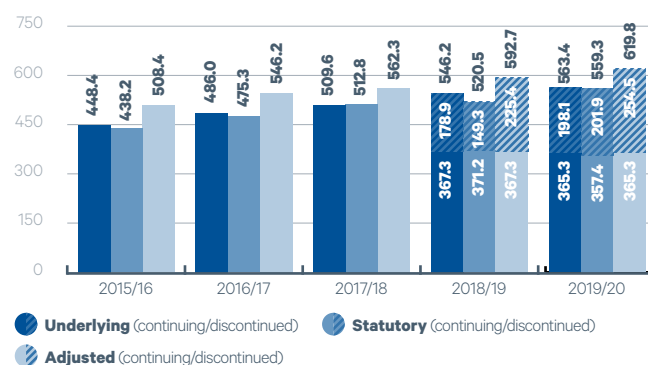
The Board has evaluated the Group's dividend for 2019/20 in light of the COVID-19 pandemic and has concluded that it is appropriate for Pennon to continue to deliver on its dividend commitment. The Group has significant cash and liquidity of £1.6 billion and has not received any government support measures. In addition, the majority of Pennon's shareholders are UK-based pension funds, charities, employees, customers and other retail holders who rely on this income.

(1) Underlying earnings are presented to provide a more useful comparison on business trends and performance. A reconciliation of underlying and statutory earnings is set out in the alternative performance measures section on page 191.

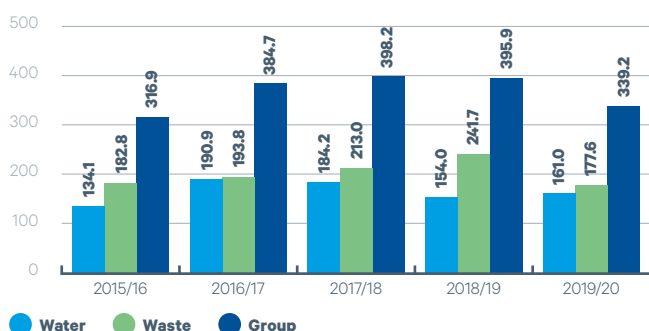
Revenue (£m)



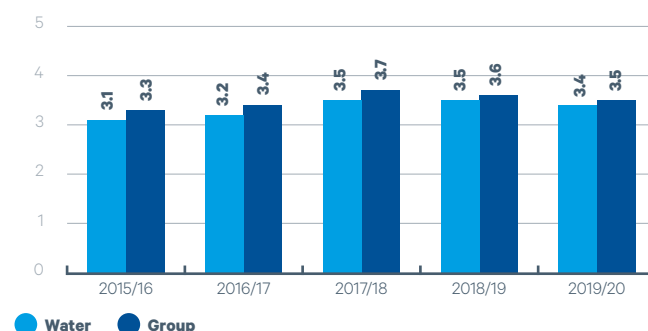
EBITDA (£m)



Capex (£m)



Interest rate on average net debt (%)



Report of the Chief Financial Officer

continued

For 2019/20, the Board has recommended a final dividend of 30.11p, subject to shareholder approval at the AGM on 31 July 2020. Together with the interim dividend of 13.66p, this will result in a total dividend of 43.77p, an increase of +6.6% from last year. This is in line with our dividend policy for 2010-2020 of RPI +4% growth per annum, which has been achieved while investing more than £3.6 billion in our businesses over the past 10 years. Pennon offers shareholders the opportunity to invest their dividend in a Dividend Reinvestment Plan (DRIP).

The crystallisation of the Viridor sale is equivalent to 22.66p per share of the 2019/20 dividend. This implies a Continuing Group dividend (after excluding Viridor) of 21.11p per share.

With respect to the future dividend policy of the Continuing Group the dividend will grow, from a rebased dividend of 21.11p per share, in line with CPIH +2% per annum from 2020-25. The rebased dividend reflects the sector-leading position of the Continuing Group, with expectations for outperformance on financing and totex, supporting the dividend growth policy, consistent with sustainable cover. Details of additional returns to shareholders from the sale of the Viridor business will be announced in due course.

Statutory financial performance

The Group's statutory profit before tax, being the profit before tax from continuing operations, at £193.1 million was down marginally compared with the prior year (2018/19 £201.4 million). Earnings per share from continuing operations decreased to 27.7p (2018/19 38.2p) with a significant non-underlying deferred tax charge of £30.3 million on continuing operations relating to the change in the headline corporation tax rate from 17% to 19%. South West Water forms the significant majority of the Group's continuing operations and has seen a reduction in revenues driven by the prolonged wet weather with rainfall 50% higher than levels seen in 2018/19 and higher than long-term averages. The regulatory mechanisms do ensure any shortfalls in determined revenues are recovered in future years.

The performance of the underlying business is set out in more detail below in the pro forma financial performance section.

Profit before tax from discontinued operations was £108.4 million (2018/19 £58.9 million).

The statutory results include the impact of non-underlying items totalling a charge after tax of £22.1 million to continuing operations and £7.2 million to discontinued operations (2018/19 £9.0 million credit to continuing operations and £23.9 million charge to discontinued operations). The Directors believe excluding non-underlying items and deferred tax provides a more useful comparison of business trends and performance.

The non-underlying items before tax for the Continuing Group and Viridor total a credit £13.9 million and after tax total a charge of £29.3 million, consisting of:

- The movement in the fair value of long-dated derivatives associated with South West Water's 2040 bond. These derivatives no longer met the Group's accounting hedging requirements and early settlement enabled South West Water to lock in a 'mark to market' gain. This has resulted in the recognition of a pre-tax credit of £18.0 million (2018/19 credit of £5.8 million) and cash proceeds on termination of the derivative of £87.2 million
- A provision for expected credit losses of £9.0 million related to the impacts of COVID-19 pandemic
- Aspects of the close down of defined benefit pension commitments following the cessation of the Greater Manchester recycling operating contract have resulted in a pre-tax credit of £4.9 million
- A net tax charge on the above items of £2.6 million
- A deferred tax charge of £40.6 million resulting from the now announced change of tax rates from 17% to 19%.

Further details of non-underlying items are given in note 6 to the financial statements.

Implementation of IFRS 16 'Leases'

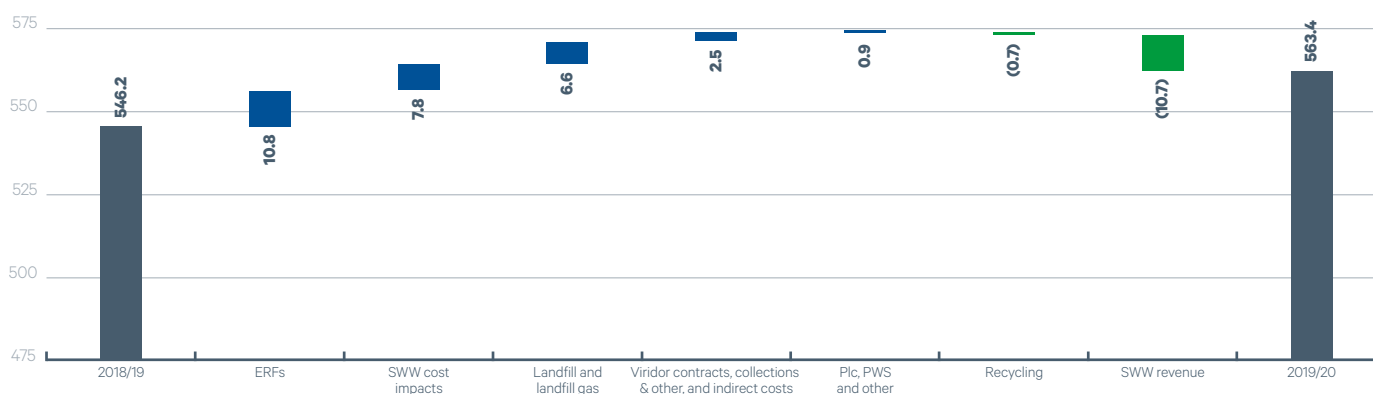
From 1 April 2019, the new accounting standard IFRS 16 'Leases' has been adopted, which results in all leases, whether operating or financing leases under the previous IAS 17 classifications, being treated on a consistent basis within the reported results with the lease being recognised as a liability on the balance sheet along with an associated right-of-use asset. Overall there is marginal net impact on the income statement and the balance sheet. On a pro forma basis, the impacts from the implementation are:

- At 1 April 2019, recognition of £132.2 million of right-of-use assets within property, plant and equipment and £145.7 million of lease obligations (these lease obligations are excluded for the purposes of banking covenants)
- £17.9 million increase in EBITDA in 2019/20 across the total Group (reflecting the removal of operating lease rentals) with a £1.9 million increase in the Continuing Group
- £14.0 million increase in depreciation in 2019/20 (arising from the depreciation on the newly recognised right-of-use assets), £1.4 million of the increase relating to the Continuing Group
- £4.5 million increase in interest charges in 2019/20 (reflecting the interest on the newly recognised lease liabilities) with £1.2 million of the increase in respect of the Continuing Group
- £0.6 million overall reduction in profit before tax in 2019/20, with £0.7 million reduction relating to the Continuing Group.

Pro forma financial performance from the Continuing Group and Viridor (before non-underlying items)⁽¹⁾

Given the significant contribution of Viridor to the Group's results for the entire financial year, pro forma results for the whole Group, including continuing and discontinued operations, have been presented alongside the statutory results in the income statement. The commentary on the overall performance of the Group in this section is based on the pro forma results.

Pro forma Group EBITDA (before underlying items) (£m)



Revenue

Pro forma Group revenue has reduced by 6.0% (£88.3 million) to £1,389.9 million (2018/19 £1,478.2 million). The majority of this reduction was due to the planned cessation of the Greater Manchester recycling operating contract and lower landfill tax receipts in Viridor. South West Water's revenue has reduced marginally due to customer demand falling as a result of prolonged wet weather in comparison with the levels of demand experienced in 2018/19. Revenues in Pennon Water Services are broadly in line with the previous financial year, with an increase in revenues outside of the South West Water region net of in region attrition, albeit there has been a focus on customer profitability with the resultant improvement in profitability as outlined below.

Group EBITDA and adjusted EBITDA⁽²⁾

Pro forma Group EBITDA and adjusted EBITDA were ahead of last year by 3.1% to £563.4 million (2018/19 £546.2 million) and 4.6% to £619.8 million (2018/19 £592.7 million) respectively driven by good operational cost control across the Group and strong performance across Viridor's activities, particularly from the fleet of ERFs.

As a result of lower revenue in 2019/20, South West Water's EBITDA and operating profit reduced by 0.8% and 2.3% respectively. The ongoing focus on strong cost control and efficiency delivery, as well as extreme weather costs in the prior period which have not been repeated, resulted in operating costs decreasing by 2.3%, below inflation. South West Water's bad debt performance remains strong with a charge of 0.5% (excluding the impact of COVID-19) as a percentage of revenue. This reflects the continuation of efficient cash collections, with the annual charge below the levels assumed for K6 in the Final Determination.

Pennon Water Services' performance has been driven through stable revenues and a focus on reducing operating costs. Revenue has remained broadly stable with a focus on value added services to large national customers and winning dual tariff customers offsetting the attrition from businesses switching retailer. Operating costs, excluding the impact of COVID-19, have reduced through automation, increased self-service and overhead efficiencies which has resulted in EBITDA almost doubling on last year. Increasing cash collections has reduced the level of debt further reducing the interest costs. The focus continues to be on improving services but driving efficiency to reduce the cost to serve our customers.

Overall for the Continuing Group, while revenue has marginally increased by 0.6% (£4.1 million) compared with the previous financial year, the mix of revenue generated between household and non-household customers has resulted in a marginal reduction in EBITDA of 0.5% to £365.3 million (2018/19 £367.3 million).

The results of Viridor are shown as discontinued in the statutory presentation of the income statement. Viridor's EBITDA increased by 10.7% (£19.2 million) to £198.1 million (2018/19 £178.9 million).

The ERF business has performed strongly during the year with Glasgow, Beddington and Dunbar facilities ramping up through the year and Avonmouth going in to commissioning at the end of the year. The EBITDA generated from our portfolio was 7.0% higher at £165.6 million (2018/19 £154.8 million) and availability has been in line with expectations at 90%⁽³⁾.

The landfill and landfill gas business has performed strongly in the year with EBITDA up 26.0% at £32.0 million (2018/19 £25.4 million) being achieved through high levels of reliability and higher year on year pricing.

Recycling EBITDA at £14.2 million is 4.7% down on last year (2018/19 £14.9 million) with unfavourable pricing conditions impacting performance.

Both of our joint ventures have performed above expectations and have increased the contribution to pro forma adjusted EBITDA from £31.9 million to £41.3 million, an increase of 29.5%, supported by the full year impact of the additional investment made in the Runcorn I ERF joint venture (TPSCo) in December 2018.

In the year indirect costs have reduced by £5.5 million through the efficiencies generated following the termination of the Greater Manchester run-off operating contract which completed on 31 May 2019.

IFRIC 12 interest receivable at £15.1 million is broadly comparable with 2018/19 at £14.6 million.

Net finance costs

Pro forma underlying net finance costs of £88.7 million are £5.5 million higher than last year (2018/19 £83.2 million), primarily due to the move from construction to operations of the Beddington, Glasgow and Dunbar ERFs.

The Group continues to secure funding at a cost that is efficient with the effective interest rate reducing to 3.5% (2018/19 3.6%), reflecting lower margins on new and renewed financing. The effective interest rate for South West Water has also reduced to 3.4% (2018/19 3.5%).

During 2019/20 underlying net finance costs were covered 3.8 times⁽⁴⁾ by Group operating profit (2018/19 4.1 times).

Profit before tax

Pro forma Group underlying profit before tax was £287.6 million, an increase of 2.6%, compared with the prior year (2018/19 £280.2 million). Included in pro forma profit before tax is our share of joint venture profit after tax of £14.8 million (2018/19 £12.4 million). After non-underlying items, pro forma profit before tax was £301.5 million (2018/19 £260.3 million) reflecting a combined non-underlying credit before tax from continuing and discontinued operations of £13.9 million (2018/19 charge of £19.9 million).

Tax charge

On an underlying basis the pro forma net tax charge of £52.0 million (2018/19 £42.7 million) consists of:

- Current year current tax charge of £28.0 million, reflecting an effective tax rate of 9.7% (2018/19 £32.4 million, 11.6%). The lower effective rate versus the UK's mainstream corporation tax rate of 19% reflects the accelerated level of capital allowance claims available to the Group compared with the depreciation charge
- Current year deferred tax charge of £26.7 million (2018/19 £23.2 million) primarily reflecting capital allowances across the Group in excess of depreciation charged.

Following the completion and submission of the prior year's tax computations and returns to HMRC, the following prior year amounts have been recognised:

- Current tax credit of £9.2 million (2018/19 credit of £3.0 million)
- Deferred tax charge of £6.5 million (2018/19 £9.9 million credit), reflecting finalisation of capital allowance claims.

The 2019/20 non-underlying items result in a £43.2 million net tax charge (2018/19 £5.0 million credit).

Overall, the total tax charge for the year of £95.2 million was higher than the prior year (2018/19 £37.7 million).

Earnings per share

Earnings per share from continuing and discontinued operations on a statutory basis have reduced by 6.7% to 47.7p (2018/19 51.1p) driven by £41 million non-underlying deferred tax charge relating to the change in tax rate from 17% to 19%. Earnings per share from continuing and discontinued operations on an underlying basis have increased by 6.7% to 61.7p⁽⁴⁾ (2018/19 57.8p). Earnings per share from continuing operations on a statutory and underlying basis have decreased to 27.7p (2018/19 38.2p) and 35.2p (2018/19 36.7p) respectively.

Dividends and retained earnings

The statutory net profit attributable to ordinary shareholders of £200.4 million has been transferred to reserves.

The Board has evaluated the Group's dividend for 2019/20 in light of the COVID-19 pandemic and has concluded that it is appropriate for Pennon to continue to deliver on its dividend commitment.

The Directors recommend the payment of a final dividend of 30.11p per share for the year ended 31 March 2020. Together with the interim dividend of 13.66p per share paid on 3 April 2020 this gives a total dividend for the year of 43.77p, an increase of 6.6% over 2018/19. This is in line with our dividend policy for 2010-2020 of RPI +4% growth per annum. Pennon offers shareholders the opportunity to invest their dividend in a DRIP.

Proposed dividends totalling £184.3 million are covered 14 times⁽⁴⁾ by net profit (before non-underlying items and deferred tax) (2018/19 14 times). Dividends are charged against retained earnings in the year in which they are paid.

With respect to the future dividend policy of Pennon Group for the period 2020 to 2025, the dividend will grow in line with CPIH +2% per annum. The choice of indexation aligns with the regulatory inflation measure being used for K7. The dividend growth policy reflects the sector-leading positions of the Continuing Group, consistent with sustainable cover. Details of additional returns to shareholders from the sale of the Viridor business will be announced in due course.

(2) EBITDA and adjusted EBITDA are set out in the alternative performance measures section on pages 191 to 194.

(3) Weighted by capacity. Includes joint ventures at 100%, excludes GRREC due to different technology.

(4) Calculations are set out in the alternative performance measures section (pages 191 to 194).

Report of the Chief Financial Officer

continued

Group capital investment

Group capital investment from continuing and discontinued operations was £339.2 million⁽⁴⁾ in 2019/20 compared with £395.9 million in 2018/19.

South West Water

South West Water's capital expenditure in the year was £161.0 million, compared with £154.0 million in 2018/19 including schemes to finalise the K6 capital plan and with additional expenditure to make an early start on key K7 initiatives focused on ODI delivery.

Key areas of investment and activity during 2019/20 included:

- Further investments in our drinking water quality programme including installation of granular activated carbon (GAC) treatment at College water treatment works in Cornwall. This £10 million project will improve the resilience of our water quality for c.35,000 customers
- Continued investment in the network to drive leakage reduction to support pledges made in the K7 regulatory period
- Investment in the Plymouth region to improve resilience of water supplies with the completion and commissioning of the Mayflower water treatment works and upgrades to the network and pumping stations
- Schemes to deliver National Environment Programme (NEP) commitments, including phosphorus and ammonia discharge reductions
- Continued improvements at wastewater treatment works, including flood resilience and at pumping stations to reduce pollution incidents.

Viridor

Viridor's capital spend in the year was £177.6 million (2018/19 £241.7 million), a reduction of £64.1 million compared with 2018/19 as the ERF assets have moved from construction to operations.

The majority of the expenditure relates to the ERF portfolio, principally the continued development of Avonmouth ERF where commissioning is now underway. Other larger projects in the year include the commencement of construction of the £65.0 million Avonmouth plastics recycling facility.

Ongoing restoration and remediation programmes continue for Viridor's landfill sites, ensuring we meet or exceed our environmental duties and responsibilities.

Cash inflow from operations, continuing investment in future growth

The Group's operational cash inflows⁽⁴⁾ in 2019/20 were £728.6 million (2018/19 £649.0 million). These funds have been put to use in efficiently financing the Group's capital structure and investing in future growth. This capital investment has resulted in higher Group net debt.

Sustainable funding position underpinning investment

The Group has a strong liquidity and funding position with £1,639 million cash and committed facilities at 31 March 2020. This consists of cash and deposits of £666 million in the Continuing Group (including £226 million of restricted funds representing deposits with lessors against lease obligations), £33 million in the Viridor Disposal Group and undrawn facilities of £940 million. At 31 March 2020 the total Group borrowings were £3,963 million with £3,715 million of borrowings in the Continuing Group and £248 million of lease liabilities transferring with Viridor as part of the disposal. The net debt of the total Group including the Disposal Group was £3,264 million, an increase of £184 million during the year (2018/19 £3,080 million), which is largely attributable to £137.5 million of lease liabilities on the balance sheet at 31 March 2020 in accordance with IFRS 16. The net debt of the Continuing Group as at 31 March 2020 is £3,049 million.

Pennon has pioneered a Sustainable Financing Framework to integrate commitments to environmental and social objectives into a variety of funding opportunities across the Group. The framework allows Pennon to access future funding opportunities aligned with the Green Loan Principles, Green Bond Principles and Social Bond Principles. The framework has been certified by DNV GL a leading sustainability verifier. Pennon is committed to continuous annual improvements in sustainability ratings and KPIs which may lead to improved interest rate margins.

During the year, £840 million of new and renewed facilities have been signed, £500 million in Pennon Group plc and £340 million in South West Water. The total includes a short-term Pennon revolving credit facility (RCF) which provides the Group with flexible, efficient and effective funding during the ongoing strategic review. In total, £245 million of the new facilities signed in the year are linked to the

sustainable nature of the business. A new £50 million CPI-linked sustainable loan was signed in 2019/20, this maintains South West Water's proportion of index-linked net debt in line with the Ofwat notionally funded company and is in support of the transition from RPI to CPIH.

During this year the Group also early settled the fixed to floating rate derivatives associated with the South West Water Finance plc 2040 bond. The settlement locked in the value and removed the future volatility from the income statement, the resulting cash inflow of £87.2 million will be utilised to fund South West Water's capital commitments.

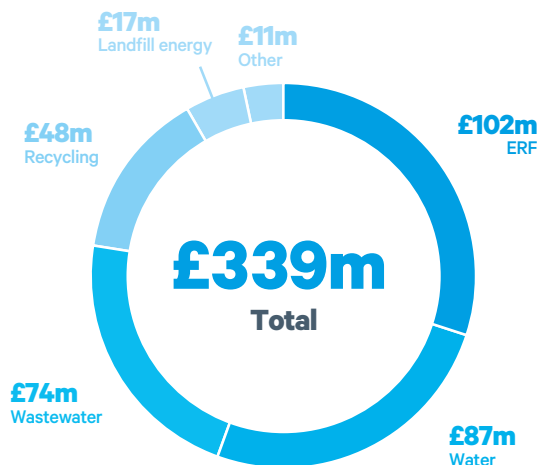
In preparation for the announced abolition of LIBOR in 2021, South West Water has completed the first LIBOR to Sterling Overnight Index Average (SONIA) amendment for a sustainable RCF. While financial institutions finalise the precise workings of the successor measure to LIBOR, widely expected to be SONIA, this amendment to an existing facility allows the Group to address documentation and early system changes that will be required. Further work continues and later this year it is expected that financial institutions will no longer provide LIBOR-linked financial products.

Efficient long-term financing strategy

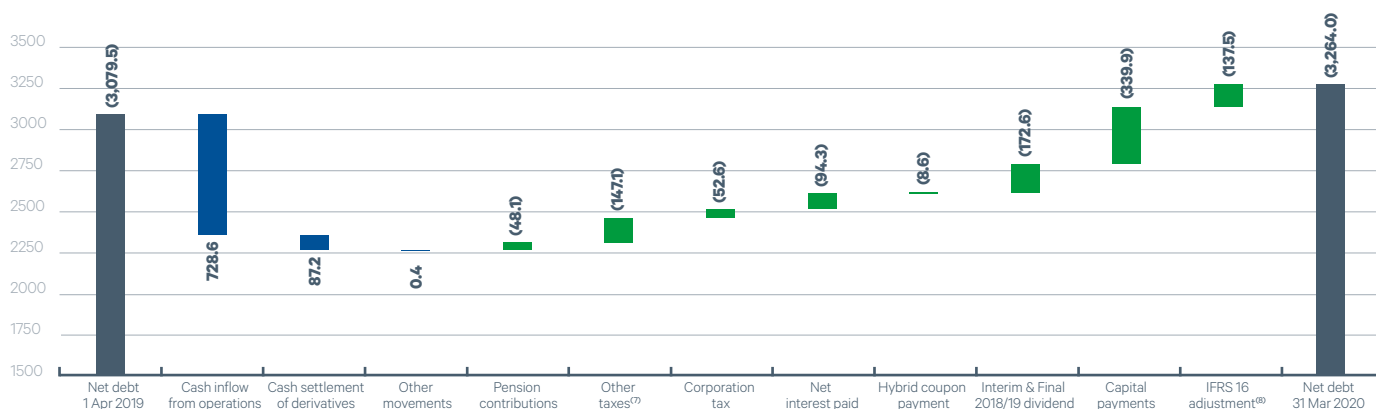
The total Group has a diversified funding mix of fixed (£1,797 million, 55%), floating (£844 million, 26%) and index-linked borrowings (£623 million, 19%). The Group's debt has a maturity of up to 37 years with a weighted average maturity of c.17 years. Much of the Group's debt is floating rate and derivatives are used to fix the rate on that debt.

Following the K7 (2020-25) South West Water Final Determination the Group has aligned its hedging strategy with the changed regulatory methodology in this area. A proportion of new debt will be hedged in K7 on a rolling ten-year basis while still maintaining flexibility within the overall portfolio. Embedded debt hedging is aligned with the five-year regulatory delivery period. Around 60% of South

Major categories of capital expenditure



Net debt movements (strong cash inflow from operations, £m)



West Water's embedded floating net debt has already been hedged through K7, taking advantage of falling swap rates and assuring the Group transitions smoothly into the new regulatory period.

South West Water's cost of finance is among the lowest in the industry. Around two-thirds of South West Water's net debt is from leases which provide a long maturity profile. Interest charges benefit from the fixed credit margins which are secured at the inception of each lease. £576 million (c.26%) of South West Water's net debt is index-linked. This is below Ofwat's notional assumption of 33%, giving an advantageous position through regulatory transition from RPI to CPIH.

Net debt position

The net debt of the total Group including Viridor was £3,264 million an increase of £184 million during the year (2018/19 £3,080 million), which is largely attributable to £138 million of lease liabilities being recognised in accordance with IFRS 16. The net debt of the Continuing Group as at 31 March 2020 is £3,049 million. For the purposes of banking covenants these lease obligations remain excluded from net debt.

The gearing ratio at 31 March 2020, being the ratio of net debt to (equity plus net debt), was 64.6%⁽⁵⁾ (31 March 2018 64.7%).

The combined South West Water and Bournemouth Water debt to RCV ratio is 63.6%⁽⁶⁾ (31 March 2018 58.9%) which is broadly in line with Ofwat's K6 target for efficient gearing of 62.5%, but is presently above the new K7 notional assumptions of 60.0%. During the year South West Water also made a voluntary accelerated pension deficit recovery payment of £17.2 million covering two years of planned payments, adding 0.5% to gearing.

Group net debt includes £2,227 million for South West Water and £215 million for Viridor, with £822 million implied for Pennon, the Company.

In the year, cash inflow from operations were strong at £728.6 million (2018/19 £649.0 million).

Pension contributions were £48.1 million (2018/19 £32.2 million).

Corporation tax payments were £52.6 million (2018/19 £29.2 million) while payments of all other operational taxes were £147.1 million (2018/19 £137.9 million).

Net interest payments totalled £94.3 million (2018/19 £73.6 million).

Dividend payments and coupon payments on the perpetual capital securities were £172.6 million (2018/19 £162.0 million) and £8.6 million (2018/19 £5.8 million) respectively.

Cash outflows relating to the capital programme totalled £339.9 million (2018/19 £384.5 million).

Internal borrowing

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

Taxation strategy

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

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

We were once again awarded the Fair Tax Mark in November 2019. This is an independent UK accreditation scheme for businesses paying their fair share of corporation tax and reporting on their tax practices transparently. Achieving the Mark demonstrates that we are paying the right amount of corporation tax in the right place at the right time and apply the gold standard of transparency. Having taken the lead, we have also helped to inspire other water companies to apply for the accreditation, thereby improving the tax transparency of the sector in which we operate.

Under our tax strategy we:

- At all times consider the Group's corporate and social responsibilities and operate appropriate tax risk governance processes to ensure that the policies are applied throughout the Group
- Comply with our legal requirements, file all appropriate returns on time and make all tax payments by the due date
- Consider all taxes as part of ongoing decisions
- Not enter into artificial tax arrangements nor take an aggressive stance in the interpretation of tax legislation

- Not undertake transactions which are outside the Group's low-risk appetite for tax or not in line with the Group's Code of Conduct
- Engage with HMRC in a proactive and transparent way and discuss our interpretation of tax laws in real time, such interpretations following both the letter and spirit of the laws
- Not have any connections with tax havens unless it is necessary for the purposes of trading within those jurisdictions.

As a long-term business with a long-term approach to financial management there has been just a single change to the Group's overall tax strategy this year compared to last and that is to explicitly state that we will not have any connections with tax havens unless it is necessary to be able to trade in those jurisdictions. The tax strategy is reviewed and reaffirmed on an annual basis.

Further details are given in the Group's Tax Strategy document available on the Pennon Group website.

Tax contribution 2019/20 – borne/collected

The Group's total tax contribution (TTC) for 2019/20 amounted to £278 million (2018-19 £281 million). TTC is a standardised measure of a group's total tax contribution, having been developed by PwC and the 100 Group (FTSE 100 finance directors). It is acknowledged as being a fair and comparable representation of total tax cost.

TTC looks at taxes borne, and taxes collected. Taxes borne includes all taxes which are a cost to the Group, such as landfill tax, business rates, corporation tax and employers' National Insurance contributions (NICs). Taxes collected and recovered highlights where the business is collecting tax on behalf of HMRC. A net amount of £33 million (2018/19 £34 million) was collected on behalf of the authorities for employee payroll taxes and VAT.

(5) Before the impact of IFRS 16. Group gearing including the impact of IFRS 16 is 65.6%.

(6) Before the impact of IFRS 16. South West Water company net debt to RCV after the impact of IFRS 16 is 64.6%.

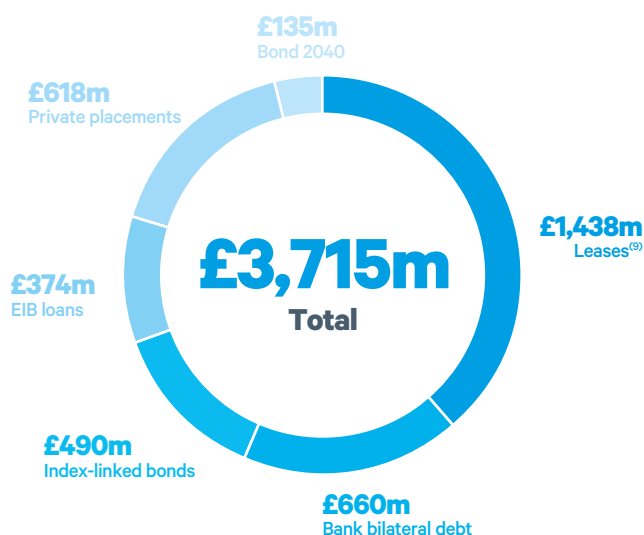
(7) Other taxes include business rates, employer's national insurance, fuel excise duty, carbon reduction commitment, environmental payments, climate change levy and external landfill tax.

(8) IFRS 16 adjustment reflects impact of the new accounting standard on Group net debt. This non-cash impact has no debt covenant impact.

Report of the Chief Financial Officer

continued

Major components of the Continuing Group's debt finance at 31 March 2020



Landfill tax of £91 million (2018/19 £121 million) was borne and paid on waste material deposited at our landfill sites by our customers. The reduction year on year reflects the nature of the waste materials disposed and additional volumes which are now processed by our ERFs. The amount includes £5 million (2018/19 £7 million) paid to local environmental bodies via the Landfill Tax Credits Scheme. Landfill tax is a significant operating cost in respect of the landfill business. In addition, the Group incurred landfill tax of £13 million (2018/19 £10 million) on the disposal of waste to third parties. This is an operating cost for the Group and reduces profit before tax. The total amount of landfill tax paid to HMRC by the Group represents 16% of HMRC's landfill tax receipts in the year.

Employment taxes totalled £64 million (2018/19 £65 million) including employees' Pay As You Earn (PAYE) and total NICs. Employers' NICs of £18 million (2018/19 £19 million) were charged approximately 75% to operating costs with 25% capitalised to property, plant and equipment.

The Group also paid £1 million in apprenticeship levy (2018/19 £1 million). The total amount of £64 million includes PAYE of £3 million (2018/19 £3 million) on pension payments made by the Group pension scheme. A net amount of £45 million (2018/19 £45 million) was collected on behalf of the authorities for employee payroll taxes.

Business rates of £42 million (2018/19 £41 million) were paid to local authorities. This is a direct cost to the Group and reduces profit before tax.

The main elements of the £52 million UK corporation tax payment to HMRC in the year (2018/19 £26 million) were £40 million in relation to 2019/20 instalment payments and £12 million in relation to earlier years. This is an increase of £26 million on the prior year and relates to changes to the payment on account legislation which has been amended to accelerate payment of tax which ultimately sees all tax now paid in year. To facilitate this acceleration, the Group has paid six instalments during the year, two in relation to the prior year and four in relation to the 2019/20 year. In future years, the Group will pay four instalments all of which will relate to the relevant financial year.

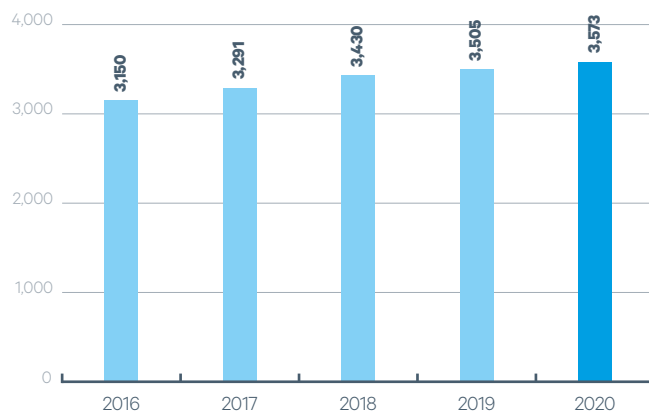
VAT of £12 million has been received (2018/19 £12 million has been received) by the Group from HMRC. VAT has no material impact on profit.

Payments to the Environment Agency and other regulatory bodies total £13 million (2018/19 £11 million). This reduces profit before tax.

Fuel excise duty of £7 million (2018/19 £9 million) related to transport costs. This reduces profit before tax.

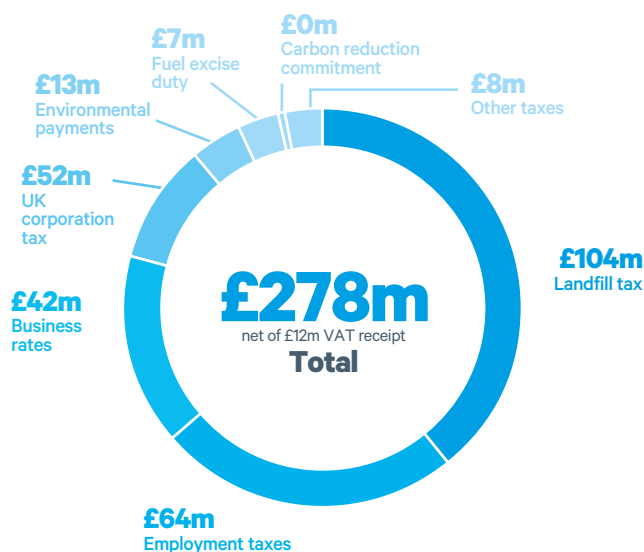
Carbon Reduction Commitment (CRC) payment for the Group was £0.2 million (2018/19 £1 million). This reduces profit before tax. This scheme ceased in April 2019 and has been replaced by a new streamlined energy and carbon reporting (SECR) framework. The change will be neutral as there has been an increase in Climate Change Levy.

Regulatory capital value as at 31 March (£m)



⁽⁹⁾ Includes leases previously defined as operating leases under IAS 17 of £36 million.

Tax contribution 2019/20 (borne/collected)



Pensions

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

At 31 March 2020, the Group's pension schemes showed an aggregate deficit (before deferred tax) of £8.5 million (March 2019 £60.8 million), a reduction of £52.3 million as a result of:

- £32.6 million contributions over and above the ongoing service and net interest charges following the Group's decision to voluntarily accelerate a significant proportion of the planned deficit recovery payments
- Reduction in liabilities of £51.9 million due to lower long-term inflation rates reducing liabilities
- Greater Manchester recycling operating contract cessation has decreased liabilities by £2.0 million
- £25.1 million reduction in asset values caused by the financial market uncertainty arising from the COVID-19 pandemic
- Changes in other actuarial assumptions increasing the net deficit by £9.1 million.

Of these liabilities a surplus of £6.6 million relates to the Continuing Group and a deficit of £15.1 million relates to Viridor.

On completion of the Viridor sale, expected early summer 2020, the Continuing Group will assume responsibility for near all of Viridor's defined benefit obligations.

The net aggregate liabilities of c.£7 million (after deferred tax) represents less than 0.2% of the Group's market capitalisation at 31 March 2020.

For the Group's principal scheme, of which South West Water accounts for around 82% and Viridor 12%, the 2019 triennial valuation has been finalised, recording an actuarial technical provisions deficit of c.£53 million. In agreeing to the valuation, the Group committed to deficit recovery contributions in line with those agreed at the 2016 triennial actuarial

valuation to 2022, noting the significant acceleration of contributions during the year. The schedule of contributions is in line with the 2016 triennial actuarial valuation.

In addition to the principal scheme, the Group has further pension liabilities (£20.9 million at March 2019 calculated on an actuarial technical provisions basis), that relate to schemes in which the Group participates in connection with Viridor's Greater Manchester recycling operating contract which ceased in May 2019. Following the planned exit from the Greater Manchester recycling operating contract, it is expected that the assets and liabilities associated with all active members of these schemes at 31 May 2019 will transfer to the new operator's pension fund. A non-underlying credit of £4.9 million has been recognised in the income statement in connection with active employees moving to deferred status in these schemes.

The Group is in the process of consulting with all employees on plans to modernise its pension arrangements. The proposals which are being consulted on include the closure of the main defined benefit scheme to future accrual with all employees transitioning to a new defined contribution scheme offered through a master trust arrangement. The outcome of the consultation is expected to be announced in June 2020.

Energy hedging

Pennon has adopted a Group portfolio management approach to energy hedging. Currently around 50% of volumes generated are either used within the Group (South West Water and Viridor) or contracted for the long term through private wire offtake agreements (c.40% for Viridor internal usage).

The Continuing Group is a net energy buyer and has the ability to hedge the pricing for its generation for periods up to five years ahead, further helping to protect revenues. Forward hedges for South West Water not already under long-term contracts have been put in place in the liquid market with 100% of the energy requirements hedged until March 2021 and c.92% until March 2022.

Insurance

Pennon Group manages its property and third-party liability risks through insurance policies that mainly cover property and business interruption, motor, 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 that have good credit ratings.

Conclusion

Pennon Group has continued to deliver a solid underlying performance, through our sustainable approach to operations. This has resulted in a successful close to the K6 regulatory period for South West Water and the realisation of strategic value through the expected sale of Viridor in summer 2020, valuing the business at 18.5 times EBITDA multiple. It is intended that the proceeds generated from this transaction would be used to reduce our pension fund deficit, reduce net borrowings of the Company and provide a return to shareholders, subject to other value creating opportunities that may arise. While the precise impacts of COVID-19 are yet to fully emerge, the Continuing Group, with the benefit of the crystallisation of value from the Viridor sale, will continue with its sustainable approach to gearing and benefits from the significant strength and liquidity in the Group's balance sheet, providing stability to the business in these challenging times.

Susan Davy
Chief Financial Officer

Pennon Group plc

Risk report

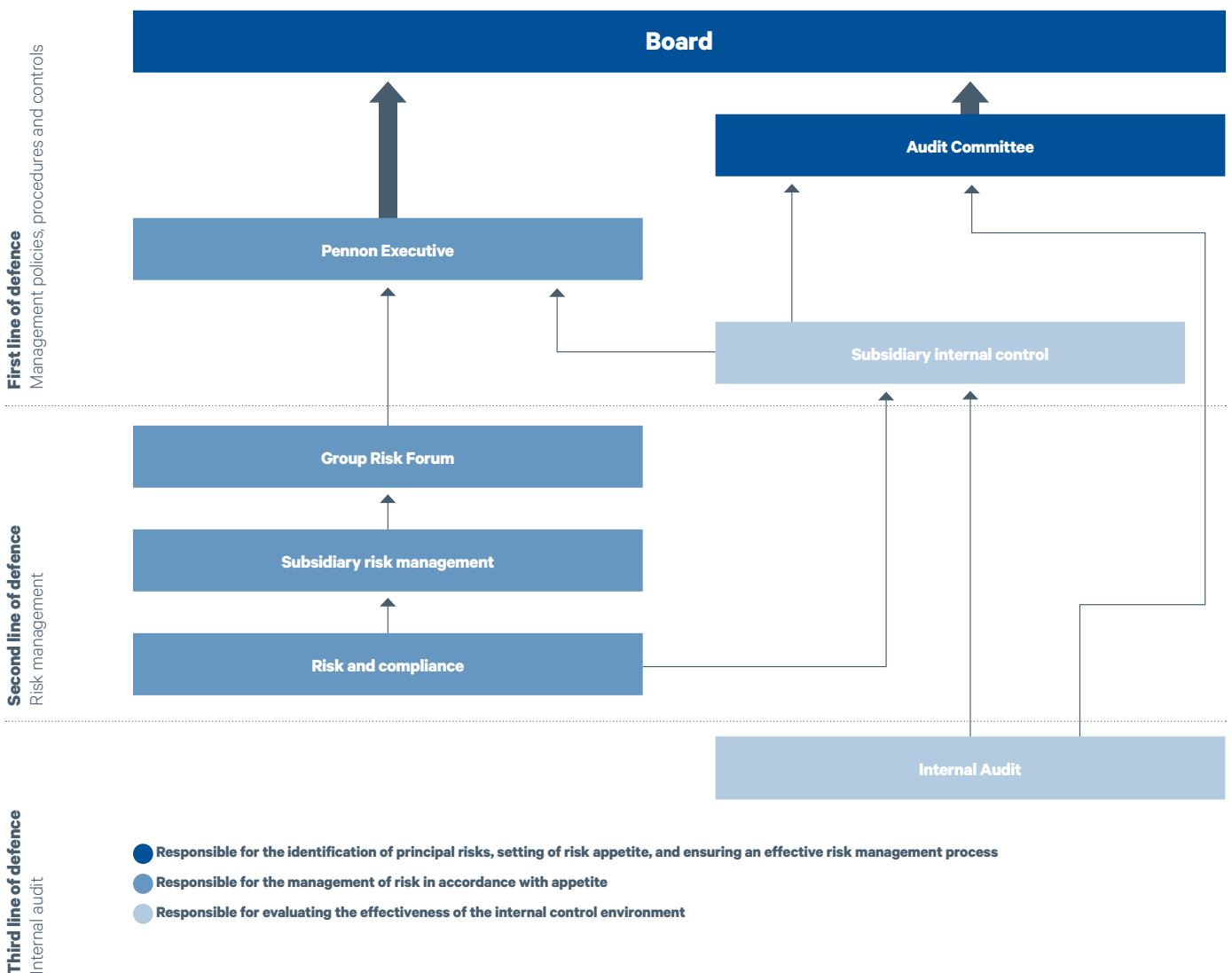
The Pennon Board and Pennon Executive are committed to the effective management of risks and opportunities to ensure the long-term success of the Group.

Risk management and internal control framework

Our core business activities inherently expose the Group to a variety of risks which could materially impact our ability to achieve our strategic priorities. The Pennon Board and Pennon Executive are committed to the effective management of risks and opportunities to ensure the long-term success of the Group.

Pennon operates a mature Group-wide risk management framework (see diagram below) which is embedded into our culture and ways of working at all levels of our business. This framework forms a key part of our governance structure to ensure that there is robust review, challenge and assurance over the management of both our current and emerging risks and opportunities.

Risk management framework



Our risk management framework encompasses both a 'top down' and 'bottom up' approach. This allows risks and opportunities to be cascaded and escalated effectively, while enabling a common understanding of the risks and opportunities that the Group is exposed to and their potential impact on the achievement of our strategic priorities.

Environmental, social and governance (ESG) considerations are a key focus for the Group. The consideration of ESG risks and opportunities, including the potential impact of climate change on our business, is integrated into the Group's overall risk management framework and reflected within the assessment of relevant principal risks. The delivery of the Group's ESG actions and commitments is monitored through our ESG framework. Further detail is provided on page 20.

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

Emerging risks and opportunities are considered to be factors and events which could potentially have a future positive or negative impact on the achievement of the Group's strategic priorities. Horizon scanning of emerging risks and opportunities is embedded within the risk and opportunity review process undertaken by each subsidiary and the respective leadership teams. Emerging risks are also reviewed by the Group Risk Forum, Pennon Executive and Pennon

Board as part of their regular assessment of the Group's risk profile. Once an emerging risk is deemed to have crystallised, it is assessed applying the Group's methodology and appropriate mitigating actions are established.

The Group manages its risk exposure, in line with the desired risk appetite and tolerance levels, through the operation of a robust internal control and assurance framework which is aligned to the 'three lines of defence' model. The subsidiary leadership teams, Pennon Executive and the Pennon Board obtain assurance over the effectiveness of the internal control environment through visibility of the outputs from a variety of internal and external assurance providers, including an independent Group Internal Audit.

The key elements of the Group's risk management process include:

	Key risk management responsibilities	Key assurance activities
First line of defence	Board	<ul style="list-style-type: none"> • Quarterly review of the Group's principal risks against the determined risk appetite • Quarterly review of the Group's emerging risk log
	Audit Committee	<ul style="list-style-type: none"> • Performs quarterly deep dive reviews on principal risks • Approves the Group Internal Audit Plan • Receives reports on the outcomes of key assurance activities
	Pennon Executive	<ul style="list-style-type: none"> • Day-to-day management of the Group's principal and operational risks • Establish the relevant Group-wide risk management processes and procedures • Maintains the internal control framework • Performs a thorough appraisal of the Group's principal and emerging risk profile quarterly • Monitors the Group's performance against KPIs and financial performance • Establishes and reviews policies, procedures and delegated authorities
Second line of defence	Group Risk Forum	<ul style="list-style-type: none"> • Provides review and challenge over subsidiary/functional principal risks and mitigation strategies • Alignment of the top down and bottom up risk management process • Performs horizon scanning on emerging risks and opportunities • Quarterly review of Group and subsidiary principal risks • Undertakes deep dive reviews of specific risks Topics include: cyber security, customer service, health & safety, energy management, GDPR and ODI preparedness
	Individuals subsidiaries/ functions	<ul style="list-style-type: none"> • Identifies and assesses subsidiary level risks • Implements and executes appropriate risk mitigation strategies, aligned with the agreed risk appetite • Monitors compliance with internal control framework • Review of subsidiary/functional principal risks on a quarterly basis by executive management teams • Compliance functions provide second line assurance including regulatory, legal, health & safety and ISO compliance and other key business processes • Self-certification of compliance with internal control framework
Third line of defence	Group Internal Audit	<ul style="list-style-type: none"> • Provides independent, risk-based assurance on the effectiveness of the internal control framework • Coordination of independent assurance activities • Regular reporting to Audit Committee and Pennon Executive on the effectiveness of internal controls and the outcomes from other third line assurance activity

Risk report continued

South West Water technical (non-financial) data

In addition to the framework above which applies across the Group, recognising the importance of the regulatory ODI framework, South West Water engages an independent, third-party auditor, Jacobs, to audit the accuracy of the technical (non-financial) data reported in its annual performance report, including its performance commitments and environmental data. DNV also perform further assurance work over the Group's sustainability measures (see page 89).

Continuous improvements to risk management and internal control

The Group seeks to continually improve its approach to risk management and internal control to ensure it remains fit for purpose. During the year the following activities have been undertaken which have further enhanced these processes, including:

- Revised key risk indicators and associated metrics have been established, aligned to the priorities over the next regulatory period, to support the monitoring of the Group's principal risks against its risk appetite
- Risk forums within South West Water have been streamlined into a single forum to allow greater consideration of cross cutting issues and challenges
- The second line health & safety assurance programme has adopted a risk-based approach to allow assurance to be focused on the areas of greatest impact

- The delivery of ISO compliance activity across the Group has been further standardised to enhance the overall assurance provided
- A project is underway to enhance the Group's resilience arrangements, with a Director of Resilience appointed for South West Water to deliver commitments detailed within its business plan for the next regulatory period
- An electronic learning and policy acceptance platform has been implemented to enable more effective communication and dissemination of the Group's key policies and standards.

Group risk management and protection of South West Water

Pennon manages its risks in such a way that South West Water, as a regulated company, is protected from risk elsewhere in the Group. The Group's principal risks and uncertainties include those Group-level risks which could materially impact on South West Water.

Pennon's risk management and internal control frameworks ensure that it does not take any action that would cause South West Water to breach its licence obligations. Further, the Group's governance and management structures mean that there is full understanding and consideration of South West Water's duties and obligations under its licence, as well as an appropriate level of information sharing and disclosure to give South West Water assurance that it is not exposed as a result of activities elsewhere within the Group.

Risk appetite

The UK Corporate Governance Code requires the Group to determine the risk appetite considered appropriate in achieving the Group's strategic objectives. Striking an appropriate balance between risk and reward is key to the success of the Group's strategy.

The Board has established its risk appetite for each risk category and also for each principal risk. This allows the business to pursue value-enhancing opportunities, while maintaining an overall level of risk exposure that the Board considers to be appropriate. The Board's evaluation of the effectiveness of internal control is also considered in the context of the stated risk appetite. The risk appetite for each risk category is detailed below:

Risk category	Risk appetite statement
Law, regulation and finance	The Board is committed to fully complying with, and being seen to be complying with, all relevant laws, regulations and obligations and has no appetite for non-compliance in this area. This includes (but is not limited to) health & safety where the Board places the highest level of importance on the welfare of our employees, the public and those who work with or on behalf of Pennon. The Group also operates a prudent approach to our financing strategy to ensure our long-term financing commitments are met. The Board acknowledges, however, that the Group operates in a complex environment influenced by Government policy and regulatory reform. Consequently, there is a greater acceptance of risk in these areas and the Group seeks to mitigate any potential downside and leverage opportunities that may arise from Government policy and regulatory change.
Market and economic conditions	The Board recognises that our activities are exposed to changes in macroeconomic and external market conditions. The Group seeks to take well-judged and informed decisions to mitigate these risks where possible but accepts that a level of residual risk may remain beyond the Board's control.
Operating performance	The Board has a low appetite for significant operational failure of our water assets and seeks to reduce both the likelihood and impact through long-term planning and careful management of our operational assets. There is greater appetite for well-informed risk taking to develop further markets, subject to this not detrimentally impacting on the level of service that we provide to our existing customer base.
Business systems and capital investment	While capital investment activities contain a degree of inherent risk, all decisions are taken on an informed basis with risks weighted against the expected level of return on a case-by-case basis. The Group seeks to minimise technology and security risk to the lowest possible level without detrimentally impacting on the Group's operations.

Overview of Pennon's principal risk profile

Strategic priorities

1

Leadership in UK infrastructure

2

Cost base efficiency

3

Sustainable growth

Risk level



High



Medium



Low



Increasing

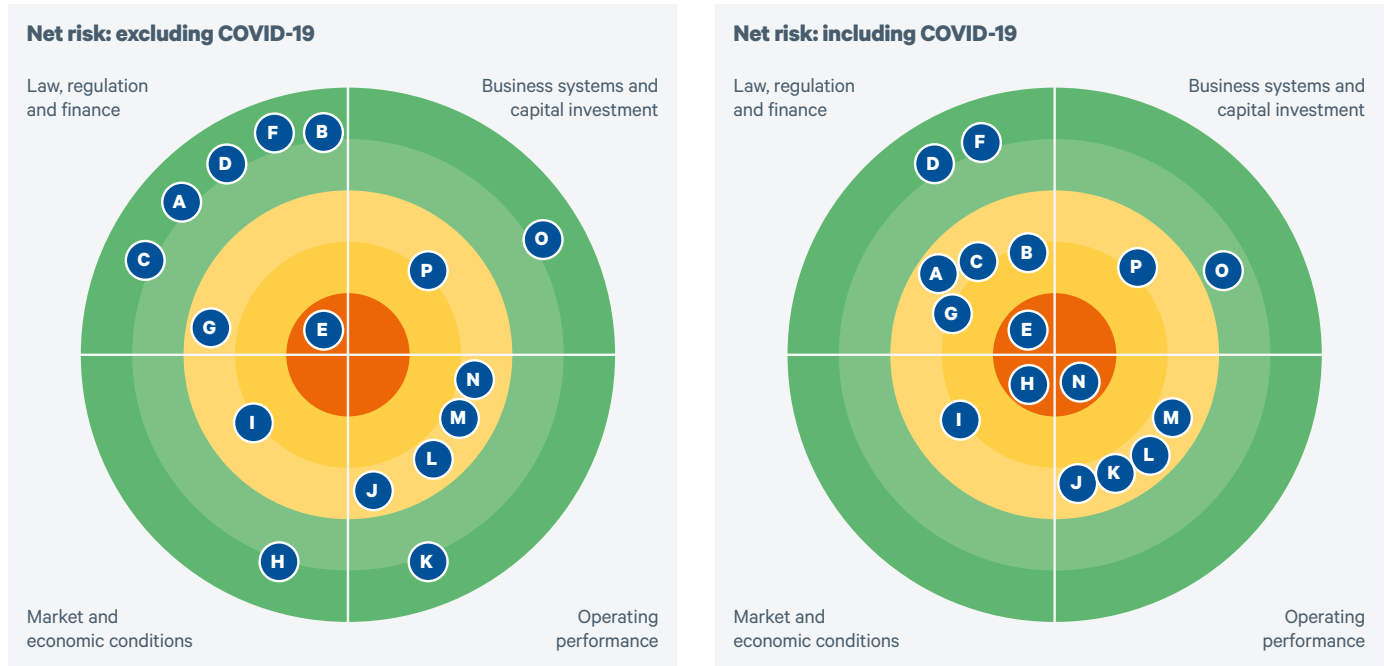


Stable



Decreasing

Long-term priorities affected



Category	Ref	Strategic priorities	Risk description	Excluding COVID-19	Including COVID-19
Law, regulation and finance	A	1 2	Changes in Government policy	●	↑
	B	1 2	Regulatory reform	↑	↑
	C	1 2	Compliance with laws and regulations	↑	↑
	D	1 3	Maintaining sufficient finance and funding to meet ongoing commitments	●	●
	E	1 2 3	Non-compliance or occurrence of avoidable health & safety incident	●	↑
	F	2	Tax compliance and contribution	●	●
	G	2	Failure to pay all pension obligations as they fall due and increased costs to the Group should the defined benefit pension scheme deficit increase	↑	↑
Market and economic conditions	H	1 2	Non-recovery of customer debt	↑	↑
	I	3	Macroeconomic risks impacting inflation, commodity and power prices	↓	↑
Operating performance	J	1	Poor operating performance due to extreme weather or climate change	●	●
	K	1 3	Poor service and/or increased competition leading to loss of customers	↑	↑
	L	1 3	Business interruption or significant operational failures/incidents	●	↑
	M	1 2 3	Difficulty in recruitment, retention and development of skills	●	↑
	N	1 2 3	Non-delivery of regulatory outcomes and performance commitments	↑	↑
Business systems and capital investment	O	1 3	Failure or increased cost of capital projects/exposure to contract failures	●	↑
	P	1	Failure of IT systems, management and protection including cyber risks	↑	↑

Risk report continued

Principal risks and uncertainties

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

While the ability of the Group to influence these macro level risks is limited, they continue to be regularly monitored and the potential implications are considered as part of the ongoing risk assessment process. The Group performs a range of scenario planning and analysis exercises to understand the risk exposure of one, or a number, of these events occurring.

The Group's principal risks have been reviewed and updated to reflect the transfer of risks associated with waste activities as a result of the proposed sale of Viridor, which has received shareholder and European Commission approval. This has resulted in the removal or reassessment of a number of the Group's principal risks when compared with previous annual reports, reflecting the focus of the Group on its water and wastewater businesses.

Britain's exit from the European Union

Prior to Britain's exit from the EU, detailed contingency plans had been established and tested to mitigate against potential issues that may have occurred in the event of a no-deal scenario. Negotiations on a future trading agreement between Britain and the EU is ongoing and continues to be closely monitored.

The impact of any agreement on the Group's operations and processes will be fully evaluated as further detail is confirmed. In the event that no agreement is reached, and trade arrangements revert to World Trade Organization (WTO) rules, existing contingency plans will ensure that the Group is well prepared to mitigate against any short-term impact that is likely to arise from this scenario.

Impact of COVID-19

The Board recognise the significant impact that COVID-19 has had globally and within the UK. In response to the current situation the UK Government has designated key worker status to our frontline operational water and waste activities. In order to continue delivering the expected levels of service to our stakeholders we have reviewed our processes and ways of working and drawn on our resilience and continuity plans, while continuing to prioritise the health, safety and wellbeing of our employees and customers which remains paramount during this period. We also continue to work closely with our key stakeholders and peers including local resilience forums, Water UK, Ofwat and Defra ensuring a joined up and collaborative response. Both the Pennon Executive and Pennon Board continue to receive regular updates on the Group's response.

To date, our business has remained broadly resilient to the immediate risks that have been presented by COVID-19. It is likely, however, that there will be ongoing restrictions in place during 2020/21, which could provide continued challenges to the delivery of our key operational activities. Medium-term response planning has been undertaken to establish strategies to mitigate these risks where possible, which has considered a range of potential scenarios and been informed by actions taken by other countries impacted by the pandemic. These plans will continue to be reviewed and updated as further Government and Public Health guidance is provided.

The principal risks detailed below have been assessed applying the Group's impact and likelihood methodology, separately identifying both the underlying risk assessment prior to the onset of the COVID-19 virus and the assessment of risk reflecting the potential impact of COVID-19. The commentary for individual principal risks also provides further detail on additional mitigation steps that have been taken in response to this event.

The Directors confirm that during 2019/20 they have carried out a robust assessment of current and emerging risks facing the Group. The assessment of the Group's principal risks has considered the impact on its business model, future performance, solvency and liquidity. These principal risks have been considered in preparing the viability statement on page 68.

Law, regulation and finance

Principal risk	Strategic impact	Mitigation	Net risk (pre-COVID-19)	Net risk (including COVID-19)	Risk appetite
A: Changes in Government policy	<p>Long-term priorities affected:</p> <p>1 2</p> <p>Changes in Government policy may fundamentally impact our ability to deliver the Group's strategic priorities impacting shareholder value.</p>	<p>The General Election in December 2019 has provided greater certainty over Government policy, with the current UK Government supportive of the existing regulatory model. We continue to engage with MPs, all political stakeholders, customers and wider stakeholders, both directly and via Water UK, demonstrating the value received from our operational performance and continued investment in the network infrastructure.</p> <p>The UK Government has also committed to the £50 Government contribution made to household customers of South West Water being retained for 2020/21.</p> <p>The speed at which action announced by the Government in response to COVID-19, including changes to restrictions and ongoing support to the economy, presents challenges in ensuring the impact to the business is minimised.</p>	<p>●</p> <p>↔</p>	<p>●</p> <p>↑</p>	<p>We recognise that Government policy evolves. The Group seeks to minimise potential risk and maximise opportunities through regular engagement, communication and robust scenario planning.</p>
B: Regulatory reform	<p>Long-term priorities affected:</p> <p>1 2</p> <p>Reform of the regulatory framework may result in changes to the Group's priorities and the service we provide to our customers. It may have a significant impact on our performance which can impact shareholder value.</p>	<p>Greater certainty over reform of the regulatory framework has been provided through the announcement of South West Water's Final Determination for the 2020-25 regulatory period. Both South West Water and Pennon Water Services maintain ongoing dialogue directly with regulators and through sector-wide forums and engage fully with consultations and proposed reforms of the regulatory frameworks.</p> <p>A number of temporary regulatory changes have been introduced in response to COVID-19; in particular in respect of the water retail market, including wholesaler support. The speed at which these changes are being introduced has impacted on the ability to fully consult with regulators and increases the possibility that these changes are detrimental to the Group's activities.</p>	<p>●</p> <p>↑</p>	<p>●</p> <p>↑</p>	<p>We accept that regulatory reform occurs and seek to leverage opportunities where possible and minimise the negative impact of regulatory reform by targeting changes which are NPV neutral over the longer term to protect customer affordability and shareholder value.</p>
C: Compliance with laws and regulations	<p>Long-term priorities affected:</p> <p>1 2</p> <p>The Group is required to comply with a range of regulated and non-regulated laws and regulations across our businesses. Non-compliance with one or a number of these may result in financial penalties, a negative impact on our ability to operate effectively and reputational damage.</p>	<p>The Group operates within robust and mature regulatory frameworks ensuring compliance with Ofwat, Environment Agency and other relevant requirements. These frameworks are subject to regular review by South West Water, Pennon Water Services and the Pennon Executive.</p> <p>Compliance with the regulatory framework has become more complex as a result of a number of temporary changes introduced by our regulators in response to COVID-19. All regulatory changes are subject to detailed review and, where necessary, internal processes, systems and controls are revised to ensure compliance.</p> <p>The Group also maintains a comprehensive internal framework to ensure compliance with corporate laws and regulations. This is reinforced through key policies such as the Group's Code of Conduct, supply chain code of conduct and anti-slavery policy. Additionally, the Group's Speak Up whistleblowing process allows any concerns to be raised confidentially and dealt with through appropriate investigations.</p>	<p>●</p> <p>↑</p>	<p>●</p> <p>↑</p>	<p>The Group has the highest standards of compliance and has no appetite for legal or regulatory breaches.</p>
D: Maintaining sufficient finance and funding, within our debt covenants, to meet ongoing commitments	<p>Long-term priorities affected:</p> <p>1 3</p> <p>Failure to maintain funding requirements could lead to additional finance costs and put our growth agenda at risk. Breach of covenants could result in the requirement to repay certain debt.</p>	<p>The Group has mature treasury, funding and cash flow arrangements in place and the impact of political, economic and regulatory risks on the Group's financing commitments and cash flow is regularly reviewed by Pennon Executive and the Board.</p> <p>The Group has £16 billion of cash and committed facilities providing liquidity and ensuring South West Water is prefunded into the next regulatory period.</p> <p>During 2019/20 £840 million of new or renewed funding was entered into, including £245 million of funding through the Sustainable Funding Framework for South West Water.</p> <p>The strength of our position provides the Group with added resilience in the event of volatility which may arise as a result of COVID-19.</p>	<p>●</p> <p>↔</p>	<p>●</p> <p>↔</p>	<p>The Group operates a prudent approach to our financing strategy in order to ensure our funding requirements are fully met.</p>

Strategic impact

- 1 Leadership in UK water and waste infrastructure
- 2 Leadership in cost base efficiency
- 3 Driving sustainable growth

Risk level

- High

↑

Increasing
- Medium

↔

Stable
- Low

↓

Decreasing

Risk report

continued

Law, regulation and finance continued

Principal risk	Strategic impact	Mitigation	Net risk (pre-COVID-19)	Net risk (including COVID-19)	Risk appetite
E: Non-compliance or occurrence of an avoidable health & safety incident	<p>Long-term priorities affected:</p> <p>1 2 3</p> <p>A breach of health & safety law could lead to financial penalties, significant legal costs and damage to the Group's reputation.</p>	<p>The effective management of health & safety risks continues to be a priority for the Board and Pennon Executive.</p> <p>During the year there has been two fatalities that have occurred in the delivery of our activities. Both incidents are deeply tragic and full and thorough root cause analysis has been undertaken to identify additional actions required to prevent such incidents from occurring again alongside additional training and system upgrades.</p> <p>During the year the Group progressed the full roll-out of HomeSafe across the Group, which has contributed to a lost time injury frequency rate of 0.9, a further improvement on prior year and the Group remains on track to achieve its LTIFR target of 0.5 by 2025.</p> <p>In response to COVID-19 additional safety measures have been introduced to ensure that key activities across the Group can continue to be performed safely, in line with Government and public health guidance. This includes remote working, social distancing and the provision of additional hygiene and appropriate personal protective equipment (PPE).</p> <p>The easing of Government restrictions continues to be carefully reviewed to ensure the Group's activities can continue to be delivered safely and Government and public health guidance will continue to be stringently followed.</p>			The Group has no appetite for health & safety-related incidents and has the highest standards of compliance within the Group, contractors, partners and other third parties.
F: Tax compliance and contribution	<p>Long-term priorities affected:</p> <p>2</p> <p>Non-compliance may result in financial penalties, legal costs and reputational damage. Furthermore, the perception that Pennon's overall tax contribution is inadequate could have a detrimental impact on the reputation of the Group.</p>	<p>The Group continues to achieve the Fair Tax Mark; an independent certification scheme, which recognises organisations that demonstrate they are paying the right amount of corporation tax in the right place, at the right time.</p> <p>The Group have an experienced and professionally qualified in-house tax team supported, where necessary, by external specialists.</p> <p>Senior accounting officers are required to review and declare annually the effectiveness of tax-related internal controls within their respective area of responsibility.</p> <p>Discussions continued with HMRC regarding the agreement of uncertain tax items in order to enable the finalisation of tax returns.</p>			The Group ensures full compliance with HMRC requirements and will not enter into artificial tax arrangements or take an aggressive stance in the interpretation of tax legislation.
G: Failure to pay all pension obligations as they fall due and increased costs to the Group should the deferred pension scheme deficit increase	<p>Long-term priorities affected:</p> <p>2</p> <p>The Group could be called upon to increase funding to reduce the deficit, impacting our cost base.</p>	<p>The Group has an experienced in-house Pensions team who also engage professional advisers to manage the pension scheme's investment strategy, ensuring the scheme can pay its obligations as they fall due.</p> <p>The triennial 2019 valuation of the Group's principal pension scheme has recently been completed, with a recovery plan to return to full funding on a technical provisions basis by March 2022. In addition, the Group has sought to support the scheme through the acceleration of contributions of £17 million during the year.</p> <p>The Group is currently consulting on potential changes to its pension scheme arrangements including closure to future accrual of the main scheme which, if implemented, will be effective from July 2020.</p>			The Group will ensure that all obligations are met in full but seeks to manage this without unnecessary increased costs to the Group.

Strategic impact

- 1 Leadership in UK water and waste infrastructure**
- 2 Leadership in cost base efficiency**
- 3 Driving sustainable growth**

Risk level

- High**
↑ Increasing
- Medium**
↔ Stable
- Low**
↓ Decreasing

Market and economic conditions

Principal risk	Strategic impact	Mitigation	Net risk (pre-COVID-19)	Net risk (including COVID-19)	Risk appetite
H: Non-recovery of customer debt	<p>Long-term priorities affected:</p> <p>1 2</p> <p>Potential impact on revenue as a result of reduced customer debt collection, particularly with regards to vulnerable customers and affordability.</p>	<p>South West Water has mature and embedded debt collection strategies which has continued to deliver improved collection rates and decreased debt exposure during the year. The collection of debt within Pennon Water Services has also improved during the year.</p> <p>The potential impact of COVID-19 could place affordability pressure on both our domestic and business retail customers negatively impacting on collection rates and debt exposure. Measures introduced by regulators within the retail water market, including the deferral of payments to wholesalers, may also impact on immediate debt levels.</p> <p>We have worked proactively with our customers, identifying and contacting those most in need and supporting them in the most appropriate way. This has included automatically extending social tariffs and payment plans for our domestic customers.</p> <p>Additional short-term flexibility, requested by our regulators, has already been incorporated within our collection processes for both our domestic and retail water businesses.</p>	<p>●</p> <p>↑</p>	<p>●</p> <p>↑</p>	While seeking to minimise non-recoverable debt, we recognise customer affordability challenges and the inability to disconnect household customers results in a residual risk of uncollectable debt remaining.
I: Macroeconomic risks impacting inflation, commodity and power prices	<p>Long-term priorities affected:</p> <p>3</p> <p>Changes such as currency exchange movements, tariffs and volatility within the energy markets could increase the Group's cost base.</p>	<p>The Group has a dedicated procurement function supported by established processes to ensure the quality of provision and price for goods and services procured.</p> <p>There remains the potential for increased costs arising from COVID-19 due to demand and exchange rate volatility for the limited goods purchased from outside the UK, in particular chemicals, which increases risk in this area.</p> <p>Energy usage is minimised and where possible on-site renewable generation schemes are implemented to reduce the requirement to purchase electricity from the grid.</p> <p>Despite the current volatility experienced within the spot market, partly as a result of COVID-19, medium-term electricity markets are relatively stable and South West Water had hedged the majority of wholesale power costs for the first two years of the new regulatory period.</p>	<p>●</p> <p>↓</p>	<p>●</p> <p>↑</p>	The Group seeks to take well-judged and informed decisions while ensuring plans are in place to mitigate the potential impact of macroeconomic risks.

Operating performance

Principal risk	Strategic impact	Mitigation	Net risk (pre-COVID-19)	Net risk (including COVID-19)	Risk appetite
J: Poor operating performance due to extreme weather or climate change	<p>Long-term priorities affected:</p> <p>1</p> <p>Failure of our assets to cope with extreme weather conditions may lead to an inability to meet our customers' needs, environmental damage, additional costs and reputational damage.</p>	<p>The increased frequency and impact of extreme weather exposes our assets to risk, while there continues to be a reduced appetite for reduced performance arising from such incidents from the regulator and our stakeholders.</p> <p>The Group seeks to mitigate this risk proactively through a planned capital investment programme as well as established emergency resources and contingency planning.</p> <p>As part of the risk management process the Group also performs horizon scanning on the longer-term impacts of climate change on its operations.</p> <p>Further improvement in South West Water's resilience is a key focus within the next regulatory period. A Director of Resilience has been appointed during the year to lead this workstream.</p>	<p>●</p> <p>↔</p>	<p>●</p> <p>↔</p>	The Group seeks to reduce both the impact and likelihood through long-term planning and forecasting to ensure that sufficient measures are in place to mitigate the impact of extreme weather and climate change on our operations.
K: Poor service and/or increased competition leading to loss of customers	<p>Long-term priorities affected:</p> <p>1 3</p> <p>Poor customer service has a direct impact on the ability of Pennon Water Services to retain and grow market share.</p>	<p>Despite the retail water market continuing to remain highly competitive, Pennon Water Services has a knowledgeable key account team to support customers. The business has strategically targeted high-consumption customers to maintain market share.</p> <p>As a result of restrictions imposed in response to COVID-19 a proportion of Pennon Water Services' customers have temporarily ceased operating. If these businesses are unable or choose not to resume trading following the easing of restrictions this could result in overall attrition to the customer base. Regular contact and communication is being maintained with customers to support them during this period.</p>	<p>●</p> <p>↑</p>	<p>●</p> <p>↑</p>	The Group continually seeks to increase customer satisfaction and maximise customer retention while taking well informed risk to develop further markets and offerings.

Risk report

continued

Operating performance continued

Principal risk	Strategic impact	Mitigation	Net risk (pre-COVID-19)	Net risk (including COVID-19)	Risk appetite
L: Business Interruption or significant operational failures/incidents	<p>Long-term priorities affected:</p> <p>1 3</p> <p>Operational failure in our water business could mean that we are unable to supply clean water to our customers or provide safe wastewater processes. This has a direct impact on the successful delivery of the PR19 business plan.</p>	<p>South West Water has mature processes in place for the management of their assets which is done through a programme of sophisticated planned and preventive maintenance and effective management of stores.</p> <p>In the event of a significant incident South West Water maintains detailed contingency plans and incident management procedures which are regularly reviewed.</p> <p>Existing processes have been extensively reassessed in light of the potential impact of COVID-19 and appropriate measures and actions have been introduced, working with the wider water sector and our key strategic partners, to ensure the continued delivery of our highest priority activities. This has included new working processes, adjusted shift patterns and enhanced operational cover to provide added resilience.</p> <p>These actions have been effective to date in ensuring the resilience of our operations, however, the potential ongoing impact of COVID-19 on our business will continue to remain a risk.</p>	<p>●</p> <p>↔</p>	<p>●</p> <p>↑</p>	The Group operates a low tolerance for significant operational failure and seeks to mitigate these risks where possible.
M: Difficulty in the recruitment, retention and development of appropriate skills required to deliver the Group's strategy	<p>Long-term priorities affected:</p> <p>1 2 3</p> <p>Failure to have a workforce of skilled and motivated individuals will detrimentally impact all of our strategic priorities. We need the right people in the right places to innovate, share best practice, deliver synergies and move the Group forward.</p>	<p>The Group's HR Strategy continues to be embedded across the organisation in order to continue to attract, retain and develop our employees. Succession plans remain in place for senior and other key positions while the Group recruited an additional 191 new apprentices during the year.</p> <p>There are also various engagement forums across the Group which provide opportunities for employees to regularly discuss business priorities and challenges with business leaders.</p> <p>The impact of these initiatives is measured through the results of the most recent Great Places to Work Best Workplace Survey which showed an improved Trust Index score of 63% and maintained last year's engagement score of 68%. We also achieved our highest ever participation rate at 83%, demonstrating employees value this mechanism for feedback.</p> <p>During COVID-19 we have refocused our resources where appropriate to essential parts of our business and not furloughed any employees. To date there has been no immediate impact of COVID-19 on the ability to attract and retain necessary skills within the Group. It is recognised that there may be longer-term challenges and action is underway to minimise the impact of these.</p>	<p>●</p> <p>↔</p>	<p>●</p> <p>↑</p>	While turnover of employees does occur we ensure the appropriate skills and experience is in place with succession plans providing adequate resilience.
N: Non-delivery of regulatory outcomes and performance commitments	<p>Long-term priorities affected:</p> <p>1 2 3</p> <p>South West Water's Regulatory Outcomes and performance commitments cover key strategic focus areas.</p> <p>Non-delivery against these could result in financial penalties being applied as well as reputational damage to the Group.</p>	<p>The regulatory framework has been in place since 1 April 2015 and South West Water has delivered cumulative net ODI rewards of £13.3 million during 2015-20.</p> <p>The ODI regime in the 2020-25 regulatory period is more stretching with the overall reward/penalty range more penal.</p> <p>While South West Water has used the fast-track status awarded by Ofwat to commence early roll-out of key projects and initiatives, the impact of COVID-19 could present additional medium-term challenges that impact on the ability to deliver the required step change and outperform the agreed performance commitments.</p> <p>Alternative strategies and ways of working are being developed which seek to ensure the continued delivery of performance commitments into the future.</p>	<p>●</p> <p>↑</p>	<p>●</p> <p>↑</p>	The Group is committed to achieving all of our performance commitments over the length of each regulatory period. Where performance in an individual year falls below expectation we implement action plans and targeted interventions to ensure performance returns to committed levels.

Strategic impact

- 1** Leadership in UK water and waste infrastructure
- 2** Leadership in cost base efficiency
- 3** Driving sustainable growth

Risk level

- High
- Medium
- Low
- ↑ Increasing
- ↔ Stable
- ↓ Decreasing

Business systems and capital investment

Principal risk	Strategic impact	Mitigation	Net risk (pre COVID-19)	Net risk (including COVID-19)	Risk appetite
O: Failure or increased cost of capital projects/exposure to contract failures	<p>Long-term priorities affected:</p> <p>① ③</p> <p>Inability to successfully deliver on our capital programme may result in increased costs and delays and detrimentally impacts our ability to provide top class customer service and achieve our growth agenda.</p>	<p>All capital projects are subject to a robust business case process which includes challenge and risk modelling of key assumptions. Projects are delivered using skilled project management resource complemented by senior oversight and leadership.</p> <p>The scheduling of a number of projects for the 2020-25 regulatory period have been advanced and agreements are in place with strategic partners who will support the delivery of the capital programme.</p> <p>The impact of COVID-19 has seen further strain placed on the financial health of key contractors and supply chain partners. There is regular engagement and communication with our supply chain and early intervention is taken where necessary.</p> <p>Medium-term restrictions, which could include continued social distancing or restricted travel, could also impact on the costs and timescales in delivering these projects.</p>	<p>●</p> <p>↔</p>	<p>●</p> <p>↑</p>	The Group's investment activities are taken on an informed basis with risks weighed against appropriate returns.
P: Failure of information technology systems, management and protection including cyber risks	<p>Long-term priorities affected:</p> <p>①</p> <p>Failure of our information technology systems, due to inadequate internal processes or external cyber threats could result in the business being unable to operate effectively and the corruption or loss of data. This would have a detrimental impact on our customers and result in financial penalties and reputational damage for the Group.</p>	<p>The Group operates a mature and embedded governance framework over the IT environment and South West Water holds the ISO 27001 accreditation.</p> <p>There has been a significant increase in the number of employees working remotely as result of COVID-19, which has placed additional strain on the capacity of our systems. Additional bandwidth and licences have been procured and IT systems have remained resilient during this period. Disaster recovery plans are in place for corporate and operational technology, which have been updated to reflect the impact of COVID-19.</p> <p>During this period there has also been an increase in the volume and sophistication of cyber threats. These risks are mitigated by a strong preventive and detective information security framework aligned to guidance issued by the National Cyber Security Centre (NCSC).</p> <p>South West Water also continues to progress actions to meet the requirements of the Network and Information Systems (NIS) directive with activities aligned to the priorities identified by the Drinking Water Inspectorate.</p>	<p>●</p> <p>↑</p>	<p>●</p> <p>↑</p>	We seek to minimise the risk of informational technology failure and cyber security threats to the lowest level without detrimentally impacting on business operations.

Risk report continued

Viability statement

The Board has assessed the Group's financial viability and confirms that it has a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over a five-year period, the period considered to be appropriate by the Board in connection with the UK Corporate Governance Code.

While this is currently a time of change for the Group with the proposed sale of Viridor an outcome of the strategic review, the five-year period appropriately recognises the mix of business in the Group, noting in particular the ability to look forward with some certainty in the business and regulatory environment in which the Group operates, notably for South West Water.

The assessment has been made with reference to the Group's current position and prospects, including consideration of the ongoing COVID-19 pandemic, its longer-term strategy, the Board's risk appetite and the Group's principal risks and how these are managed, as detailed on pages 62 to 67 of the risk report. The Group's principal continuing operating subsidiary is South West Water, a long-term business characterised by multi-year investment programmes, with associated revenue streams.

The Group's strategic business plan, including consideration of the ongoing COVID-19 pandemic, principal risks and Ofwat viability scenarios considered in respect of South West Water (set out in further detail below) are the foundation of the scenario testing. This assessment has considered the potential impact of these and other risks arising on the business model, future performance, solvency and liquidity over the period in question.

In making their assessment, the Directors reviewed the principal risks and considered which risks might threaten the Group's viability. Over the course of the year the Audit Committee has considered a deep-dive review of the following principal risks to enable a thorough assessment of the impact of these risks on ongoing viability.

Matters considered by the Audit Committee

Group cyber security
Group health & safety
Energy management
General Data Protection Regulation (GDPR)
Brexit readiness across the Group
ODI preparedness
Dam safety
Resilience and business continuity

The Group's business plan, which includes the sale of Viridor to KKR for net proceeds of c.£3.7 billion and a best assessment of the likely impacts of COVID-19, has been stress tested. Through this testing, it has been determined that none of the individual principal risks or Ofwat viability scenarios would in isolation, or in aggregate, compromise the Group's viability. In performing this stress testing the following factors have been considered:

- Ofwat viability scenarios have been modelled and monetised
- A near-term downside impact of COVID-19 has been modelled
- Principal risks have been ascribed a value with reference to risk weighting, factoring in the likelihood of occurrence and financial impact
- Proceeds from the Viridor sale have been utilised in part to repay Pennon company debt.

In addition, a reversed engineered scenario that could possibly compromise the Group's viability over the five-year assessment period has been modelled. This scenario builds on the factors above and additional assumes all the Group's principal risks incurring each year with maximum effect and no probability weightings attached, a scenario akin to modelling the downside scenario on COVID-19 over the whole five-year period and the Viridor sale proceeds are fully utilised.

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

In making its assessment of the Group's viability, the Directors have taken account of the Group's robust capital solvency position, the impact of the Viridor sale, the Group's latest assessments of the impact of the COVID-19 pandemic, its ability to raise new finance and a key potential mitigating action of restricting any non-contractual payments. In assessing the prospects of the Group, the Directors note that, as the Group operates in a regulated industry which potentially can be subject to non-market influences, such assessment is subject to uncertainty, the level of which depends on the proximity of the time horizon. Accordingly, the future outcomes cannot be guaranteed or predicted with certainty. As set out in the Audit Committee's report on page 86, the Directors reviewed and discussed the process undertaken by management, and also reviewed the results of the stress testing performed.

Additionally, South West Water Limited's own viability has been considered. This additional assessment considered South West Water's regulatory financial ring fence through the following scenarios that are recommended to be tested by Ofwat:

- Totex underperformance (15% of totex)
- ODI penalty (3% of RoRE) in one year
- Inflation sensitivities (+/-3%)
- Increase in the level of bad debt (20%)
- New debt financed at 2% above forward projections
- Financial penalty – equivalent to 3% of turnover
- Any relevant inter-company financing scenarios.

These scenarios were considered in isolation and in the following combination:

- 10% totex underperformance in each of the five years
- ODI penalty of 1.5% in each of the five years
- A one-off financial penalty of 1% of revenue.

These scenarios in isolation and the combination noted above did not compromise the viability of South West Water over their assessment period to 2030. South West Water uses a longer viability period noting a greater visibility of future cash flows, being a regulated business.

Forward-looking statements

This strategic report, consisting of pages 1 to 69 and 121, contains forward-looking statements regarding the financial position; results of operations; cash flows; dividends; financing plans; business strategies; operating efficiencies; capital and other expenditures; competitive positions; growth opportunities; plans and objectives of management; and other matters. These forward-looking statements including, without limitation, those relating to the future business prospects, revenues, working capital, liquidity, capital needs, interest costs and income in relation to Pennon Group and its subsidiaries, wherever they occur in this strategic report, are necessarily based on assumptions reflecting the views of Pennon Group and its subsidiary companies, as appropriate.

They involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. Such forward-looking statements should, therefore, be considered in the light of all relevant factors, including those set out in this section on principal risks and uncertainties.

Customer ownership: WaterShare & WaterShare+

Sharing our success and enhancing our relationship with water customers

South West Water's 2015-20 business plan introduced WaterShare – a unique, innovative scheme which enables the financial benefits of successful company performance to be shared with customers in a more open and timely way. As part of the New Deal plan for 2020-25 the WaterShare+ mechanism takes this even further, moving from customer engagement to customer empowerment by giving customers 'a greater stake and a say' in the company.

WaterShare has been central to South West Water's customers since 2015. An independent WaterShare panel – which met twice in 2019/20 – scrutinises company performance against the business plan, and reviews and challenges recommendations on how any benefits should be shared with customers. Previously this has included reinvestment to improve services or through bill reductions. The company's performance is reported to customers through the WaterShare scorecard and framework, overseen by the panel, and financial benefits resulting from regulatory outperformance are discussed with customers through focus groups and regular surveys.

As part of the 2020-25 business plan the established WaterShare approach was scrutinised with the aim of further building on the existing relationship with customers and embedding the sharing of regulatory outperformance. Research was undertaken to better understand how customers would like to receive financial benefits.

Options included bill reductions (immediate and deferred), monetary rebates, reinvestment in services and the choice of being given an enduring 'financial stake' in the business.

While 77% of customers do not own shares or have a financial stake in any company, 79% believe share ownership would be a positive step as:

- Customers' interests would be more aligned with investors – customers would receive a share of the Company profits in the form of dividends on the Company's ordinary shares as and when shareholders do, in addition to owning a capital stake in the Company
- Customers would have a vote and an opportunity to share their views through general meetings.

Our pledge for our 2020-25 business plan is therefore to offer customers the choice, alongside bill reductions, rebates and reinvestment, of taking a financial stake in the business via an equity share in Pennon.

Since the business plan submission to Ofwat in September 2018, we have continued to engage with customers about the principles of WaterShare+ to ensure that share ownership is still something they would see as a positive step to evolving the relationship between customer and the company.

Subject to a second confirmatory vote at the 2020 Annual General Meeting (AGM), the first being approved in 2019, eligible household customers will have the option of receiving the benefit in a rebate or in the form of Pennon shares from 2020. These will be purchased in the market, avoiding any dilution of existing shareholdings, with the purchase to be funded by the benefits of outperformance that South West Water has already committed to return to customers via the WaterShare sharing mechanism.

During 2020/21 c.£20 million of accrued benefit from the 2015-20 period will be passed back to customers.

This approach has been endorsed through the regulatory review by Ofwat, with South West Water's plan fast tracked. As shareholders, participating customers will then:

- Receive a share of company profits, in the form of dividends, just as shareholders do when dividends are paid
- Be able to vote and have their say at the company Annual General Meeting
- Receive annual reports and financial statements.

Our performance during 2020-25 will continue to be reviewed and challenged by an independent WaterShare+ Customer Panel and these meetings will be held quarterly in public, providing even more transparency and openness.

We will also be introducing a customer AGM, which all customers will be invited to attend. The first of these will be held in the summer of 2021.

This strategic report, consisting of pages 1 to 69 and 121, was approved by the Board on 3 June 2020.

By order of the Board



Simon Pugsley
Group General Counsel and
Company Secretary

3 June 2020

Good governance remains at the heart of our business and benefits all our stakeholders.





Governance

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Chairman's letter to shareholders



Strong governance is central to our successful management of the Group for the benefit of all our stakeholders.



Sir John Parker
Chairman

Dear Shareholder

On behalf of the Board, I am pleased to introduce the corporate governance report for 2020. This continues to be the Board's principal method of reporting to shareholders on our governance policies and on our application of the principles of good corporate governance.

Strong governance is central to our successful management of the Group and it provides the framework for the effective delivery of our strategy, the creation of shareholder value and the ongoing development of our sustainable business. As Chairman of Pennon, one of my overriding responsibilities is to ensure that we continue to operate to the highest standards of corporate governance. This year, for the first time, we are reporting formally on our performance against the Principles of the 2018 UK Corporate Governance Code. The table on pages 74 and 75 will help you to navigate our reporting and evaluate our performance.

One consequence of Pennon's ownership of South West Water, a regulated water and wastewater business, is that to meet the requirements of Ofwat, South West Water Limited maintains its own independent board of directors and continues to operate in the manner of a publicly listed company in its own right. Further detail of South West Water's operations and governance will be contained in its annual report and accounts. Also, this year, Viridor Limited, our waste management business is reporting on its application of the Wates Governance principles during the year; further information will be published in Viridor's annual report and accounts in due course.

Our current board and committee framework allows us to streamline our decision-making process. The South West Water board, which includes certain Pennon Executive and Non-Executive Directors, as well as three South West Water only non-executive directors, convenes on the same day as each Pennon Board meeting and considers South West Water strategy, performance and regulatory planning. In its meetings the Pennon Board concentrates on strategic forward-looking matters for all parts of the Group, including South West Water.

Our governance framework has served the complex structure of the Group well. It has been put to the test in recent weeks but I am pleased to say it has shown itself to be robust and effective in the way it has supported decision-making in relation to the Viridor disposal at the same time as dealing with Pennon's response to the COVID-19 risk and the usual oversight of the Company's performance and delivery of its strategy. Following the completion of the proposed sale of Viridor, we are mindful that modifications may need to be considered to ensure our system of governance remains appropriate and continues to support the delivery of our strategy.

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 each of the Directors, and the Board as a whole, to perform effectively to promote the success of the Company for the benefit of its shareholders and other stakeholders.

It is my view that the Board is highly effective with a good understanding of the Group's opportunities as well as the threats facing the business. This view is supported by the results of this year's Board and Committee performance evaluations, which are reported on pages 90 and 91, as well as hard evidence. I refer to the Board's understanding of a wide range of opportunities from the release of value in Pennon's waste business in the form of the Viridor sale, to the need for investment in plastics recycling for the benefit of the environment and our communities, and the New Deal for South West Water customers. We keep under constant review the threats to the future success of the business, the most immediate being COVID-19.

Culture

Organisations that embody a clear sense of vision and purpose deliver good results and the most successful workplace cultures are built on trust. The Board relies on employee engagement as a way of monitoring the organisation's culture, most notably our Trust Index score. This is explained on page 38.

Stakeholder engagement

The Board understands the part the Group can play in bringing resources to life and creating a more sustainable UK. We are committed to carrying out our business in a responsible way and remain focused on improving the provision of water services for the benefit of all our stakeholders.

This year, and in full compliance with The Companies (Miscellaneous Reporting) Regulations 2018, we have provided a section 172 statement, which describes in more detail how the Board has had regard to the interests of all our stakeholders when carrying out its duties. Our section 172 statement, which can be found on page 121, should be read alongside pages 26 to 29 and the summary opposite of how stakeholder interests were taken into consideration by the Board in decision making during the year.

There are a number of routes through which the Board gains an understanding of employees' views on key decisions, most notably staff forums, employee surveys and the Big Chat. We were particularly interested to see the results of the employee 'pulse survey' on home working during the COVID-19 pandemic; these views are reflected in the measures that have been taken to ensure the safety and wellbeing of our people. Further information on employee engagement is provided on page 38.

The Board also carries out site visits and we were disappointed when visits scheduled for March 2020 had to be cancelled due to COVID-19. We look forward to those being rescheduled during 2020/21.

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

Shareholder engagement

Our shareholders are just one of our key stakeholder groups and we continue to manage a comprehensive engagement programme with them throughout the year. During this past year we undertook some 90 meetings and conference calls with both current and prospective investors. Pennon also attended eight city conferences and sales force briefings and hosted 11 road shows and investor events in the UK, USA and mainland Europe. Pennon maintains a stable, high-quality shareholder register with almost two-thirds of investors based in the UK. The majority of Pennon's issued share capital is held by institutions, with the remainder largely held by private client investment managers.

The Chief Financial Officer continues to report to the Board regularly on major shareholders' views about the Group, and the Company's corporate brokers present frequently to the Board on equity market developments and shareholder perceptions.

This helps to ensure that the Board is fully briefed on the views and aspirations of shareholders.

It is always pleasing to be part of a well-attended Annual General Meeting (AGM) and it was very pleasing to see many familiar faces at the 2019 AGM. I am sorry to say that we expect this year's AGM, which will be held on 31 July 2020, to be very different. We are closely monitoring developments relating to the COVID-19 pandemic and as at the date of this report, compulsory government measures remain in force restricting public gatherings and non-essential travel. This means that shareholders will not be able to attend the meeting and the Company will arrange for a quorum to be present to transact the business of the meeting.

We are very aware that the AGM provides an important forum for shareholders to meet the Board and raise questions and, assuming the restrictions remain in place, we will provide an online/telephone facility to allow shareholders to participate remotely. We also encourage our shareholders to vote on the resolutions by proxy. Further details will be found in the Notice of AGM.

Compliance with the UK Corporate Governance Code and other requirements

Details of how we have applied the Principles that form the UK Corporate Governance Code (the UK Code) are provided throughout this annual report and the table on pages 74 and 75 provides some useful signposting. Underpinning our application of the Principles is our compliance with the UK Code's Provisions throughout the year; I am pleased to say that we have no exceptions to report. The UK Code is published on the Financial Reporting Council (FRC) website, www.frc.org.uk.

My introduction to this corporate governance report and the following sections is made in compliance with the UK Code, Financial Conduct Authority (FCA) Listing Rule 9.8.6 and FCA Disclosure and Transparency Rules 7.1 and 7.2 and covers 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, our confirmation of the Company as a going concern and Directors' responsibility statements. Finally, in accordance with reporting requirements, on page 120 the Board is able to confirm to shareholders that the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary to assess the Company's performance, business model and strategy.



Sir John Parker
Chairman

Pennon Group plc
3 June 2020

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

Key decision	Stakeholders affected	Strategic factors taken into consideration	Outcome
Proposed sale of Viridor	Investors Employees Customers	<ul style="list-style-type: none"> Realisation of significant strategic value for shareholders Positioning for potential future growth opportunities Smooth transition for employees Continuation of high standards of customer service 	Board decision to progress the sale
COVID-19 response	Employees Customers Investors	<ul style="list-style-type: none"> Health, safety and wellbeing of employees and customers Continued delivery of essential services Helping vulnerable customers Financial security for employees Maintaining a solid funding and liquidity position 	Strong Board support for measures introduced by the management team
Pensions	Employees Shareholders Scheme trustee Employee representatives	<ul style="list-style-type: none"> Ability of pension scheme to continue to meet obligations Managing the pension scheme deficit Ensuring employees can continue to save for their future in a way that reflects their lifestyle and life stage 	Board approval of employee consultation programme on the closure of the defined benefit scheme to future accrual and an enhanced defined contribution offering
Ofwat's Final Determination of South West Water's business plan for 2020-25	Investors Employees Customers Government and regulators	<ul style="list-style-type: none"> Realisation of strategic value for shareholders Continued delivery of high standards of service to customers Alignment of investor and customer interests; increasing trust and legitimacy Giving customers a greater say in our water business Regulatory and environmental compliance Reputational matters 	Acceptance of Final Determination
Interim dividend	Investors Employee shareholders	<ul style="list-style-type: none"> Delivery of shareholder value 	Payment of dividend
New Group borrowings	Investors Employees Customers	<ul style="list-style-type: none"> Maintaining a sustainable and solid funding and liquidity position Delivery of shareholder value Continued delivery of high standards of service to customers 	Entry into new funding facilities
Subsidiary strategic plans	Investors Employees Customers Communities	<ul style="list-style-type: none"> Realisation of strategic value for shareholders Continued delivery of high standards of service to customers Regulatory and environmental compliance 	Strategic planning and roadmap agreed

Chairman's letter to shareholders

continued

How we have performed against the Principles of the 2018 UK Code

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

	UK Code principles	Where
Board leadership and company purpose	<ul style="list-style-type: none"> • An effective and entrepreneurial board • Promoting the long-term sustainable success of the Company • Generating value for shareholders • Contributing to wider society 	<ul style="list-style-type: none"> • Board of Directors (pages 76 and 77) • Strategic progress (pages 16 to 19) • Business model (page 14 and 15) • Sustainability at the heart of the business (pages 20 and 21)
	<ul style="list-style-type: none"> • Company's purpose, values and strategy are aligned with its culture • Directors act with integrity, lead by example and promote the desired culture 	<ul style="list-style-type: none"> • Business model (page 14 and 15) and throughout the annual report • Our People (page 40)
	<ul style="list-style-type: none"> • Resources, internal controls, risk management 	<ul style="list-style-type: none"> • Report of the Chief Financial Officer (page 54) • Risk report (pages 58 to 60)
	<ul style="list-style-type: none"> • Shareholder and stakeholder engagement 	<ul style="list-style-type: none"> • Our stakeholders (pages 26 to 29) • Our people (page 38)
	<ul style="list-style-type: none"> • Workforce policies and practices are consistent with the Company's values and support its long-term sustainable success • Workforce is able to raise any matters of concern 	<ul style="list-style-type: none"> • Business model (pages 14 and 15) • Our people (pages 38 to 41) • The Board and its governance framework (page 83)
Division of responsibilities	<p>The role of the Chairman is to:</p> <ul style="list-style-type: none"> • Demonstrate objective judgement • Promote a culture of openness and debate • Facilitate constructive board relations and the effective contribution of all non-executive directors • Ensure the directors receive timely, accurate and clear information 	<ul style="list-style-type: none"> • The Board and its governance framework (pages 79 to 82) • Nomination Committee report (pages 90 and 91)
	<ul style="list-style-type: none"> • Board composition – balance of executive/non-executive • Clear division of responsibilities between the Chairman and CEO 	<ul style="list-style-type: none"> • The Board and its governance framework (pages 80 and 81)
	<ul style="list-style-type: none"> • Non-Executive Director time commitment • Non-Executive Director roles – to provide constructive challenge, strategic guidance, offer specialist advice and hold management to account 	<ul style="list-style-type: none"> • Board of Directors (pages 76 and 77) • The Board and its governance framework (page 80)
	<ul style="list-style-type: none"> • The Board, supported by the Company Secretary, has the policies, processes, information, time and resources it needs to function effectively and efficiently 	<ul style="list-style-type: none"> • The Board and its governance framework (pages 81 and 82)

	UK Code principles	Where
Composition, succession and evaluation	<ul style="list-style-type: none"> • Board appointments are subject to a formal, rigorous and transparent procedure • An effective succession plan is maintained for Board and senior management • Appointments and succession plans are based on merit and objective criteria, and should promote diversity 	Nomination Committee report (pages 90 and 91)
	<ul style="list-style-type: none"> • The Board and Committees have a combination of skills, experience and knowledge • Consideration is given to the length of service of the Board as a whole and membership regularly refreshed 	Board of Directors (pages 76 and 77) The Board and its governance framework (page 79)
	<ul style="list-style-type: none"> • Annual evaluation of the Board considers its composition, diversity and how effectively members work together to achieve objectives • Individual evaluation demonstrates that each director continues to contribute effectively 	Nomination Committee report (pages 90 and 91)
Audit, risk and internal control	<ul style="list-style-type: none"> • The Board has established policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of the financial and narrative statements 	Audit Committee report (page 87)
	<ul style="list-style-type: none"> • The Board presents a fair, balanced and understandable assessment of the Company's position and prospects 	Audit Committee report (page 87) Directors' report (page 120)
	<ul style="list-style-type: none"> • The Board has established procedures to manage risk, oversee the internal control framework and determine the nature and extent of the principal risks the Company is willing to take in order to achieve its long-term strategic objectives. 	Risk report (pages 58 to 60)
Remuneration	<ul style="list-style-type: none"> • Remuneration policies and practices are designed to support strategy and promote long-term sustainable success. • Executive remuneration is aligned to the Company's purpose and values, and is clearly linked to the successful delivery of the long-term strategy 	Directors' remuneration report (page 95)
	<ul style="list-style-type: none"> • There is a formal and transparent procedure for developing policy on executive remuneration and determining director and senior management remuneration • No director is involved in deciding their own remuneration outcome 	Directors' remuneration report (page 98)
	<p>Directors:</p> <ul style="list-style-type: none"> • Exercise independent judgement and discretion when authorising remuneration outcomes; and • Take account of Company and individual performance, and wider circumstances 	Directors' remuneration report (pages 107 to 109)

Board of Directors



Sir John Parker
Chairman



Christopher Loughlin
Chief Executive Officer



Susan Davy
Chief Financial Officer

Board Committee members

- Pennon Executive
- Nomination Committee
- Audit Committee
- Remuneration Committee
- Sustainability Committee
- ▲ Chair of Committee

Sir John Parker Chairman



GBE, FEng, DSc (Eng), ScD (Hon), DSc (Hon), DUniv (Hon), FRINA

Sir John was appointed Chairman on 1 August 2015, having joined the Board as Deputy Chairman on 1 April 2015. He is also chairman of the Nomination Committee.

Skills and experience

Sir John is a highly experienced and independent chairman and brings a wealth of leadership experience across a range of industries. He is widely recognised for his policy work on the value of diversity in the boardroom, having chaired the Government's review on Ethnic Diversity on UK Boards in 2017. Prior to that, he was a member of the Davies Committee – Women on Boards.

He has chaired six FTSE 100 companies and was previously the chairman of Anglo American plc and National Grid plc, senior non-executive director and chair of the Court of the Bank of England, senior non-executive director of the Cabinet Office Board, deputy chairman of DP World, joint chair of Mondi and chair of BVT and P&O plc. He was also president of the Royal Academy of Engineering from 2011 to 2014 and is a Visiting Fellow of the University of Oxford.

External appointments

Sir John is the chairman of construction and engineering company Laing O'Rourke. He is also a non-executive director of Carnival PLC and Carnival Corporation and is a senior adviser to Spencer Stuart.

Christopher Loughlin Chief Executive Officer



BSc Hons, MICE, CEng, MBA

Chris was appointed to the Board on 1 August 2006 upon joining Pennon as Chief Executive of South West Water. He became the Group Chief Executive Officer on 1 January 2016. Chris is chairman of the Pennon Executive and a member of the Sustainability Committee. Chris also serves as Managing Director of South West Water.

Skills and experience

Chris has extensive experience of the regulated business environment and the management of major engineering and infrastructure services. He started his career as a chartered engineer working in both the consulting and contracting sectors and, after holding a number of senior positions with British Nuclear Fuels plc, joined its board as an executive director. Prior to joining Pennon, he was chief operating officer with Lloyds Register and before that, executive chairman of Magnox Electric plc. He was also a senior diplomat in the British Embassy, Tokyo.

Chris has a comprehensive understanding of the water industry. He was previously a board member (and, for a period, president) of the Institute of Water, and between April 2008 and March 2012 was chairman of Water UK.

An enthusiastic advocate of local business, Chris was previously the vice-chairman of the Cornwall Local Enterprise Partnership.

External appointments

Chris is currently chairman of British Water and of Reall Limited, a director of Water UK and a director of Mears Group PLC.

Susan Davy Chief Financial Officer



BSc Hons, ACA

Susan joined the Board on 1 February 2015. She is a member of the Sustainability Committee and the Pennon Executive.

Skills and experience

Susan is a graduate qualified chartered accountant with over 20 years' experience in the utility sector. Prior to her current appointment, Susan was Finance Director at South West Water between 2007 and 2015, during which time she was responsible for the company's business plan to 2020. She has also held a number of other senior finance roles in the water sector, including as Head of Regulation and Head of Finance (Wastewater) at Yorkshire Water.

Susan's knowledge of the industry coupled with her financial and regulatory expertise has supported the development of Pennon's strategy and her input has been invaluable to the Board in its deliberations. Susan is highly respected in the City and has been instrumental in building Pennon's reputation.

External appointments

Susan is a non-executive director and chairman of the audit committee of Restore plc and is also chair of the CBI South West council and a member of the A4S (Accounting for Sustainability) CFO leadership network.

Gill Rider Senior Independent Director (Non-Executive)



CB, PhD, CCIPD

Gill was appointed to the Board on 1 September 2012. She is chairman of the Remuneration Committee and a member of the Audit, Nomination and Sustainability Committees.



Gill Rider
Senior Independent Director (Non-Executive)



Neil Cooper
Independent (Non-Executive Director)



Iain Evans
Independent (Non-Executive Director)



Claire Ighodaro
Independent (Non-Executive Director)

Skills and experience

Gill has a wealth of experience in leadership, governance and remuneration across a broad range of sectors, including professional services, education, not for profit and government.

Gill was the senior independent director of Charles Taylor plc until its sale in January 2020.

Formerly, she was head of the Civil Service Capability Group in the Cabinet Office, reporting to the Cabinet Secretary and prior to that held a number of senior positions with Accenture LLP, culminating in the post of chief leadership officer for the global firm. She was previously president of the Chartered Institute of Personnel and Development and chair of the council of the University of Southampton.

As chair of the Remuneration Committee Gill is helping to steer Pennon's approach on executive remuneration, ensuring that it is aligned with and supports the Group's strategy.

External appointments

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

Neil Cooper

Independent
Non-Executive Director



BSc Hons, FCMA

Neil was appointed to the Board on 1 September 2014. He is chairman of the Audit Committee and a member of the Remuneration and Nomination Committees.

Skills and experience

Neil brings to the Board extensive experience in a wide variety of corporate and financial matters. He is currently the chief financial officer of Currencies Direct, a foreign exchange broker and international payment provider. Previously, he was group finance director of Barratt Developments plc and, before that, group finance director of William Hill plc and Bovis Homes plc. He also held senior finance positions at Whitbread plc, worked for PricewaterhouseCoopers as a management consultant and held a number of roles with Reckitt & Colman plc.

As chairman of the Audit Committee, Neil has been influential in directing Pennon's approach on a number of significant matters, including internal control, governance and financial reporting.

External appointments

Executive director, Currencies Direct.

Iain Evans

Independent
Non-Executive Director



CBE, BSc Hons, FCA, MBA

Iain was appointed to the Board on 1 September 2018. He is chairman of the Sustainability Committee and a member of the Audit, Nomination and Remuneration Committees.

Skills and experience

Iain has 40 years of extensive global experience in advising companies and governments on issues of complex corporate strategy. In 1983 he co-founded L.E.K. Consulting in London and built it into one of the world's largest and most respected corporate strategy consulting firms with a global footprint, active in a wide range of industries. Iain was appointed as a non-executive director of Welsh Water plc in 1989 and served on the board for nearly ten years, including five as chairman.

As chairman of the Sustainability Committee, Iain is leading Pennon's development of a sustainability programme that underpins the delivery of Pennon's strategy.

External appointments

Iain is a non-executive director of Bologna Topco Limited and also acts as an independent corporate strategy consultant.

Claire Ighodaro

Independent
Non-Executive Director



CBE, BSc Hons, FCMA, DUniv (Hon)

Claire was appointed to the Board on 1 September 2019. She is a member of the Audit and Sustainability Committees.

Skills and experience

Claire has held a number of senior roles and directorships of UK and International organisations and has extensive board experience of serving on audit and governance committees. In May 2019, she stepped down from Bank of America's Merrill Lynch International Board having served the maximum term.

Claire is a past president of CIMA and was the first woman to lead this organisation. She spent most of her executive career with BT plc and has also held non-executive directorships across a diverse portfolio including audit committee chair of Lloyd's of London, The Open University and various UK public bodies including UK Trade & Investment and the British Council.

Claire was awarded a CBE in 2008 for services to business. A board level mentor, with Savile Group, from 2009-14, she has also helped executives transitioning into non-executive roles.

External appointments

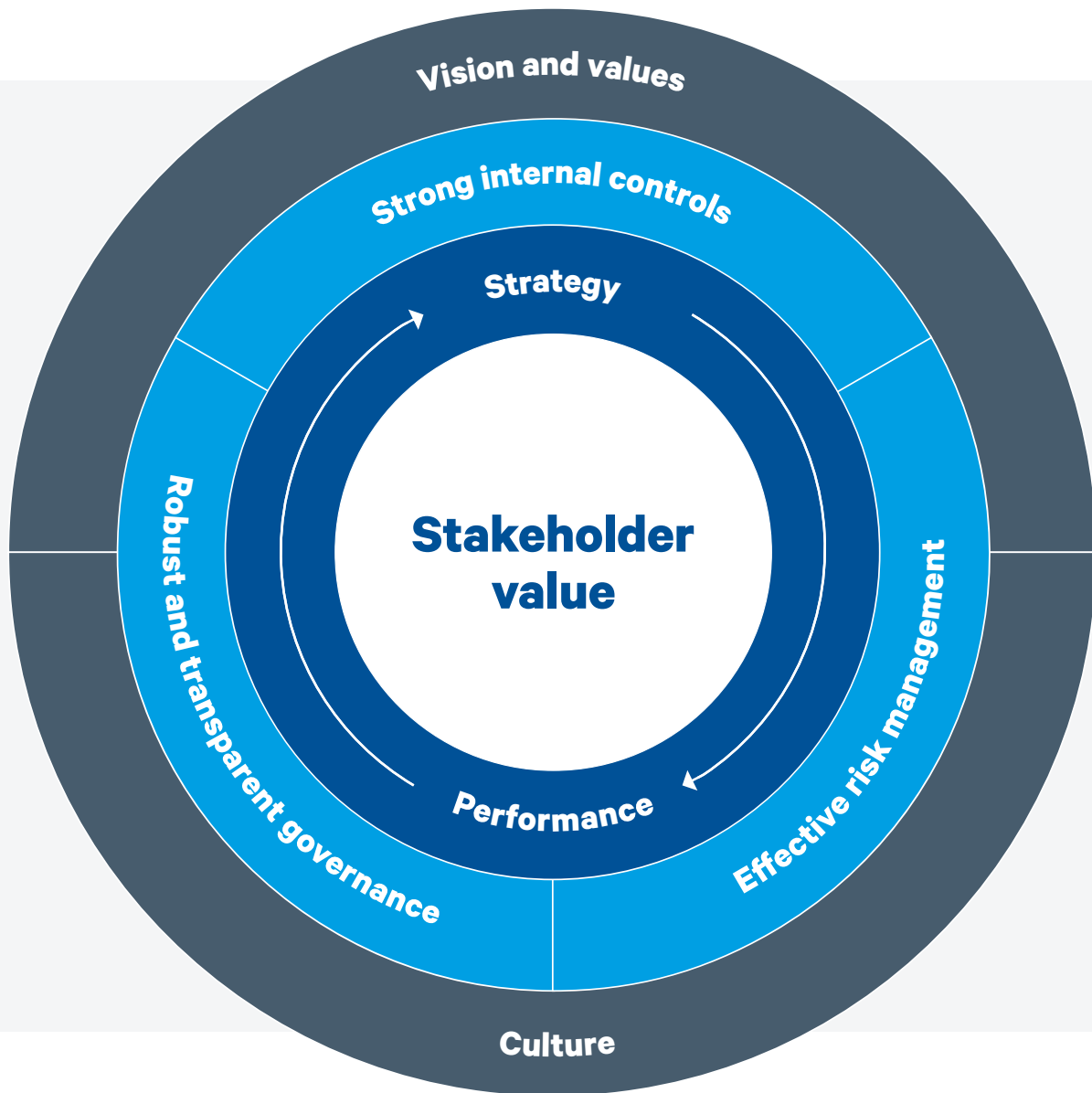
Claire is non-executive chairman of Axa XL UK entities and non-executive director of Flood Re, where she is also chair of the audit committee.

The Board and its governance framework

The Board acts as the main governing body for the purpose of oversight for the Group with additional supervision of the regulated business of South West Water being provided by South West Water's own board.

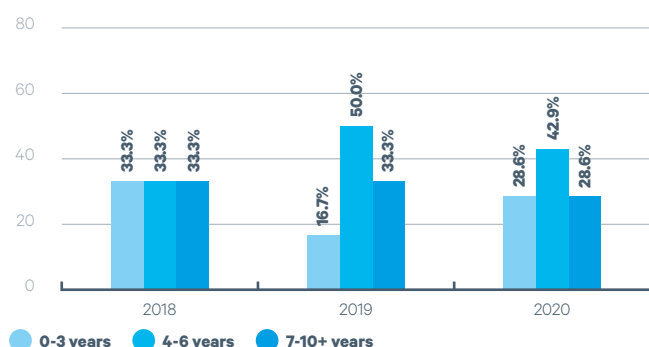
Our approach to governance is an integral part of our culture, guiding how we do business and create value for our stakeholders.

 See pages 14 and 15 for further information

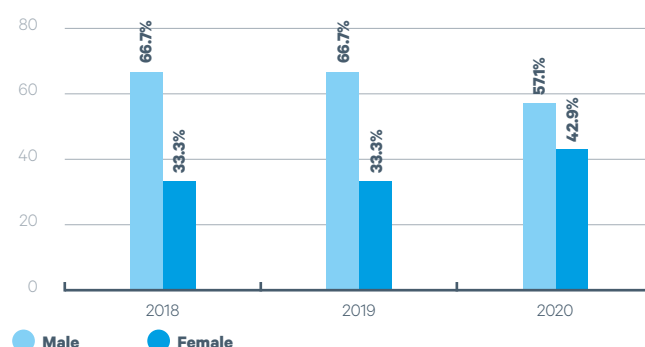


Pennon Board composition, independence and experience

Tenure as at 31 March



Gender diversity as at 31 March



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

Stakeholder value

We deliver sustainable value for our stakeholders by providing high-quality environmental infrastructure and customer services.

Strategy

Our strategy is to lead in the UK's water and waste sectors, invest for sustainable growth and drive value through efficiency.

Performance

Our financial and operational performance is driven by our strategic sustainability objectives.

Robust and transparent governance

We are committed to operating to the highest standards of corporate governance.

Effective risk management

We have a mature integrated risk management framework which is embedded into existing governance structures and ways of working.

Strong internal controls

We keep the effectiveness of our internal control environment under regular review and seek continually to improve our approach.

Vision and values

Our vision – bringing resources to life – and its supporting values of trusted, collaborative, responsible and progressive, will help drive our strategic priorities over the long term.

Culture

We are developing a culture that can be lived throughout the Group with integrity and transparency, ensuring Pennon is trusted and valued by all its stakeholders.

All of the Non-Executive Directors are considered by the Board to be independent. None of the relationships or circumstances set out in the UK Corporate Governance Code (the UK Code) applied to the Non-Executive Directors listed on the following page. Claire Ighodaro joined the Board in September 2019.

Gill Rider, having served in excess of six years in 2019, had her contract extended by the Board for a further three years, subject to annual re-election at each AGM. The Board remains satisfied that, based on her participation at meetings and her contribution outside of the boardroom, Gill continues to demonstrate independence of character and judgement in the performance of her role.

Sir John Parker met the independence criteria set out in the UK Code on his appointment as Chairman and there have been no significant additions to his overall external commitments since his appointment.

Chris Loughlin was appointed a non-executive director of Mears Group PLC and accepted the Chair of Reall during the year, with the full approval and support of the Board. The Executive Directors are encouraged to serve as non-executive directors of external companies; the Board is of the opinion that the experience gained provides additional and different business experience and a fresh insight into the role of a non-executive director.

All Directors are subject to re-election each year.

All the Non-Executive Directors are considered to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations. Their biographies on pages 76 and 77 demonstrate collectively a broad range of business, financial and other relevant experience.

The Board and its governance framework

continued

Directors' roles

Neil Cooper is chairman of the Audit Committee and in accordance with the UK Code and FCA Disclosure Guidance and Transparency Rule 7.1.1 he has recent and relevant financial and accounting experience (as set out in his biography on page 77). The Board is satisfied that the Committee as a whole has competence relevant to the sector in which the Group operates.

There is a clear separation of responsibilities between the Chairman and the Chief Executive Officer, divided between managing the Board and the business, while they of course maintain a close working relationship.

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

Position	Director	Role
Chairman	Sir John Parker	<ul style="list-style-type: none"> Leading the Board and setting its agenda Promoting the highest standards of integrity and probity and ensuring good and effective governance Managing Board composition, performance and succession planning Providing advice, support and guidance to the Chief Executive Officer Representing the Group and being available to shareholders Discussing separately with the Non-Executive Directors performance and strategic issues.
Chief Executive Officer	Chris Loughlin	<ul style="list-style-type: none"> Managing the Group and providing executive leadership Developing and proposing Group strategy Leading the operation of the Group in accordance with the decisions of the Board Coordinating with the Chairman on important and strategic issues of the Group and providing input to the Board's agenda Contributing to succession planning and implementing the organisational structure Leading on acquisitions, disposals, business development and exploiting Group synergies Managing shareholder relations.
Senior Independent Director	Gill Rider	<ul style="list-style-type: none"> Assisting the Chairman with shareholder communications and being available as an additional point of contact for shareholders Acting as a sounding board for the Chairman Being available to other Non-Executive Directors if they have any concerns that are not satisfactorily resolved by the Chairman Responsible for ensuring an annual performance evaluation of the Chairman, with the support of the other Non-Executive Directors.
Chief Financial Officer	Susan Davy	<ul style="list-style-type: none"> Supporting the Chief Executive Officer in providing executive leadership and developing Group strategy Reporting to the Board on performance and developments across the business Implementing decisions of the Board Leading the Pennon strategic review, including the proposed sale of Viridor Managing specific business responsibilities Managing investor relations including financing and treasury activities.
Non-Executive Directors	Neil Cooper Iain Evans Claire Ighodaro Gill Rider	<ul style="list-style-type: none"> Critically reviewing the strategies proposed for the Group Critically examining the operational and financial performance of the Group Evaluating proposals from management and constructively challenging management's recommendations Contributing to corporate accountability through being active members of the Committees of the Board.

Board meetings and attendance

The Directors and their attendance at the six scheduled meetings of the Board during 2018/19 are shown below:

Position	Member	Appointment date	Attendance
Chairman	Sir John Parker	April 2015	6/6
Non-Executive Directors	Gill Rider	September 2012	6/6
	Neil Cooper	September 2014	6/6
	Iain Evans	September 2018	6/6
	Claire Ighodaro	September 2019	4/4
Executive Directors	Chris Loughlin	August 2006	6/6
	Susan Davy	February 2015	6/6

Claire Ighodaro was appointed to the Board on 1 September 2019. All other members of the Board served for the full year.

The Executive teams of South West Water, Viridor and Pennon meet in advance of each meeting of the Board in order to ensure clear ownership and management of the operations of the business prior to the formal Board and Committee meetings.

In addition to the six scheduled Board meetings, a strategy day is held in September each year, and extra ad hoc Board meetings are arranged as required.

A number of unscheduled Board meetings were convened during the year, allowing the Directors to receive reports and recommendations from the sub-committee charged with overseeing the strategic review process and presentations from the Company's advisers. More information on the governance arrangements for the strategic review can be found on page 120.

Managing the Group and its subsidiaries

The Board's responsibilities include overall leadership of the Group, setting the Group's values, policies and standards, approving Pennon's strategy and objectives and providing oversight of the Group's operations and its performance. The Board makes decisions in relation to the Group's business in accordance with its schedule of matters reserved.

The South West Water board continues to operate as a separate independent board in accordance with its own schedule of matters reserved thus ensuring compliance with Ofwat's principles on board leadership, transparency and governance. In addition, the independent non-executive directors of South West Water are also invited to attend Pennon Board and Committee meetings in order to gain a greater overview of the wider business.

While certain matters may be delegated to the Board Committees and to the Executive Directors, as appropriate, the matters reserved to the Board include:

- All acquisitions and disposals
- Major items of capital expenditure
- Authority levels for other expenditure
- Risk management process and monitoring of risks
- Approval of the strategic plan and annual operating budgets
- Group policies, procedures and delegations
- Appointments to the Board and its Committees.

The Board also endorses certain decisions taken by the South West Water board, including major capital projects and investments, long-term objectives and commercial strategy, the five-year regulatory plan, annual budgets, and certain decisions relating to financing. This approach remains compatible with Ofwat's 2019 Board leadership, transparency and governance principles.

Operation of the Board

The Board operates by receiving written reports circulated in advance of the meetings from the Executive Directors and the Group General Counsel and Company Secretary on matters within their respective business areas. The Board also receives presentations on key areas of the business and undertakes site visits to meet employees and gain a better understanding of the operation of business initiatives.

Under the guidance of the Chairman, all matters placed before the Board are discussed openly. Presentations and advice are received frequently from senior executives within the Group and from external advisers to facilitate the decision-making of the Board. In the year under review, the Board has considered a wide range of matters in order to meet its obligations and estimates that 30% of its time has been taken up in discussions around strategy, 30% in operations of the Group, including that of both main operating subsidiaries, 25% on financial aspects of the Group and 15% on legal and risk matters.

The Board and its governance framework

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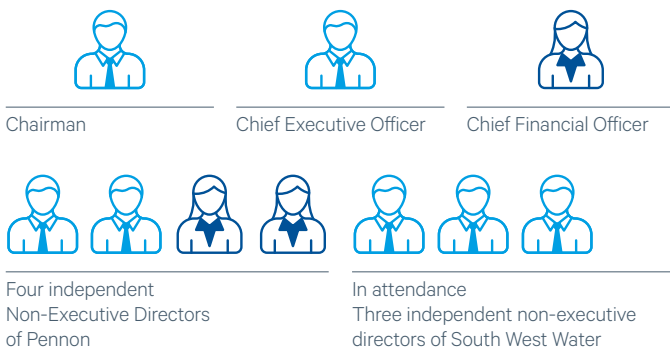
Pennon Executive management

The role of the Pennon Executive is to define and drive the business priorities that will achieve delivery of the strategy. It is responsible for ensuring, to the extent of the authority delegated by the Board, the proper and prudent management of Group resources to create and maximise shareholder value while protecting the interests of the wider stakeholder group. Chaired by the Chief Executive Officer, the Pennon Executive meets regularly to receive reports from the management committees and to review and refine recommendations to be presented to the Board.

Members of the Pennon Executive

Chris Loughlin	Chief Executive Officer and Managing Director of South West Water
Susan Davy	Chief Financial Officer
Phil Piddington	Managing Director, Viridor*
Simon Pugsley	Group General Counsel and Company Secretary
Adele Barker	Group Director of Human Resources
Steve Holmes	Health, Safety, Security and Assurance Director
Ed Mitchell	Group Director of Environment & Sustainability, and Director of Wastewater Services, South West Water
Sarah Moody	Director of Corporate Affairs & Investor Relations
Paul Ringham	Commercial Director, Viridor*

Pennon Board composition



Board support and training

Directors have access to the advice and services of the Company Secretary, and the Board has an established procedure whereby Directors, in order to fulfil their duties, may seek independent professional advice at the Company's expense. The Company Secretary is responsible for ensuring that the Board operates in accordance with the governance framework and that information flows effectively between the Directors, the Board and the Committees.

Newly appointed Directors receive a formal, tailored induction, which includes, inter alia, an explanation of the Group structure, regulatory and legal issues, the Group governance framework and policies, the Group's approach to risk management and its principal risks (financial and non-financial, including environmental, social and governance (ESG) risks), duties and obligations (including protocols around conflicts of interest and dealing in shares), and the current activities of the Board and its Committees. Newly appointed Directors are also invited to visit different operating facilities across the Group and to meet with employees in order to better understand key processes and systems. Claire Ighodaro received such a tailored induction programme, following her appointment in September 2019, details of which can be found on page 83.

The training needs of Directors are reviewed as part of the Board's performance evaluation process each year. Training may include attendance at external courses organised by professional advisers and also internal presentations from senior management.

Board Committees' terms of reference

In accordance with Group policies, a range of key matters are delegated to the Board's Committees as set out on pages 84 to 115 of this governance report.

The terms of reference of each of the Board's Committees are set out on the Company's website www.pennon-group.co.uk/about-us/board-committees and are also available from the Group Company Secretary upon request. The terms of reference, as well as the Board's schedule of matters reserved, were reviewed during the year to ensure that they remained appropriate and relevant.

Dealing with Directors' conflicts of interest

In accordance with the directors' interest provision of the Companies Act 2006 and the Company's Articles of Association, the Board has in place a procedure for the consideration and authorisation of Directors' conflicts or possible conflicts with the Company's interests. The Board considers that this has operated effectively during the year.

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

Related parties

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

Risk management and the Group's system of internal control

The Board is responsible for maintaining the Group's system of internal control to safeguard shareholders' investment and the Group's assets and for reviewing its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group that has been in place throughout 2019/20 and up to the date of the approval of this Annual Report & Accounts.

The Group's system of internal control is consistent with the FRC's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' (FRC Internal Control Guidance).

The Board confirms that it applies procedures in accordance with the UK Code and the FRC's Internal Control Guidance, which brings together elements of best practice for risk management and internal control by companies. The Board's risk framework described on pages 58 to 60 of the strategic report provides for the identification of key risks, including ESG risks, in relation to the achievement of the business objectives of the Group, monitoring of such risks and ongoing and annual evaluation of the overall process. ESG risks identified and assessed by the Board cover areas such as health & safety, climate change, changes to government policy on waste and recycling, and tax compliance. Details of the key risks affecting the Group are set out in the strategic report on pages 61 to 67.

Key performance indicators are in place to enable the Board to measure the Company's ESG performance (pages 21, 36, 37 and 42 to 47) and a number of these are linked to remuneration incentives (page 108).

As part of the review of the effectiveness of the system of risk management and internal control under the Group risk management policy, all Executive Directors and senior managers are required to certify on an annual basis that they have effective controls in place to manage risks and to operate in compliance with legislation and Group procedures.

* Until completion of the proposed sale of Viridor.

The Group's processes and policies serve to ensure that a culture of effective control and risk management is embedded throughout the Group and that the Group is in a position to react appropriately to new risks as they arise.

Code of Conduct and policies

The Group's Code of Conduct and related policies set out Pennon's commitment to promoting and maintaining the highest ethical standards. Areas covered in the Code of Conduct and policies include our impact on the environment and our communities, our workplace and our business conduct.

The Group's policy on anti-bribery and anti-corruption strictly prohibits employees from offering or accepting bribes, facilitation payments and kickbacks. The policy requires proper due diligence checks of third parties doing business with the Group, including a corruption risk assessment by the relevant unit, to examine the nature of the proposed work or transaction. The policy sets the framework for our clear requirement that everyone who works with or for us must act honestly and with integrity at all times. It has been rolled out comprehensively into all parts of the Group, with ongoing face-to-face and online training provided into business units by the dedicated Group legal compliance team. Enforcement of the policy is achieved through planned and ad hoc checks, the training mentioned, and detailed investigations into allegations or whistleblows received from employees, customers and suppliers around potential wrongdoing.

Specific risk assessments undertaken by the Group internal audit function identify more vulnerable areas of the Group. In order to try and mitigate risk wherever possible, targeted authorisation and oversight processes apply to the areas identified as being more vulnerable and additional training is provided.

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

The policy also sets out the employment consequences for breach of the policy and potential legal sanctions under bribery laws. Any breaches or failure to adhere to the Group's strict standards of integrity and honesty will be subject to disciplinary action, up to and including dismissal from the Company. All employees are required to read, understand and comply with the policy and report any circumstances or any suspicions of fraud, bribery, corruption or other irregularities, either to a line manager or by using the Group's confidential whistleblowing (Speak Up) service.

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

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

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

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

Our Code of Conduct and our policies are available on our website at www.pennon-group.co.uk/about-us/policies.



Claire Ighodaro's induction

Claire Ighodaro CBE joined the Board in September 2019. Claire has a wealth of experience across industry and business in the UK, and was previously the financial director of BT Broadband. She is a past president of the Chartered Institute of Management Accountants, and presently holds positions, in addition to that held at Pennon, including as a non-executive director of Flood Re where she is chair of its Audit Committee, and XL Catlin Insurance Company UK Limited where she is board chair.

Claire received a tailored induction programme, relevant to her skills and experience, comprising a mix of written papers and verbal updates on the strategic matters and challenges relevant to the Group and its operations. The programme was devised in order to provide her with necessary detail relevant to her position as a Non-Executive Director of the Pennon Board and a full understanding of the Group and its activities. As part of the programme, Claire was provided with copies of past Board and Committee papers, and met with relevant members of the Pennon Executive to receive a detailed update on their individual roles and to allow full discussion of strategic matters and the Group's operations. One of the first Board meetings Claire attended was the annual strategy review, at which the Board and key Executives reviewed the year's performance and debated where the strategy should be directed going forward.

As an important part of the induction, Claire visited South West Water's Countess Wear wastewater treatment works in Exeter, and the Viridor energy recovery facility at Ardley, in Oxfordshire, where she met operational employees and was shown at first hand the operations of those plants. Claire also met both with our auditor, Ernst & Young LLP, to gain an understanding of the auditing and financial oversight of the Group, and with our external legal advisers, Allen & Overy to discuss directors' duties and legal matters relevant to the Group. The induction programme gave Claire proper insight into the Group needed to allow her to fulfil her role as a Non-Executive Director of the Company.

Board Committees' reports

Audit Committee report



The Audit Committee's work is focused on the quality and integrity of financial reporting and the adequacy of internal control and risk management systems and processes.



Neil Cooper
Audit Committee Chairman

Audit Committee composition and meetings

Position	Director	Date of appointment to Audit Committee	Attendance
Committee chairman	Neil Cooper	September 2014	5/5
Committee members	Gill Rider	September 2012	5/5
	Iain Evans	September 2018	5/5
	Claire Ighodaro ⁽¹⁾	September 2019	4/4

(1) Appointed to the Committee on 1 September 2019.

Dear Shareholder

I am pleased to introduce the Audit Committee's report for the financial year ended 31 March 2020. The report provides details of the work carried out by the Committee and highlights our focus areas over the past year. The Committee supports the Board in fulfilling its responsibilities in respect of monitoring the quality and integrity of financial reporting, the adequacy of risk management and internal controls processes, and governance and compliance matters.

The principal responsibilities of the Committee continue to be focused on three key areas:

- Ensuring the adequacy of the Group's financial reporting; an activity that includes the assessment of the application of accounting policies given underlying standards, testing of accounting judgements made in preparing financial reporting and the assessment of whether the presentation of the Group's activities is fair, balanced and understandable
- Reviewing and challenging the ongoing effectiveness of the internal control environment
- The scope and adequacy of risk management processes across the Group. This includes monitoring the Group's risk appetite as well as acting as a forum for carrying out more detailed reviews of higher risk areas of the operation.

These responsibilities are discharged throughout the year in accordance with a schedule of business reflecting the annual reporting cycle of the Group, which is designed to allow sufficient time for their consideration while also permitting time to be spent on related key financial matters. Monitoring and reviewing the effectiveness of the external auditor and the internal audit function is a further important ongoing element of the Committee's assurance activities.

The Group's executive risk management forum continues to assess risk appetite and monitor key risks and their mitigation, with the Committee subsequently receiving detailed 'deep dive' presentations from senior management on areas impacting our principal risks. During the year, these covered a wide range of topics including dam safety at South West Water, Group health & safety, Group cyber risk management, energy management, resilience and business continuity, ODI preparedness, Brexit readiness across the Group and the Group's approach to the General Data Protection Regulation (GDPR). More detail on our risk management processes, principal risks and their associated mitigation can be found on pages 58 to 67.

Together with this risk orientated activity, we continue to review the output of the Group's viability assessment over varying periods; both short term in assessing the Group's going concern status and over a period of five years as it relates to the Group's continuing viability. Significantly this year, the viability assessment has considered a range of financial projections given a more complex environment including a UK general election, the Brexit transition period, the proposed sale of Viridor and most recently the ongoing COVID-19 pandemic. While the Group maintains a five-year viability assessment period, South West Water has continued to use a longer assessment period to 2030, noting a greater visibility of future cash flows, being a regulated business. Our viability statement is reported on page 68.

As part of the half-year and year-end reporting review process, we reviewed and challenged the key financial reporting judgements of management as set out on page 86. Significant matters considered by the Committee both during the year and in relation to the year-end financial statements are laid out in this report.

Looking ahead to 2020/21, as the full impact of COVID-19 emerges, the Committee will continue to monitor developments and adapt its approach – where necessary – to best support the Group's stakeholders.

Neil Cooper
Audit Committee Chairman

Audit Committee composition

Claire Ighodaro was appointed to the Committee on 1 September 2019, following her appointment to the Board. All other members of the Committee served for the full year.

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

In addition, the Board Chairman has an open invitation to attend the Committee meetings. In the last year his attendance included those meetings at which the Committee reviewed the half-year and full-year financial results of the Group.

In accordance with the UK Code, the Board is satisfied that Neil Cooper, Iain Evans and Claire Ighodaro have recent and relevant financial experience and

also, in accordance with FCA Rule 7.11R of the FCA's Disclosure Guidance and Transparency Rules, have competence in accounting or auditing. Details of each Director's significant current and prior appointments are set out on pages 76 and 77.

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

Significant matters considered by the Committee

The calendar of business of the Committee sets in place a framework for ensuring that it manages its affairs efficiently and effectively throughout the year and is able to concentrate on the key matters that affect the Group.

The most significant matters that the Committee considered and made decisions on during the year and, where appropriate, since the year end, are set out below and opposite.

Financial reporting	<ul style="list-style-type: none"> • Monitored the integrity of the financial statements of the Group and the half-year and full-year results announcements relating to the Group's financial performance, including reviewing and discussing significant financial reporting judgements contained in the statements • Reviewing the internal assessment of going concern and longer-term viability on behalf of the Board • After a detailed review in accordance with its established process, advised the Board that the presentation of the Annual Report & Accounts is fair, balanced and understandable in accordance with reporting requirements and recommended their approval for publication • Internal control and compliance • Review of internal audit reports on core systems and processes across the Group.
External auditor	<ul style="list-style-type: none"> • Considered the auditor's report on its audit of the annual results focusing on key findings • Assessed external auditor effectiveness in respect of the previous year's external audit process • Recommended to the Board reappointment of the external auditor for approval at the Annual General Meeting with the Committee being authorised to agree the external auditor's remuneration • Considered and approved the audit plan and audit fee proposal for the external auditor • Considered the auditor's report on control themes and observations for the year ended 31 March 2019, which did not identify any significant deficiencies • Recommended to the Board the reappointment of Ernst & Young LLP (EY) as senior statutory auditor following a thorough review and benchmarking of their operation following the conclusion of the 2018/19 audit, • Noted the appointment of a new EY audit partner, Christabel Cowling, following the scheduled rotation of her predecessor • Considered the likely financial year in which the Group will next tender for its external audit provider.
Risk management	<ul style="list-style-type: none"> • Reviewed the Group's risk management framework and compliance with that framework during the year and after the year end up until the publication of the Company's annual report • Reviewed the assessment of the risks by the Executive Directors and considered risk appetite • Reviewed the Group risk register and considered appropriate areas of focus and prioritisation for the audit work programme for the year which is now aligned to the Group's financial year • Management of information security across the Group in mitigating key IT risks • Received as part of the risk management review the annual report on any whistleblowing • Carried out regular deep dives at Committee meetings on principal risk areas.
Governance	<ul style="list-style-type: none"> • Reviewed new annual report disclosure requirements, including the audit report • Considered and approved Group accounting policies, including the impact of new accounting standards, used in the preparation of the financial statements • Confirmed compliance with the UK Code • Regularly held meetings with the external auditor and the Group director of Risk and Assurance without members of management being present.

In connection with the proposed sale of Viridor, the Group issued a Circular to shareholders in May 2020. In support of the Circular's preparation, through the Board, Committee members scrutinised management's near-term working capital projections and the accountants report thereon, prepared by EY. These projections were based on a sale of Viridor and included a reasonable worst-case scenario that considered the cumulative impact of the Group's principal risks, Ofwat mandated viability sensitivities and a downside assessment of the potential impact of the current COVID-19 pandemic. This working capital assessment indicated that the continuing Group has adequate headroom for the period assessed.

In addition to the matters above the Committee also reviewed and considered communications with the Financial Reporting Council (FRC), following their review of the Group's 2019 Annual Report & Accounts. The FRC requested further information with regard to a number of the Group's disclosures and where

appropriate we have sought to include enhanced disclosure in this Annual Report & Accounts following the constructive discussions. We are pleased to report the FRC has satisfactorily concluded their review noting their review scope has limitations and is performed on a non-reliance basis. In respect of the monitoring of the integrity of the financial statements, which is a key responsibility of the Committee identified in the UK Code, the significant areas of judgement considered in relation to the financial statements for the year ended 31 March 2020 are set out in the following table, together with details of how each matter was addressed by the Committee. At the Committee's meetings throughout the year the Committee and the external auditor have discussed the significant matters arising in respect of financial reporting during the year, together with the areas of particular audit focus, as reported on in the independent auditor's report on pages 124 to 131. In addition to the significant matters set out in the table below, the Committee considered a range of other matters.

Audit Committee report

continued

These included:

- Implementation and measurement considerations for IFRS 16 'Leases' which was adopted on 1 April 2019
- Presentational matters including contingent liabilities and assets and the non-underlying disclosures; and
- Ensuring a fair presentation of statutory and non-statutory performance and financial measures.

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

Area of focus	How the matter was addressed by the Committee
Revenue recognition	Given the nature of the Group's revenue, the areas of judgement for South West Water continue to be in respect of revenue recognition relating to income from measured water services and estimates of timing of receipt of unmeasured revenue, accounting for revenue. For Viridor, the focus was from long-term service concession arrangements under IFRIC 12, in particular for Glasgow Recycling and Renewable Energy Centre (GRREC). The Committee relied on South West Water's refined assessment of water into supply and its track record of assessing an appropriate level of accrual at previous year ends as compared to invoiced revenue and Viridor's internal processes for analysing complex long-term contracts. The Committee also closely considered the work in respect of these areas at year end by the external auditor as well as reviewing disclosures around revenue recognition accounting policies.
Non-current asset impairment review and environmental provisions	Recognising that the value of certain non-current assets and long-term environmental provisions within Viridor can be sensitive to changes in assumptions over future discount rates and cash flow projections which require judgement, the Committee pays careful attention to asset impairment and environmental provisioning. The Committee noted the substantial headroom in the mandatory review of goodwill for impairment and management's review of evidence of indicators for potential impairment of non-current assets concluded that these areas were less sensitive to changes in these assumptions. The recent £4.2 billion sale value agreed in March 2020 for Viridor validates this substantial goodwill headroom. Following a detailed review of the analysis undertaken, and consideration of the most recent management assumptions in relation to the value of environmental provisions including latest assessments of the discount and inflation rates, the Committee was satisfied that a robust and consistent approach had been followed and that management's assertion that the carrying value of these liabilities remained reasonable, and therefore the Committee was able to approve the disclosures in the financial statements. This key area was also closely reviewed as part of the year-end audit by the external auditor.
Bad and doubtful debts	Regular updates on progress against debt collection targets and other contractual payments due are received by the Board. Performance is monitored regularly across the Group against historical collection records and the track records of other companies in the relevant sectors. The Committee was particularly mindful of the impact of COVID-19 pandemic on the assessment of expected credit losses in determining the bad debt provision, noting the likely impacts of the pandemic on the water businesses and Viridor. At the year end the external auditor reported on the work it had performed, which, together with the detailed analysis reported, enabled the Committee to conclude that management's assessment of the year-end position and its provisions for expected credit losses was reasonable.
Glasgow Recycling and Renewable Energy Centre (GRREC) – outstanding contractual claims against Interserve	In November 2016 the lead construction contract for GRREC was terminated due to delays and underperformance. Additional costs required to complete the project have been incurred and form part of a claim being brought against the principal contractor, Interserve Construction Limited. The Committee has reviewed developments relating to the amount due regarding both the ongoing legal proceedings to recover the asset and financial analysis from management regarding Interserve's financial condition impacting likely recoverability. The Committee noted management's update on the progression of the legal proceedings during the year. The report contained legal analysis of developments and progress made towards recovery and an updated assessment of Interserve's credit worthiness having regard to publicly available information, including latest filings at Companies House and benchmarked movement in credit against similar companies. The Committee is satisfied that the asset recognition criteria for this amount continues to be met, the quantum of a credit loss provision made is appropriate in the circumstances and that appropriate disclosures have been made.
Going concern basis for the preparation of the financial statements and viability statement	A report from the Chief Financial Officer on the financial performance of the Group, including forward-looking estimates of covenant compliance and funding levels under different scenarios, is provided to the Board on a periodic basis. Rolling five-year strategy projections and the resultant headroom relative to borrowings are also regularly reviewed by the Board, including scenarios to enable the Committee to better understand the potential range of outcomes. At the end of each six-month period the Chief Financial Officer prepares for consideration by the Committee a report focusing on the Group's liquidity over the 12-month period from the date of signing of either the annual report or half-year results. The report for 2019/20 included a downside scenario for the unfolding COVID-19 pandemic, as well as considering scenarios for the Group if Viridor is or is not sold within the going concern assessment period. The Committee also reviewed a report from the Chief Financial Officer on the Group's financial viability over an appropriate period, which the Board considers to be five years, in connection with the UK Corporate Governance Code requirement for a viability statement to be given by the Board. Similarly, this report also considered the viability of the Group considering a downside COVID-19 scenario alongside the manifestation of other adverse events modelled from the Group's principal risks and Ofwat's mandated sensitivities for water companies. South West Water uses a longer assessment period to 2030, noting a greater visibility of future cash flows, being a regulated business. Consideration of these reports and constructive challenge on the findings of the reports, including the scenario testing carried out by management, has enabled the Committee to form its assessment and satisfy itself that it remains appropriate for the Group to continue to adopt the going concern basis of accounting in the preparation of the financial statements and in addition advise the Board on providing the viability statement set out on page 68.
Disclosure of the sale of Viridor	The Committee considered the appropriateness of the disclosure for Viridor's financial performance and assets and liabilities following the announcement of its sale on 18 March 2020. We considered management's assessment of the likelihood of the sale completing in the next 12 months in relation to the specific conditions precedent contained in the Share Purchase Agreement, and agreed it was appropriate to disclose Viridor as a discontinued operation (requiring the prior year income statement to be restated) and as an asset held for sale on the balance sheet as at March 2020.

Effectiveness of the external audit process

Receiving high-quality and effective audit services is of paramount importance to the Committee. We continue to monitor carefully the effectiveness of our external auditor as well as its independence, bearing in mind that it is recognised there is a need to use our external auditor's firm for certain non-audit services. We have full regard to the FRC's Ethical Standard and ensure that our procedures and safeguards meet these standards.

The current external auditor, Ernst & Young LLP (EY), was appointed following a comprehensive audit tender process and approval by shareholders at the Company's 2014 AGM. Their reappointment was approved at the 2019 Annual General Meeting. Christabel Cowling is the audit partner, replacing Debbie O'Hanlon, and is in her first year.

The external auditor produced a detailed audit planning report in preparation for the year-end financial statements, which has assisted the auditor in delivering the timely audit of the Group's annual report & financial statements and which was shared with, and discussed by, the Committee in advance.

The effectiveness review of the external auditor is undertaken as part of the Committee's annual performance evaluation. Further details of the performance evaluation are provided on pages 90 and 91. No issues were raised during that review and the Committee concluded that the auditor was effective during the year.

The Committee considered that it is appropriate that the external auditor be reappointed and has made this recommendation to the Board. The Committee chairman has also met privately with the external auditor to discuss key matters.

Auditor independence

The Committee carefully reviews on an ongoing basis the relationship with the external auditor to ensure that the auditor's independence and objectivity is fully safeguarded.

The external auditor reported on their independence during the year and again since the year end, confirming to the Committee that they have complied with the FRC's Ethical Standard and, based on their assessment, that they were independent of the Group.

Provision of non-audit services

In line with the requirements of the EU Audit Directive and Regulation which came into force on 17 June 2016, the Committee continues to have a robust policy for the engagement of the external auditor's firm for non-audit work. The Committee receives a regular report covering the auditor's fees including details of non-audit fees incurred.

Recurrent fees typically relate to agreed procedures in relation to annual regulatory reporting obligations to Ofwat; work which is most efficiently and effectively performed by the statutory auditor. The policy is for non-audit fees not to exceed 70% of the audit fee for statutory work and for the Committee chairman to approve all non-audit work performed by the statutory auditor. The Committee carefully reviews non-audit work proposed for the statutory auditor, taking into consideration whether it was necessary for the auditor's firm to carry out such work and would only grant approval for the firm's appointment if it was satisfied that the auditor's independence and objectivity would be fully safeguarded. If there were another accounting firm that could provide the required cost-effective level of experience and expertise in respect of the non-audit services, then such firm would be chosen in preference to the external auditor.

The level of non-audit fees payable to the external auditor for the past year is 15% of the audit fee, which is well within the Group's 70% non-audit fee limit.

The Chief Financial Officer regularly reports to the Committee on the extent of services provided to the Company by the external auditor and the level of fees paid. The fees paid to the external auditor's firm for non-audit services and for audit services are set out in note 7 to the financial statements on page 153.

Internal audit

The internal audit activities of the Group are a key part of the internal control and risk management framework of the Group. At Group level there is a long-standing and effective centralised internal audit service which makes a significant contribution to the ability of the Committee to deliver its responsibilities.

Following last year, in which the Group established a new directorate of Risk and Assurance encompassing Group risk reporting and internal audit, the Group's internal audit function has bedded down well. The 2019/20 Group internal audit plan was approved in March 2019. It takes account of the principal risks, the activities to be undertaken by the external auditor, and the Group's annual and ongoing risk management reviews. This approach seeks to ensure that there is a programme of internal and external audit reviews focused on identified key risk areas throughout the Group.

The director of Risk and Assurance reported regularly through the year to the Committee on audit reviews undertaken and their findings, and there were regular discussions, correspondence and private meetings between the director of Risk and Assurance and the Committee chairman.

An external assessment of the internal audit function was last performed by KPMG LLP in 2016 and concluded that the Company's internal audit function conforms to IIA standards issued by the Institute of Internal Auditors but identified some areas for improvement including the alignment of the internal audit annual programme with the financial year and refreshed reporting content. These have been actioned.

Fair, balanced and understandable assessment

To enable the Committee to advise the Board in making its statement that it considered that the Company's Annual Report & Accounts is fair, balanced and understandable (FBU) on page 120, the Committee applied a detailed FBU review framework that takes account of the Group's well-documented verification process undertaken in conjunction with the preparation of the Annual Report & Accounts. This is in addition to the formal process carried out by the external auditor to enable the preparation of the independent auditor's report, which is set out on pages 124 to 131.

In preparing and finalising the 2020 Annual Report & Accounts, the Committee considered a report on the actions taken by management in accordance with the FBU process and an FBU assessment undertaken by the Pennon Executive. This assisted the Committee in carrying out its own assessment and being able to advise the Board that it considered that the Annual Report & Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

Statement of compliance with CMA order

Having undertaken a competitive audit tender process in 2014, the Company is in compliance with the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Following the rotation of the senior statutory auditor, the Committee considers a full tender for the Group's external audit services, subject to its annual reviews, likely no later than the year ending March 2024. This allows for any potential new audit firm to take up the role no later than for the year ending March 2025. The Committee believes this approach is in the best interest of shareholders, as over this period the Group will benefit from an efficient and effective audit, while receiving fresh challenge from a new senior statutory auditor.

Sustainability Committee report



In a busy and important year for Pennon, we have refined and approved a full set of three-year targets and associated KPIs to monitor progress against our agreed strategic sustainability objectives, within the ESG framework.



Iain Evans
Sustainability Committee Chairman

Sustainability Committee composition and meetings

Position	Director	Date of appointment to Sustainability Committee	Attendance
Committee chairman	Iain Evans	September 2018	4/4
Committee members	Gill Rider	September 2012	4/4
	Susan Davy	March 2018	4/4
	Chris Loughlin	November 2006	4/4
	Claire Ighodaro ⁽¹⁾	September 2019	3/3

(1) Appointed on 1 September 2019.

Dear Shareholder

I am pleased to report on the Sustainability Committee's activities during the year and am pleased to welcome Claire Ighodaro who brings considerable experience to the Committee.

Designed to add value and resilience to our business, our sustainability strategy was refreshed in 2018/19 and is integrated with Pennon's business, people and health & safety strategies. It clearly sets out our long-term objectives, three-year targets and our associated KPIs and implementation plans required to ensure continuously improving sustainability performance and responsible business practice throughout the organisation.

The role of the Sustainability Committee is to ensure robust scrutiny of key aspects of environmental, social and governance (ESG) performance and to oversee Pennon's performance against its strategic sustainability objectives. In what has been a busy and important year, we have refined and approved a full set of three-year targets and associated KPIs to monitor progress against our agreed strategic objectives, within the ESG framework.

In the development of our new strategy we have tested thoroughly the materiality of our areas of focus and consulted a cross-section of our key stakeholders. We have also set Group-wide three-year sustainability targets in support of the new strategy which we will use to monitor progress towards our strategic objectives. We will report on our performance against these targets regularly.

We have also assessed and aligned our objectives and targets against the most relevant of the United Nations Sustainable Development Goals (SDGs) and will increasingly monitor our performance using the SDGs.

A strong performance against these SDGs and our own sustainability objectives, ensures high standards of corporate responsibility for the benefit of all our stakeholders – our customers and communities, our people, suppliers and regulators, and our investors.

This annual report provides an integrated assessment to show how a responsible approach to sustainability helps us to balance the immediate and longer-term needs of society with the delivery of sustained commercial success.

Iain Evans
Sustainability Committee Chairman

Claire Ighodaro was appointed to the Committee on 1 September 2019. All other members of the Committee served throughout the year.

The Sustainability Committee assesses performance against a range of approved targets for the Group's subsidiaries, set as part of their business planning processes. Progress is reported to the Committee throughout the year.

In addition, the South West Water sustainability committee provides assessment and oversight of South West Water's performance against sustainability targets that are core to the successful delivery of its K6 business plan 2015-20. This is consistent with Ofwat's requirement for independent governance of the regulated business.

The Committee ensures challenging targets are set and approved. As at 31 March 2020, Pennon remains on track to achieve all of its 12 three-year targets, with most KPIs having been achieved in the year, apart from our environmental compliance KPI due to a single Category 2 incident, and our natural and social capitals baseline assessment which, largely due to its complexity, is slightly behind schedule. It is also noted that although we remain on track to meet our health, safety and wellbeing targets and LTIFR KPIs, the fatal accidents that sadly occurred during 2019/20 are acknowledged and investigations continue. Full details of the sustainability performance for South West Water and Viridor in 2019/20 are given in their respective reports.

During the year the Committee continued to note Pennon's engagement with Business in the Community (BiTC), The Prince's Responsible Business Network and a leading business-led charity. Pennon is an active participant in BiTC's South West Regional Board and Viridor is a founder member of its Circular Economy Task Force.

The Sustainability Committee continues to aim to ensure a transparent approach to conducting business in a responsible manner, within a business focused on delivering robust financial performance and sustainable value for shareholders and stakeholders.

The Committee reviews and approves appropriate strategies, policies, management processes, initiatives, disclosures, targets and performance of the Pennon Group companies in the areas of occupational health, safety, wellbeing and security, environment and compliance, workplace policies, responsible and ethical business practice, supply chain, customer service and engagement, community benefit, and the role and value of the Group in society.

During 2019/20, the Committee has considered a wide range of matters in the course of fulfilling its duties in accordance with its terms of reference:

- The Group's health & safety performance and the effectiveness of health & safety policies and procedures, including the continued roll-out of the HomeSafe programme
- Sustainability and environmental strategy and performance
- Sustainability reporting and disclosures for 2019 and the associated verifier's reports and recommendations
- Progress against the sustainability targets for 2019/20 and sustainability targets for 2020-23
- Performance in respect of customer service, satisfaction and engagement
- The Group's approach to community relations, community benefit and investment
- Performance against the Group's workplace policy, within its people strategy, including the results of the latest Group-wide employee engagement survey
- Climate change and carbon management strategy
- Sustainable supply chain procurement and practices, including a new suppliers' code of practice
- Natural and social capital net impact assessment and methodologies
- Priority programmes (plastics, biodiversity and sustainable finance)
- Good governance review.

Reporting and assurance

In reporting on sustainability, the Company has sought to comply with the Investment Association Guidelines on Responsible Investment Disclosure.

Pennon's sustainability performance and reporting has been assured by DNV GL, an independent management consultancy specialising in technical assurance in the utility sector. Pennon considers that DNV GL's method of assurance – which includes testing the assumptions, definitions, methods and procedures that are followed in the development of data and the auditing thereof to ensure accuracy and consistency – complements the best practice insight gained through the Group's continued membership of BiTC. Certain disclosures within this annual report that relate to the sustainability performance of South West Water and Bournemouth Water have been subject to an independent audit of regulatory data conducted by Jacobs. DNV GL has reviewed the consolidation of these into total Pennon data, but not their preparation.

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

DNV GL's independent limited assurance report is available at www.pennon-group.co.uk/sustainability.

Benchmarking

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

Pennon sustainability report

Pennon's sustainability reporting is integrated throughout the strategic report and specifically in the following sections:

- Business model, page 14
- Strategic priorities, page 16
- Sustainability at our core, page 20
- Chairman's statement, page 10
- Our stakeholders, page 26
- Chief Executive Officer's review, page 32
- Key performance indicators, pages 21 and 36 to 37
- Our people, page 38
- Our operations, pages 42 to 49

Viridor and South West Water sustainability reports

While this is a fully integrated annual report, South West Water and Viridor continue to produce their own sustainability reporting. The sustainability report for Viridor will be published in August 2020 and South West Water's company Annual Performance Report and regulatory reporting, to be published in July 2020, will incorporate its sustainability reporting. South West Water's report will be available to view from www.pennon-group.co.uk/sustainability and both documents will be published on the relevant company's website.

Nomination Committee report



We remain focused on encouraging diversity and ensuring inclusion across all parts of the Group.



Sir John Parker
Nomination Committee Chairman

Nomination Committee composition and meetings

Position	Director	Date of appointment to Nomination Committee	Attendance
Committee chairman	Sir John Parker	April 2015	3/3
Committee members	Gill Rider	September 2012	3/3
	Neil Cooper	September 2014	3/3
	Iain Evans	September 2018	3/3

The Nomination Committee met three times during the year to fulfil the duties set out in its terms of reference. All of the members served on the Committee throughout the year.

Only the members of the Committee are entitled to attend the meetings of the Committee. Other regular invitees to Committee meetings during the year included the Chief Executive Officer, the Group Director of Human Resources and the General Counsel and Company Secretary.

Matters considered by the Committee during the year included:

- The annual review of the Group policy on diversity, respect and inclusion and the Group's progress on diversity
- A review of succession planning for Non-Executive Directors and a horizon scanning exercise for potential Non-Executive Directors to complement the current boards of both Pennon and South West Water Limited
- A review of the time spent by Non-Executive Directors in fulfilling their duties
- Finalising the appointment of Claire Ighodaro to the Board effective from 1 September 2019 and, after reviewing the current composition of committees to ensure a balance, recommending Claire be appointed to the Sustainability and Audit Committees
- A review of the Group's succession plans, leadership of the Group and the Group's approach to succession planning and in light of the ongoing strategic review
- A review of the Group's gender pay disclosure for 2019 and the ongoing action plan
- Discussions around the Group's ethnic diversity ambition and ensuring Pennon made the appropriate contribution to the Parker Review
- Oversight of the Board effectiveness review
- A review of the Committee's terms of reference.

It is the practice of the Committee, led by the Chairman, to appoint an external search consultancy to assist in Board appointments to ensure that an extensive and robust search can be made for suitable candidates. Claire Ighodaro was appointed during the year and, as reported in the 2019 annual report, the Committee were assisted in the appointment by the Inzito Partnership. Inzito had no other connection with the Company.

Board effectiveness review

The Board undertakes a formal and rigorous review of its performance and that of its Committees and Directors each year. This year, the Committee engaged independent board performance consultancy Condign Limited (Condign) to facilitate the review. Condign has no other connection with the Group. The exercise was conducted in March 2020 by way of:

- A review of the papers submitted to the Board and Committees over the course of the year
- Attendance at the Board meeting in March 2020 to observe the proceedings and debate
- A series of structured interviews with each member of the Board
- A review of the results of the 2019 performance evaluation and an assessment of whether the issues identified in that report had been addressed.

The Senior Independent Director separately carried out a review of the individual Directors' performance and led the evaluation of the Chairman's performance.

Condign collated and analysed the output from their activities and prepared a report, which was discussed by the Board and its Committees. The report noted that the Board had risen to the challenge of maintaining oversight of the existing businesses and risks, while effectively guiding delivery of South West Water's 2020-25 business plan and directing the strategic review, and throughout had operated effectively on behalf of shareholders.

Having reviewed the report, the Committee agrees that the composition of the Board provides a good balance of skill, experience, knowledge, diversity and understanding of stakeholder interests. Further, it was noted that the Directors work well together and that each Director continues to contribute effectively to boardroom debate. The Committee concludes therefore that no modification to the composition of the Board is required as a result of the review.

The areas identified in the Board effectiveness review as requiring future focus are largely driven by the outcome of the strategic review: ensuring the continued effectiveness of the Board and the Group's governance framework; the Group's future strategy; and succession planning. In addition, the review confirmed the Board's commitment to health & safety and a desire to fully understand the leadership and cultural drivers required to drive improvements in health & safety performance. The Committee considers that while good progress has been made in the areas identified in the 2019 review, matters such as diversity and Directors' training and development deserve ongoing attention. The Committee welcomes the regular review of succession planning to ensure that this continues to support the Group's strategy.

Talent management and succession planning

Internal talent development as well as the ability to attract, retain and develop skilled, high potential individuals across the Group are areas on which the Committee continues to focus. The Committee, supported by the Group Director of Human Resources, reviews both the executive and non-executive leadership, including flight risks and mitigation plans as part of a regular agenda. Horizon scanning externally has also become a more regular activity, to ensure that the Board remains flexible to respond to changing priorities of the Group.

Board diversity policy

The Committee is required by the Board to review and monitor compliance with the Board's diversity policy and report on the targets, achievement against those targets and overall compliance in the annual report each year.

The Board's diversity policy confirms that the Board is committed to:

- The search for Board candidates being conducted, and appointments made, on merit, against objective criteria and with due regard to the benefits of gender and ethnic diversity on the Board
- 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. The Committee is mindful of the direction of travel of the 2018 UK Corporate Governance Code and the Board will endeavour to achieve and maintain:
 - A minimum of 33% female representation on the Board
 - A minimum of 33% female representation on the Group's senior management team.

The Committee is pleased to report that as at 31 March 2020, 42.9% of the Board's Directors were women, as disclosed on page 79.

Action is being taken to improve diversity across the workforce, which will assist in increasing female representation at senior management level as described on pages 38 and 39. In support of this aim, both our Chairman and our Chief Executive Officer are members of the 30% Club, a UK campaign that supports the goal of women holding 30% of board seats and promotes initiatives to expand the female talent pipeline at all levels.

During 2019, our participation in the 30% Club increased with three of our senior leaders actively mentoring future women leaders, and a further three employees being mentored. Plans are underway to increase this in 2020 together with active membership of 'Women in Water' promoting female talent across the industry by encouraging networking and the progression of women into more senior roles.

Our position in the Hampton-Alexander review improved to 24 out of the 250 companies in the FTSE 250. This is up from 85 last year primarily driven by a transitional change in the composition of our Board when the analysis was undertaken. In September 2019, Claire Ighodaro was appointed to the Board as an additional independent Non-Executive Director.

We remain committed to the targets as proposed by Hampton-Alexander of 33% representation of women on the Board and on the Executive Committee.

Pennon was among the 325 companies listed in the 2020 Bloomberg Gender-Equality Index (GEI) which tracks the financial performance of public companies committed to disclosing their efforts to support gender equality through policy development, representation and transparency.

Pennon contributed to the updated Parker Report, the survey for which is undertaken on a voluntary basis. Released in February 2020, at the time of surveying, Claire's appointment was not included. However, our Board ethnic diversity now stands at 14%, and we have met the objective of the review in having at least one ethnically diverse Non-Executive Director ahead of the 2024 timeline.

The Committee and the Board will continue to monitor and promote diversity across the Group with the aim of ensuring a diverse pipeline for succession to board and senior management positions in accordance with our Diversity, Respect and Inclusion Policy, which encourages the growth of a diverse workforce where individuals from different backgrounds can fulfil their potential.

Information regarding the gender breakdown and ethnic diversity of the workforce is provided on pages 38 and 39.



Sir John Parker
Chairman

Remuneration Committee report



We are grateful for shareholder support. Our remuneration policy is important in ensuring remuneration is aligned with and supports the Group strategy and continues to meet best practice.



Gill Rider
Remuneration Committee Chairman

Remuneration Committee composition and meetings

Position	Director	Date of appointment to Remuneration Committee	Attendance
Committee chairman	Gill Rider	September 2012	5/5
Committee members	Neil Cooper Iain Evans	September 2014 September 2018	5/5 5/5

The Committee met five times during the year to fulfil the duties set out in its terms of reference. In particular, the Committee is responsible for:

- Ensuring remuneration is aligned with and supports the Group’s strategy, reflects our values as a Group and optimises performance
- Maintaining and, in every third year, reviewing the remuneration policy and considering any changes necessary to ensure it remains appropriate and fulfils its purpose of attracting and retaining high-calibre people who are able to contribute to the success of the Group
- Advising the Board on the framework of Executive remuneration for the Group
- Determining the remuneration and terms of engagement of the Chairman, the Executive Directors and senior executives of the Group
- Reviewing workforce remuneration and related policies for the purpose of aligning incentives and reward with culture, taking these into account when setting the remuneration policy for Executive Directors and providing the Board with feedback.

The Committee’s activities during the financial year

The Committee engaged in the following activities during the year:

- Undertook a comprehensive review and external consultation exercise in advance of releasing our updated remuneration policy, with a view to seeking shareholder approval at the 2020 AGM
- Monitored external developments in remuneration
- Undertook a pensions review, with a view to ensuring alignment of Executive Directors’ pensions with those of the wider workforce, including supporting management proposals to consult with the wider workforce with proposals to modernise the pension offering. The results have ensured higher pension contributions to employees across the Group
- Agree Executive remuneration ensuring it remains appropriate and meets all regulatory requirements, including that for South West Water in meeting the Ofwat requirements
- Reviewing the wider workforce remuneration using the Pennon pay dashboard and consider overall Group performance, to help inform executive pay decisions and ensuring cultural alignment
- Completing the annual executive salary review and the annual review of the Chairman’s fee
- Reviewing drafts of the Directors’ annual remuneration report and recommending it to the Board for approval for inclusion in the 2020 annual report
- Determining performance targets in respect of the Annual Incentive Bonus Plan for 2019/20
- Determining bonuses and deferred bonus awards pursuant to the Company’s Annual Incentive Bonus Plan in respect of the year 2018/19
- Approving the long-term incentive plan (LTIP) awards for the year
- Reviewing the Group’s gender pay gap report
- Approving the release of the 2016 deferred bonus share awards and the outcome of the 2016 LTIP awards
- Reviewing the Committee’s terms of reference and undertaking a review of the Committee’s performance in the year.

The Committee's focus for 2020/21

- Ensure that targets are stretching but also fair and achievable, so that they act to retain, motivate and incentivise the Pennon Executive to deliver the Group's strategic goals, recognise the new Group structure, delivering the PR19 regulatory commitments and creating long-term value for shareholders
- Monitor on an ongoing basis the alignment of executive pay and benefits with the strategic direction of the Group to ensure these support the long-term success of the Company and promote its values
- Consider executive pay and benefits following the conditional sale of Viridor in early summer 2020 and in the context of the Group's ongoing strategic review
- Review workforce remuneration and related policies for the purpose of aligning incentives and reward with culture, taking these into account when setting the remuneration policy for Executive Directors and providing the Board with feedback
- Monitoring of the updated remuneration policy to ensure that it is delivering what it is meant to and assists in retaining and motivating employees, while continuing to meet best practice.

All of the Committee members served throughout the year.

In accordance with the Code, all of the Committee members are independent Non-Executive Directors. The Chairman of the Board attends from time to time but is not a member of the Committee. The Chief Executive Officer also attends meetings when invited except for such part of a meeting when matters concerning his own remuneration are to be discussed.

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



Gill Rider

Remuneration Committee Chairman

Directors' remuneration report

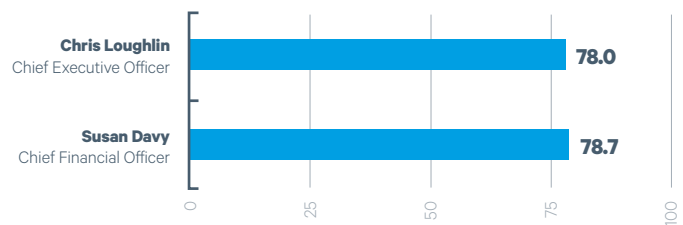
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2019/20 performance highlights and outcomes

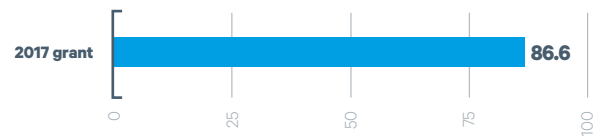
Group performance

- Underlying profit before tax up 2.6%
- 2019/20 dividend per share up 6.6% to 43.77 pence per share
- Cumulative return on regulated equity over K6 (2015-20) 11.8%
- South West Water began the K7 (2020-25) regulatory period as the only company to have achieved fast-track status for its business plan in two consecutive five-year price reviews
- Proposed sale of Viridor for an enterprise value of £4.2 billion, which will accelerate the realisation of significant value for our shareholders.

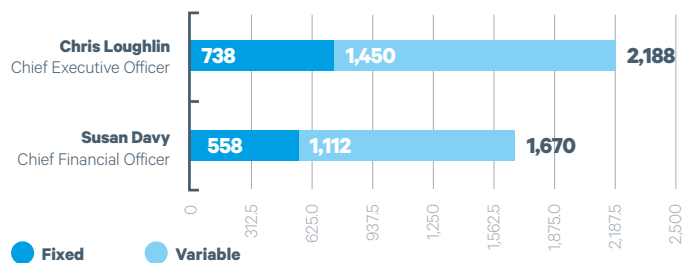
Annual bonus 2019/20 outturn (% of maximum)



Long-term incentive plan (LTIP) outturn (estimated vesting) (% of maximum)



2019/20 single figure outcome (£'000)



Link between strategy and remuneration

Group KPIs

	Link to strategy			Link to variable remuneration	
	1	2	3	Annual bonus	LTIP
Long-term					
Earnings per share (EPS)	✓	✓	✓		✓
Dividend per share	✓	✓	✓		✓
Return on capital employed (RoCE)		✓	✓		✓
Annual					
Profit before tax (PBT)	✓	✓	✓	✓	
Return on regulated equity (RoRE)	✓	✓	✓	✓	
ODI net rewards	✓		✓	✓*	
ERF availability	✓		✓	✓*	
Sustainable business					
Customer satisfaction with overall service	✓		✓	✓*	
Employee engagement	✓		✓	✓*	
Health & safety	✓		✓	✓*	
GHG emissions	✓		✓	✓*	

* Reflected in bonus operational and individual metrics.

1 Leadership in UK infrastructure

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

2 Cost base efficiency

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

3 Sustainable growth

We actively seek opportunities to invest for growth, whether through investment to increase our asset portfolio, initiatives to expand our customer base, or partnerships with other organisations.

Link to customers

Pay linked to underlying performance	<ul style="list-style-type: none"> • Significant portion of executive remuneration linked to performance of the business • Annual bonus includes customer and operational measures linked to metrics assessed by the water industry regulator, customers, communities and wider stakeholders • Stretching targets – motivate management to deliver sustainable performance • Safeguard mechanisms in place to ensure outcomes reflect underlying performance.
Performance pay – appropriately aligned with customer interests	
Bonus and long-term incentives – substantial link to stretching performance delivery for customers	

Principles used to develop remuneration policy

Clarity and simplicity	The Committee is committed to providing open and transparent disclosures with regards to executive remuneration arrangements.
Risk	Annual bonus deferral, the LTIP holding period and shareholding requirements ensure that Executive Directors are exposed to the long-term performance of the Company.
Predictability	For each component of pay, the policy outlines the maximum opportunity levels for Executive Directors. Actual incentive outcomes will vary depending on the level performance achieved against specific measures.
Proportionality	Our remuneration framework does not reward poor performance. Payment of the annual bonus and LTIP are subject to the achievement of stretching performance targets.
Alignment to culture	The metrics used to measure both short and long-term performance at Pennon are closely aligned to our business strategy and vision. Delivery of awards in shares delivered over three to five years and shareholding guidelines ensure focus on sustainable performance.

Annual statement

from the Chairman of the Remuneration Committee



This has been a significant year in the history of the Pennon Group.



Gill Rider

Remuneration Committee Chairman

Dear Shareholder

I am pleased to present the Directors' remuneration report for the year ending 31 March 2020.

This has been a significant year in the history of the Pennon Group. In addition to strong operational and financial results, South West Water's price review was fast tracked by the regulator. Then in March 2020, we announced the proposed sale of Viridor to KKR for an enterprise value of £4.2 billion, which will accelerate the realisation of significant value for our shareholders.

This provided the backdrop for decisions made in relation to executive remuneration.

Performance in 2019/20

The Group delivered another year of robust financial and operating performance in 2019/20. Overall underlying profit before tax increased to £288 million.

South West Water finished the K6 (2015-20) regulatory period with a cumulative sector-leading return on regulated equity of 11.8% and the successful conclusion of the 2019 price review process (PR19). As a result, South West Water began the K7 (2020-25) regulatory period as the only company to have achieved fast-track status for its business plan in two consecutive five-year price reviews.

This has been an important year for Viridor operationally. A pipeline of growth projects has been developed across energy recovery, plastics recycling and energy parks. This includes our new energy recovery facilities at Glasgow, Beddington and Dunbar moving to ramp up, and good progress with the construction of our plastics processing facility at Avonmouth, which is on track for contribute to earnings in 2020/21.

The Group has an ambitious road map for health & safety, largely focused on our HomeSafe programme. This has yielded a range of improving and encouraging trends in recent years, however we continue to seek improvements as we work towards our goal of being a health & safety leader in our industries.

We continue to make progress against our long-term sustainability strategy. In 2019/20, South West Water further reduced the number of serious and significant pollution incidents to one Category 2 event, building on the previous year's performance which was itself our best performance for a decade. Less serious grades of pollution incident continue to be a challenging area; an accelerated pollution plan has been implemented and we continue to make additional investment. Our water resources position recovered from the previous dry year and we have met our leakage target for 20 years in a row.

Despite the COVID-19 crisis, the Group continues to have significant cash and liquidity and has not taken any Government support measures. For 2019/20, the Board has recommended a final dividend and the total dividend of 43.77 pence per share has been achieved while investing more than £3.6 billion in our businesses over the past 10 years.

Incentive outcomes

The significant progress against financial and operational objectives is reflected in the outcomes against the bonus scorecard and individual objectives. Further details are set out on pages 107 to 109.

In September 2019, the Company announced a full review of the strategic focus, growth options and capital allocation policy for the Group.

Given the significance of this review, the Committee decided that 30% of the 2019/20 bonus for the two Executive Directors should be linked to the successful execution of the strategic review and the value created for our shareholders. The balance of the award remained subject to the normal bonus scorecard and individual objectives.

The Board are unanimous in the view that the strategic review has been highly successful. The share price rose by 42% from the announcement of the strategic review to the announcement of the proposed sale of Viridor. In March 2020 Pennon also joined the FTSE 100 index. The transaction enables our shareholders to accelerate the realisation of value from Viridor and on completion of the sale, the Board intends to use the net cash proceeds to reduce Pennon's company borrowings and pension deficit, and make a return to shareholders, while retaining a portion of funds for future opportunities.

Overall, the annual bonus earned in respect of the year is 78.0% of salary for the Chief Executive Officer and 78.7% for the Chief Financial Officer. The Committee is satisfied that the bonus outcomes are fully supported by performance in the year.

Half of the bonus earned is deferred into shares which affirms Executive Directors' commitment to creating a long-term, sustainable business.

Share awards granted under the long-term incentive plan (LTIP) in 2017 will be eligible for vesting in 2020. This award was based on EPS growth (40%), dividend growth and cover (40%) and RoCE (20%), as well as an 'underpin' evaluation, including consideration of safety, ESG factors and financial performance.

Awards are expected to vest at 86.6% of maximum, as shown on page 109. This is reflective of EPS growth of 9.5% and returns of 9.6%. We have also delivered dividends of £519 million to our shareholders for the last three financial years while also making significant investments.

Vested shares for Executive Directors will remain subject to an additional two-year holding period.

Policy review

Our previous remuneration policy was approved at the 2017 AGM, receiving support of just under 98%. Under the normal three-year renewal cycle we will be submitting a new policy for approval at the 2020 AGM.

In light of the planned sale of Viridor, the Committee concluded that any renewal of the remuneration policy at the 2020 AGM should incorporate only minor updates, with a more detailed review of the remuneration strategy deferred until later in the year when there is further clarity regarding the future structure of the Group.

The key points to note in respect of the policy to be presented to shareholders at the 2020 AGM:

- No material changes to structure - the conventional bonus and LTIP structures will be retained.
- Bonus maximum – a modest increase to the bonus maximum from 100% of salary to 125% of salary is proposed. This change is intended to provide additional focus on key financial, operational and investment priorities, as the Company moves towards delivery against the plan agreed with Ofwat for the next five-year regulatory cycle, which commenced on 1 April 2020. The proposed maximum opportunity remains towards the lower end of FTSE 100 and FTSE 250 practices. Half of the award would continue to be deferred into shares for three years.
- LTIP maximum – no change proposed (150% of salary).
- Pensions - for new hires pensions will be aligned with arrangements offered to wider employees. We also commit to aligning pensions for incumbent Executive Directors with the wider workforce by reduction in two equal steps by 1 April 2022.
- Post-cessation shareholding – executives will be expected to hold shares in the Company for two years following cessation of employment.
- Malus and clawback – provisions have been strengthened to align with best practice.

I would like to thank the major shareholders who provided feedback on these proposals during consultation earlier in the year.

The Committee intends to undertake a more wholesale review of the policy later in the year, following the completion of the sale of Viridor. To the extent that changes to the remuneration structure are proposed, we would consult and seek shareholder approval for a revised remuneration policy as appropriate.

Due to the timeframe for completion of the Viridor transaction, the Committee has determined that it would be prudent to delay the target-setting process for 2020 LTIP awards. This is to ensure that the performance criteria reflect the strategic priorities for the Continuing Group and the interests of our shareholders. Once finalised, we intend to publish the performance metrics and targets on our website.

Further detail on pay arrangements is provided in the main body of the remuneration report. I hope that our shareholders continue to support our approach.



Gill Rider
Remuneration Committee Chairman

Directors' remuneration policy

Introduction

The previous remuneration policy was approved by shareholders at the 2017 AGM, where the resolution received the support of nearly 98% of shareholders who voted. Under the normal three-year renewal process, a new remuneration policy, as described in this part of the report, will be subject to a binding shareholder vote at the AGM to be held on 31 July 2020, and if approved will come into effect from this date.

The Directors' remuneration policy will be displayed on the Company's website at www.pennon-group.co.uk/about-us/governance-and-remuneration, immediately after the 2020 AGM and will be available upon request from the Group Company Secretary.

Changes to the remuneration policy

The policy has been updated in order to be more aligned with evolving market and best practice, including the remuneration elements of the 2018 UK Corporate Governance Code. As explained on page 97, given the timing of the Group's ongoing strategic review, a more detailed review of remuneration strategy has been deferred until later in the year.

In determining the updates to the new remuneration policy, the Committee followed a robust process, discussing the detail of the policy over a series of meetings in 2019 and 2020. The overall pay structure detailed in the previous 2017 policy remains in line with mainstream FTSE practices, and therefore the Committee was satisfied that there was merit in maintaining this approach for the purposes of the 2020 policy renewal.

Throughout the Committee's deliberations on pay matters, careful consideration is given to the strategic priorities of the business, evolving market practice and investor guidance. Input is regularly sought from the management team, while ensuring that conflicts of interests are suitably mitigated. External perspective is also provided by our independent advisors. The Committee also assesses the operation of the policy against the principles of clarity, simplicity, risk-management, predictability, proportionality and alignment to culture detailed in the 2018 UK Corporate Governance Code.

The changes incorporated into this policy include:

- A reduction of pension benefits for newly appointed Executive Directors from the previous limit of 20% of salary to be aligned with arrangements offered to employees in the wider organisation and a commitment to reduce pensions for incumbent directors;
- A modest increase to the maximum bonus opportunity from 100% of salary to 125% of salary in order to provide additional focus on key financial, operational and investment priorities, as the Company moves towards delivery against the plan agreed with Ofwat for the next five-year regulatory cycle which commenced on 1 April 2020;
- Extension of shareholding guidelines to operate after an Executive Director steps down from the Board;
- Strengthening of safeguards against payments for failure, by enhancing existing malus and clawback provisions; and
- Minor changes to clarify the operation of the policy and improve its effectiveness.

Future policy table – Executive Directors

The table below sets out the elements of the total remuneration package for the Executive Directors which are comprised in this Directors' remuneration policy.

Fixed pay

Base salary	
Purpose and link to strategy	Set at a competitive level to attract and retain high calibre candidates to meet the Company's strategic objectives in an increasingly complex business environment. Base salary reflects the scope and responsibility of the role as well as the skills and experience of the individual.
Operation	Salaries are generally reviewed annually and any changes are normally effective from 1 April each year. In normal circumstances, salary increases will not be materially different to general employee pay increases. However, the Committee reserves the right to make increases above those made to general employees, for example in circumstances including (but not limited to) an increase in the scope of the role, or to reflect an individual's development in a role.
Maximum	When reviewing salaries the Committee has regard to the following factors: <ul style="list-style-type: none"> • Salary increases generally for all employees in the Company and the Group • Market rates • Performance of individual and the Company and/or development in the role • Other factors it considers relevant. There is no overall maximum.
Performance framework	None, although individual and Company performance are factors considered when reviewing salaries.

Benefits

Purpose and link to strategy	Benefits provided are consistent with the market and level of seniority to aid retention of key skills to assist in meeting strategic objectives.
Operation	Benefits currently include the provision of a company vehicle, fuel, health insurance and life assurance. Other benefits may be provided if the Committee considers it appropriate. In the event that an Executive Director is required to relocate, relocation benefits may be provided.
Maximum	The cost of insurance benefits may vary from year to year depending on the individual's circumstances. There is no overall maximum benefit value but the Committee aims to ensure that the total value of benefits remain proportionate.
Performance framework	None.

Pension-related benefits

Purpose and link to strategy	Provides funding for retirement and aids retention of key skills to assist in meeting the Company's strategic objectives.
Operation	Defined benefit pension arrangements are closed to new entrants. Defined contribution pension arrangements have been available to new employees since 2008 and we are currently consulting on proposals to further modernise our pension arrangements. A cash allowance may be provided as an alternative and/or in addition where pension limits have been reached.
Maximum	Pension benefits for new appointments will be aligned with the rate available for the majority of employees at the time of appointment. For the current Executive Directors, the pension benefits are currently 30% of salary for the CEO and 25% of salary for the CFO. These contractual benefits are consistent with the previous policy approved by shareholders. As noted in the annual report on remuneration, the intention is for these benefit levels to be reduced over time to align with the wider workforce by 1 April 2022. Legacy defined benefit pension arrangements will continue to be honoured. The current CFO is a pension member, however there are no further prospective accruals in respect of defined benefit pension arrangements.
Performance framework	None.

Variable pay and share-based remuneration

Annual bonus

Purpose and link to strategy	Incentivises the achievement of key performance objectives aligned to the strategy of the Company.
Operation	Annual bonuses are calculated following finalisation of the financial results for the year to which they relate. A portion of any bonus is deferred into shares in the Company which are normally released after three years. Normally 50% is deferred. Dividends (or equivalents) may be paid/accrued on deferred shares. Awards are subject to malus and clawback provisions. Further details are set out on page 101.
Maximum	The maximum bonus potential is 125% of base salary.
Performance framework	Performance targets may relate to financial, operational, strategic and personal objectives which are reviewed each year. Performance criteria will reflect strategic priorities and regulatory requirements. The level of payment for threshold performance will vary depending on the nature of the metric and the stretch of the target set. There is normally scaled payment for performance between the threshold and maximum performance hurdle. The measures, weighting and threshold levels may be adjusted for future years. Following the financial year end the Committee, with advice from the Chairman of the Board and following appropriate input from other Board Committees (including the Audit Committee), assesses to what extent the targets are met and determines bonus levels accordingly. The Committee may exercise its discretion in certain circumstances; further details are set out on page 101.

Directors' remuneration policy

continued

Variable pay and share-based remuneration continued

Long-term incentive plan (LTIP)

Purpose and link to strategy	Provides alignment to the achievement of the Company's strategic objectives and the delivery of sustainable long-term value to shareholders.
Operation	<p>Annual grant of conditional shares (or equivalent). Share awards vest subject to the achievement of specific performance conditions normally measured over a performance period of no less than three years.</p> <p>An 'underpin' applies which allows the Committee to reduce or withhold vesting if the Committee is not satisfied with the underlying operational and economic performance of the Company.</p> <p>In addition, a two-year holding period may apply in respect of any shares which vest at the end of the three-year performance period.</p> <p>Dividends (or equivalents) may accrue on share awards that vest.</p> <p>Awards are subject to malus and clawback provisions. Further details are set out below.</p>
Maximum	The maximum annual award is 150% of base salary.
Performance framework	<p>Performance metrics and targets are set to reflect the long-term strategic priorities of the Group. Performance criteria are linked to our long-term strategy and may include a combination of financial, operational and/or shareholder-related measures.</p> <p>The 'underpin' evaluation includes consideration of safety, environmental, social and governance (ESG) factors as well as financial performance.</p> <p>No more than 25% of maximum vests for minimum performance.</p> <p>The Committee will keep the performance measures and weightings under review and may change the performance condition for future awards if this were considered to be aligned with the Company's interests and strategic objectives, as well as the impact of regulatory changes. In certain circumstances, the Committee may exercise its discretion and adjust performance outcomes. Further details are set out on page 101.</p> <p>The Committee would seek to consult with major shareholders in advance of any proposed material change in performance measures.</p>

All-employee share plans

Purpose and link to strategy	Align the interests of all employees with Company share performance.
Operation	Executive Directors may participate in HMRC approved all-employee plans on the same basis as employees.
Maximum	The maximum is as prescribed under the relevant HMRC legislation governing the plans.
Performance framework	None

Shareholding guidelines

Shareholding guidelines

Purpose and link to strategy	<p>Create alignment between Executives and shareholders and promote long-term stewardship.</p> <p>During the course of their tenure, Executive Directors are expected to build up a shareholding equivalent to 200% of salary.</p> <p>Following the adoption of this policy, departing Executive Directors will also be expected to retain a material interest in Company shares for two years after they step down from the Board. Executives will normally be expected to hold 200% of salary (or actual relevant holding, if lower) on departure, with the guideline reducing to 100% of salary after 12 months. This guideline will apply to all share awards vesting after the adoption of this remuneration policy.</p>
Operation	The Committee retains discretion to waive this guideline in certain cases (e.g. compassionate circumstances).

Notes to the policy table

Performance measures and targets

The performance conditions for the annual bonus plan are selected by the Committee each year to reflect key performance indicators and metrics used by the Board to oversee the operation of the businesses. There is a strong emphasis on financial and operating metrics.

In prior years the LTIP was based on EPS growth, a sustainable dividend metric (comprising dividend growth and dividend cover) and RoCE. The Committee chose these measures as they were closely aligned with Pennon's strategic focus on the delivery of sustained earnings and related cash flows, our sector-leading dividend policy and the long-term capital returns generated by our businesses. As noted in the statement from the Remuneration Committee Chairman, the Remuneration Committee expects to finalise the targets for 2020 LTIP awards later in the year, following the completion of the sale of Viridor. The performance targets are set in the context of the Company's forecasts and market expectations, and are regarded as stretching targets.

The Committee may amend performance measures, weightings and targets, in the context of the Company's strategy, the impact of changes to the regulatory framework, accounting standards and any other relevant factors.

The measurement of performance against performance targets and determination of incentive outcomes is at the Committee's discretion. Adjustments may be made to reflect underlying financial or non-financial performance of the individual or the Group, consideration of overall performance in the round, and/or circumstances unforeseen or unexpected when the targets were set. When making this judgement, the Committee may take into account all factors deemed relevant.

Performance conditions may also be replaced or varied if an event occurs or circumstances arise which cause the Committee to determine that the performance conditions have ceased to be appropriate. If the performance conditions are varied or replaced, the amended conditions must, in the opinion of the Committee, be fair, reasonable and materially no less difficult than the original condition when set.

The Committee would clearly disclose any material changes to performance measures, and seek shareholder views as appropriate.

Malus and clawback

Malus and clawback provisions apply to all incentive awards. These provisions enable awards to either be forfeited prior to delivery, repaid or made subject to further conditions where the Committee considers it appropriate in the event of any significant adverse circumstances. For awards granted under the term of this policy, the circumstances in which malus and clawback may be applied include a financial misstatement, error in calculation, material failure of risk management, serious reputational damage, serious corporate failure or misconduct. In respect of the annual bonus, clawback may be applied for the period of three years following determination of the cash bonus. Under the LTIP, clawback may be applied until the end of the holding period.

Operation of executive share plans

The long-term incentive plan will be operated in accordance with the rules of the plan as approved by shareholders. The deferred bonus awards will be governed by the rules adopted by the Board from time to time. Awards under any of the Company's share plans referred to in this report may:

- Be granted as conditional share awards, nil-cost options or in such other form that the Committee determines has the same economic effect
- Have any performance conditions applicable to them amended or substituted by the Committee if an event occurs which causes the Committee to determine an amended or substituted performance condition would be more appropriate and not materially less difficult to satisfy
- Incorporate the right to receive an amount (in cash or additional shares) equal to the value of dividends which would have been paid on the shares under an award that vest up to the time of vesting (or where the award is subject to a holding period, release). This amount may be calculated assuming that the dividends have been reinvested in the Company's shares on a cumulative basis
- Be settled in cash at the Committee's discretion (e.g. due to regulatory limitations).

Pre-existing commitments

The Committee reserves the right to make any remuneration payments and/or payments for loss of office (including exercising any discretion available in connection with such payments) outside the policy set out above where the terms of the payment were agreed (i) before the 2014 AGM (the date the Company's first shareholder-approved directors' remuneration policy came into effect); (ii) before this policy came into effect, provided that the terms of the payment were consistent with the shareholder-approved directors' remuneration policy in force at the time they were agreed; or (iii) at a time when the relevant individual was not a director of the Company and, in the opinion of the Committee, the payment was not in consideration for the individual becoming a director of the Company. For these purposes 'payments' includes the Committee satisfying awards of variable remuneration and, in relation to an award over shares, the terms of the payment are 'agreed' at the time the award is granted.

Early vesting events

On a change of control or voluntary wind up of the Company, LTIP awards may vest to the extent determined by the Committee having regard to the performance of the Company and, unless the Committee determines otherwise, the period of time that has elapsed since grant. Deferred bonus awards may vest in full. Alternatively, participants may have the opportunity, or be required, to exchange their awards for equivalent awards in another company, although the Committee may decide in these circumstances to amend the performance conditions.

The Committee also has the discretion to treat any variation of the Company's share capital or any demerger, special dividend or other transaction that may affect the current or future value of awards as an early vesting event on the same basis as a change of control.

Differences in remuneration policy for all employees

When setting remuneration for Executive Directors the Committee considers relevant information about pay and conditions in the Group. Senior executives and Executive Directors generally receive a higher proportion of their total pay in the form of variable remuneration and share awards. All administrative employees of the Group are entitled to base salary and pension provision including life assurance. In addition, all administrative employees in Pennon Group and South West Water and all senior and middle management employees in the operations functions in Viridor are entitled to participate in annual bonus arrangements, the levels of which are based on the seniority and level of responsibility. Long-term incentive share awards are only available to senior executives and Executive Directors, and certain benefits are generally available only to more senior employees at management level and above.

Minor amendments to the remuneration policy

The Committee may make minor amendments to the policy (for example for regulatory, exchange control, tax or administrative purposes or to take account of a change in legislation) without obtaining shareholder approval for that amendment.

Directors' remuneration policy

continued

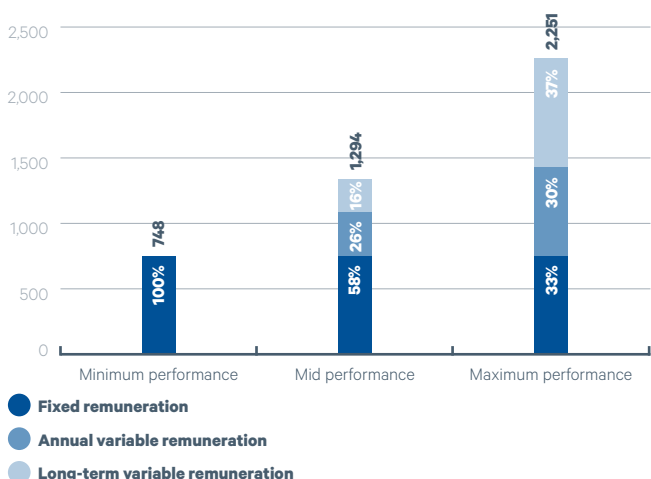
Future policy table – Non-Executive Directors

Purpose and link to strategy	Set at a market level to attract Non-Executive Directors who have appropriate experience and skills to assist in determining the Group's strategy.
Fees	
Operation	Fees are set by the Board with the Chairman's fees being set by the Committee. The relevant Directors are not present at the meetings when their fees are being determined. Non-Executive Directors normally receive a basic fee and an additional fee for any specific Board responsibility such as membership or chairmanship of a Committee or occupying the role of Senior Independent Director. In reviewing the fees, the Board, or Committee as appropriate, consider the level of fees payable to Non-Executive Directors in other companies of similar scale and complexity.
Maximum	Total fees paid to Non-Executive Directors will remain within the limits stated in the Articles of Association.
Benefits	
Operation	Where appropriate limited role-appropriate benefits may be provided. Expenses incurred in the performance of non-executive duties for the Company may be reimbursed or paid for directly by the Company (including any tax due on the expenses). The Chairman's benefits include the provision of a driver and vehicle, when appropriate for the efficient carrying out of his duties.
Maximum	None.

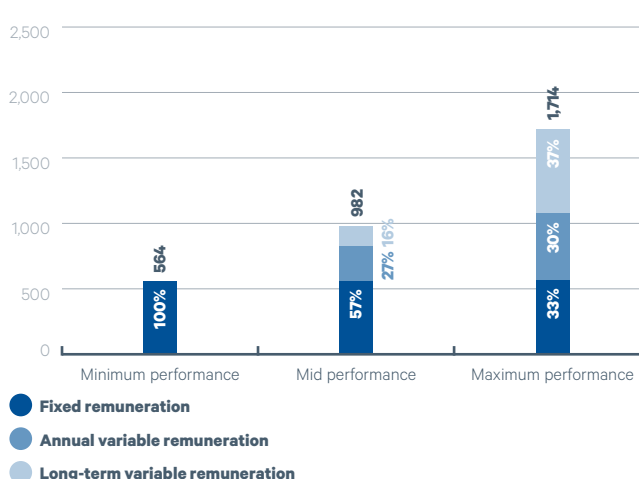
Illustrations of applications of remuneration policy

The total annual remuneration for the Executive Directors that could result from the proposed remuneration policy, based on salaries for 2020/21, is shown below.

Chris Loughlin – Chief Executive Officer (£000)



Susan Davy – Chief Financial Officer (£000)



Scenario	Assumptions
Fees	
Minimum performance	Fixed pay, which constitutes base salary, pension-related benefits and benefits in kind. These values are made up of the salaries for 2020/21 (set out on page 105) and an estimate of the value of the benefits and pension-related benefits.
Mid performance	Fixed pay and 50% of the maximum annual bonus and 25% of the maximum long-term incentive award.
Maximum	Fixed pay and 100% vesting of the annual bonus and of long-term incentive awards.

No adjustments have been made for potential payment of dividends. Benefits from all-employee schemes have also been excluded.

As long-term share awards are granted in shares and subject to stretching performance criteria, the value of the award can vary significantly depending on the extent to which targets are achieved and the movement in the share price. For example, if the share price increased by 50% over the relevant vesting and holding period, the maximum values shown in the charts above would increase to £2,660,800 for the CEO and £2,027,225 for the CFO. Conversely if the share price was to fall by 50%, the maximum values shown in the charts above would reduce to £1,840,863 for the CEO and £1,400,263 for the CFO.

Approach to recruitment remuneration

When considering the appointment of Executive Directors, the Committee seeks to balance the need to offer remuneration to attract candidates of sufficient calibre to deliver the Company's strategy while remaining mindful of the need to pay no more than is necessary.

The Committee will appoint new Executive Directors with a package that is in line with the remuneration policy that has been agreed by shareholders and is in place at the time. Base salary may be set at a higher or lower level than the previous incumbent.

Other elements of remuneration would be in line with the Company's policy set out in the in the future policy.

The maximum variable pay opportunity on recruitment (excluding buyouts) would be 275% of salary, which is in line with the future policy table. The Committee may determine for the first year of appointment that incentives may be subject to different weightings or objectives.

To facilitate recruitment, it may be necessary to recompense a new Executive Director for the expected value of remuneration arrangements forfeited on joining the Company (buyout awards). The Committee may make buyout awards in accordance with LR9.4.2 of the Listing Rules or utilising any other incentive plan operated by the Group from time-to-time. The Committee will ensure that any such award would at a maximum match the value of the awards granted by the previous employer and be made only where a Director is able to demonstrate that a loss has been incurred from joining the Company. Any buyout would take into account the terms of the arrangement forfeited, including in particular any performance conditions and the time over which they vest. The award would normally have time horizons which are in line with or greater than the awards forfeited. Where appropriate the exact nature of the buyout may be tailored based on the commercial circumstances at the time, provided that the value of the buyout remains comparable to arrangements forfeited.

For interim positions a cash supplement may be paid rather than salary (for example a Non-Executive Director taking on an executive function on a short-term basis).

Where an employee is promoted to the position of Executive Director (including if an Executive Director is appointed following an acquisition or merger), pre-existing awards and contractual commitments would be honoured in accordance with their established terms.

Non-Executive Directors' fees would be in line with the policy set out in the future policy table on page 102.

Directors' service contracts and letters of appointment

The dates of Directors' service contracts and letters of appointment and details of the unexpired term are shown below.

Executive Directors	Date of service contract	Notice period
Chris Loughlin	1 January 2016	12 months
Susan Davy	1 February 2015	12 months

Each of the Executive Directors' service contracts is subject to 12 months' notice on either side. The contract has a normal retirement age of 67, except where otherwise agreed by both the Executive Director and the Company.

Non-Executive Directors	Date of initial letter of appointment	Expiry date of appointment
Sir John Parker	19 March 2015	31 March 2021
Gill Rider	22 June 2012	31 August 2021
Neil Cooper	17 July 2014	31 August 2020
Iain Evans	16 June 2018	31 August 2021
Claire Ighodaro	28 May 2019	31 August 2022

The policy is for Executive Directors' service contracts to provide for 12 months' notice from either side.

The policy is for Non-Executive Directors' letters of appointment to contain a three-month notice period from either side.

All Non-Executive Directors are subject to annual re-election and letters of appointment are for an initial three-year term.

Copies of Executive Directors' service contracts and Non-Executive Directors' letters of appointment are available for inspection at the Company's registered office.

Policy on termination of service agreements and payment for loss of office

The Company's policy is that Executive Directors' service agreements are normally terminable on one year's notice or such other date as the parties agree.

There are no liquidated damages provisions for compensation on termination within Executive Directors' service agreements. Taking into account the circumstances of any termination, the Committee may determine that a payment in lieu of notice should be made. Any such payments would be restricted to salary and benefits (which may include pension-related benefits). In these circumstances, consideration would be given to phasing of payments and an individual's duty and opportunity to mitigate losses.

The Committee reserves the right to make any other payments in connection with a Director's cessation of office or employment where the payments are made in good faith in discharge of an existing legal obligation (or by way of damages for breach of such an obligation) or by way of compromise or settlement of any claim arising in connection with the cessation of a director's office or employment. Any such payments may include but are not limited to paying any fees for outplacement assistance and/or the director's legal and/or professional advice fees in connection with his cessation of office or employment.

The Company may meet ancillary costs, such as outplacement consultancy and/or reasonable legal costs, if the Company terminates the Executive Director's service contract.

Directors' remuneration policy

continued

Any compensation payable will be determined by reference to the terms of the service contract between the Company and the employee, as well as the rules of the various incentive plans as set out in the table below.

Annual bonus	<p>Normally no bonus is payable unless an Executive Director is employed on the date of payment.</p> <p>In certain good leaver circumstances (death, disability, redundancy, retirement and any other circumstance at the Committee's discretion) a bonus may be payable. Any such bonus would be based on performance and pro-rated to reflect the period of service with performance normally assessed at the same time as other employees. The Committee retains discretion to adjust the timing and pro-rating of any award to take account of any prevailing exceptional circumstances which they consider would be fair to the Company and to the employee. Share deferral would not normally apply.</p>
Deferred shares	<p>Unvested awards would normally lapse upon cessation. In certain good leaver circumstances, unless the Committee determines otherwise, the restricted period is not automatically terminated on cessation of employment; rather, the restricted period continues to apply as if the leaver was still in employment. However, awards may be released to participants on an earlier date following cessation of employment at the discretion of the Committee.</p> <p>Good leaver circumstances are death, injury, ill-health, disability, redundancy, retirement, the sale of the individual's employing business or company out of the Group and any other circumstance at the Committee's discretion.</p>
Long-term incentive plan	<p>Any unvested awards would normally lapse upon cessation of the individual's employment within the Group. In certain good leaver circumstances, awards vest to the extent determined by the Committee taking into account the extent to which the performance conditions have been satisfied, the period of time elapsed between grant and the cessation of employment and such other factors as the Committee may deem relevant. Awards would normally vest on the original normal vesting date and be released at the end of the two-year holding period (unless the Committee determines awards should be subject to earlier vesting and release dates).</p> <p>If a participant dies, an award will, unless the Committee determines otherwise, vest and be released as soon as possible following the participant's death, taking into account the extent to which the performance conditions have been satisfied and the period of time elapsed since grant.</p> <p>Good leaver circumstances are death, ill-health, injury, disability, redundancy, retirement, where the participant's employer is no longer a member of the Group, where the participant is employed in an undertaking which is transferred out of the Group, or for any other reason that the Committee determines.</p> <p>All awards would lapse if a participant was summarily dismissed.</p>
All-employee awards	Leavers will be treated in accordance with the HMRC approved rules.
Other awards	Where a buyout award is made on recruitment, leaver provisions would be determined at the time of award.

Statement of consideration of employment conditions elsewhere in the Company

In setting executive remuneration the Committee takes account of employment market conditions and the pay and benefits differentials across the Group. The Committee considers annual summary reports of employee remuneration and the terms and conditions of employment within each operating company and has regard to these when considering remuneration for the Executive Directors and senior management. As part of this assessment the Committee considers various metrics including data on the ratio between CEO and all-employee pay, gender pay statistics and measures of employee engagement.

Engaging our workforce around remuneration is currently undertaken as part of the Great Place to Work survey. Additionally during 2020, we have undertaken our largest consultation around remuneration as a Group as part of our plans to modernise pension arrangements. Going forward, we plan to utilise our engagement forums to proactively talk about executive remuneration and how it aligns to wider Company pay as part of our ongoing two-way communication with employees.

Statement of consideration of shareholder views

The Committee has taken into account general good governance, best practice and shareholder views when formulating the remuneration policy. The changes to our approach on pensions, the introduction of a post-employment shareholding guidelines and the updates to the malus and clawback provisions have all been made in direct response to investor comment.

The Committee would seek to consult with shareholders prior to any material changes in our approach to pay for Executive Directors. Prior to the adoption of this policy, major shareholders were notified regarding the Committee's proposed approach and views were sought. To the extent that a further review of the policy is initiated later in the year, the Committee would seek to engage with major shareholders as appropriate.

In accordance with the Companies Act 2006, shareholders have the right to vote on the Directors' remuneration report. The remuneration policy is subject to a binding vote at least every three years and the annual report on remuneration is subject to an annual advisory vote.

Annual report on remuneration

Implementation of the remuneration policy for 2020/21

The proposed changes to the remuneration policy are set out on page 98 and will be subject to a binding shareholder vote, following the date of the Company's 2020 AGM which is scheduled to be held on 31 July 2020. This section sets out how the policy will be implemented for the year 2020/21.

Executive Directors:

Base salary	Salaries are generally reviewed annually and any changes are normally effective from 1 April each year. In normal circumstances, salary increases will not be materially different to general employee pay increases. Salaries for 2020/21 were increased by 1.5%, which was in line with or lower than increases for all employees: Chris Loughlin – £546,625 Susan Davy – £417,975
Benefits	No changes. Benefits currently include the provision of a company vehicle, fuel, health insurance and life assurance. Other benefits may be provided if the Committee considers it appropriate.
Pension-related benefits	The rate for new hires in the future will be aligned with the rate available to the majority of employees at the time of appointment. The retirement benefits for incumbent Executive Directors will be aligned with the wider workforce, with reduction to be made in two equal steps to ensure alignment no later than 1 April 2022. The details of the reductions for incumbent directors will be considered later in the year, following the conclusion of the wider review of workforce pensions.
Annual bonus	Following the adoption of the new policy, the maximum bonus potential for each Director is 125% of base salary, with deferral of 50% of any bonus into shares for three years. Malus and clawback provisions apply. The annual bonus for 2020/21 will continue to be based on a combination of financial, operational and strategic objectives. In line with our regulatory requirements, a substantial portion of the bonus will be linked to customer-related goals. The detailed metrics will also require adjustment in light of the proposed sale of Viridor. The detail of bonus targets are closely aligned to the strategy and are therefore considered to be commercially sensitive. Disclosure of targets will be provided on a retrospective basis in next year's remuneration report.
Long-term incentive plan (LTIP)	Share awards vest subject to the achievement of specific performance conditions measured over three years. In addition, a two-year holding period will apply in respect of any shares which vest at the end of the three-year performance period. The maximum annual award is 150% of base salary. An underpin applies which allows the Committee to reduce or withhold vesting if the Committee is not satisfied with the underlying operational and economic performance of the Company. Malus and clawback provisions apply. As noted in the Chairman's statement, the target setting process for the 2020 LTIP grants has been deferred in light of the proposed sale of Viridor. This is to ensure that any targets for the three-year period ending 31 March 2023 are aligned with the long-term strategic priorities for the Group. Once finalised, we intend to publish the performance metrics and targets on our website.
Shareholding requirements	200% of salary for both the Chief Executive Officer and Chief Financial Officer. Following the adoption of the new policy, departing Executive Directors will be expected to hold shares in the Company for two years after they step down from the Board. Executives will be expected to hold 200% salary (or actual relevant holding, if lower) on departure, with the guideline reducing to 100% salary after 12 months. This new requirement will apply to all incentive shares vesting after the new policy comes into effect.
All-employee share plans	Executive Directors may participate in HMRC approved all-employee plans on the same basis as employees. The maximum is as prescribed under the relevant HMRC legislation governing the plans.

Non-Executive Director fees

The table below outlines how the fees will be implemented for 2020/21 (an increase of 1.5%).

	2020/21	2019/20
Chairman	£279,850	£275,700
Basic Non-Executive Director fee	£49,850	£49,100
Additional fees		
Senior Independent Director	£7,400	£7,280
Chairman of Audit Committee	£15,000	£14,785
Chairman of Remuneration Committee	£10,725	£10,560
Chairman of Sustainability Committee	£10,725	£10,560
Committee fee	£5,350	£5,280

Annual report on remuneration continued

Remuneration approach for wider employees

Consistent with best practice, the Remuneration Committee spends considerable time on matters relating to remuneration arrangements in the wider organisation. Details of pay trends for the wider employee base provide important context when making decisions regarding remuneration for the Executive Directors as well as ensuring that consistent approaches are being adopted across the organisation.

Although the structure of pay varies at different levels in the organisation, the Company applies a consistent set of guiding principles. The structure of Pennon's approach to remuneration in the wider organisation is summarised in the table below:

Base salary	Salaries reflect the scope and responsibility of the role, as well as the skill and experience of the individual. The percentage change in salary for the Chief Executive Officer in 2020 was 1.5%, compared with general increases of between 1.5% and 1.8% across the Group.
Pension and benefits	All employees of the Group are entitled to pension provision, including life assurance. Certain benefits are generally available only to more senior employees at management level and above. The Group also encourages share ownership among its employees by operating HM Revenue & Customs approved Sharesave scheme and Share Incentive Plan. All employees are eligible to participate in share plans, and there is a strong emphasis of employee buy-in and ownership.
Variable remuneration	All employees in Pennon Group plc and South West Water are entitled to participate in annual bonus arrangements. In Viridor and Pennon Water Services, all senior and middle management employees as well as many employees in operations functions are entitled to participate in annual bonus arrangements or performance incentives. The maximum bonus levels are based on seniority and level of responsibility. Long-term incentive share awards are only available to senior executives and Executive Directors.

In response to the 2018 UK Corporate Governance Code, the Committee has also reviewed the level of information provided on pay matters in the wider organisation. Key activity in this regard included:

Pennon pay dashboard	<ul style="list-style-type: none"> • We have established a pay dashboard to help support the Committee in reviewing workforce remuneration and related policies • The dashboard provided an overview of pay arrangements across the business and provides key statistics on pay in different areas of the business • The dashboard covers information on workforce demographics, employee engagement, gender pay, pay ratios, pension and benefits and incentive outcomes in different areas of the business • The Committee intends to keep the content of the dashboard under review to ensure that it continues to provide suitable information for the Committee.
Gender pay gap	<ul style="list-style-type: none"> • From April 2018 Pennon has published gender pay gap data for the business • As a Group that operates in traditionally non-diverse sectors, we are well aware of the impact our own practices may have in relation to gender, as well as the broader issue of race and ethnicity • While we firmly believe there is still much to be done, our already established programme of measures means that Group-wide we have an average gender pay gap of 4.1%, below the latest published UK average.

Employee engagement

Across Pennon we endorse the principle of strengthening opportunities for employees to engage in two-way dialogue at all levels.

We have welcomed the insight provided from the annual employee survey and the feedback from the Employee Voice and Employee Engagement Forums. We have increased the frequency of Big Chat events during the year which provides employees the opportunity to dial-in to a Group-wide call with the Pennon Executive to hear updates on key projects and participate in open question and answer sessions. This feedback is essential as we continue to work with employees to make performance improvements across the Group and motivate and engage our employees. One of the key priority areas for discussion during the last year has been on reward and remuneration and we were pleased to see an increase in our Trust Index score from 62% to 63%. We have also conducted our largest ever consultation with employees regarding our proposals to modernise pension arrangements across the Group.

Operation of the remuneration policy during 2019/20
Single total figure of remuneration tables (audited information)

	Base salary/fees (£000)		Benefits ⁽ⁱ⁾ (including Sharesave) (£000)		Annual bonus (cash and deferred shares) (£000)		Long-term incentive plan (£000)		Pension ⁽ⁱⁱⁱ⁾ (£000)		Total remuneration (£000)	
	2019/20	2018/19	2019/20	2018/19	2019/20	2018/19	2019/20 ⁽ⁱⁱ⁾	2018/19 ⁽ⁱⁱ⁾	2019/20	2018/19	2019/20	2018/19
Executive Directors												
Chris Loughlin	539	528	37	34	420	480	1,030	151	162	158	2,188	1,351
Susan Davy	412	404	29	29	324	369	788	115	117	115	1,670	1,032
Non-Executive Directors												
Sir John Parker	276	270	-	-	-	-	-	-	-	-	276	270
Gill Rider	78	77	-	-	-	-	-	-	-	-	78	77
Neil Cooper	69	69	-	-	-	-	-	-	-	-	69	69
Iain Evans	70	40	-	-	-	-	-	-	-	-	70	40
Claire Ighodaro ^(iv)	35	-	-	-	-	-	-	-	-	-	35	-

(i) Benefits comprise a car allowance, fuel allowance and medical insurance.

(ii) For 2019/20, the 2017/18 LTIP has been valued based on the average share price during the three-month period to 31 March 2020 of 1093.66p and a vesting outcome of 86.6%, as referred to on page 109, together with an estimate of the accrued dividends payable on the vesting shares. Of the vested amount, 26.6% relates to share price appreciation over the performance period. The Committee did not exercise any discretion in relation to share price changes.

The 2016/17 LTIP value for 2018/19 reflects the share price at the date of vesting of 741.2p, a vesting outcome of 32% and an additional 4.7% equivalent to the value of accrued dividends over the three-year performance period. The Committee did not exercise any discretion in relation to share price changes.

Both LTIP awards are subject to a two-year holding period.

(iii) See page 110 for further information on pensions.

(iv) Claire Ighodaro was appointed to the Board on 1 September 2019.

Notes to the single figure table

Annual bonus outturn for 2019/20

As noted in the statement from the chairman of the Remuneration Committee, the Committee determined that the basis for 2019/20 bonus awards should be adapted to reflect the strategic review that commenced in the latter half of the year.

In light of the scale and scope of the review, and the potential incremental value for shareholders, the Committee determined that it would be inappropriate for bonuses to be based solely on the conventional business-as-usual objectives. Therefore, on an exceptional basis, the Committee exercised discretion to assess bonuses for 2019/20 on the following terms:

Part A: 70% – based on combination of financial (60% of element), customer and operational (20% of element) and individual (20% of element) objectives as per original terms; and

Part B: 30% – based on the successful execution of the strategic review and the value created for shareholders.

In line with the Committee's policy, 50% of any bonus is payable in shares, the release of which is deferred for three years.

Group financial measures (60% of Part A)

Measure	Threshold	Target	Maximum	Actual outturn	Bonus outturn (% of max)
Underlying PBT (50% of Part A)	£277m	£283m	£297m	£287.6m	64%
RoRE (10% of Part A)	8%	9%	11%	11.8%	100%

Annual report on remuneration continued

Customer and operational measures (20% of Part A)

Measures	Target	Actual outturn	Target achieved	Bonus outturn (% of max)
Water metrics				
Service incentive mechanism (SIM)	Upper quartile	Median	No	
Bathing water quality	0 beaches failing	0 beaches failed	Yes	
Leakage	84 megalitres per day	84 megalitres per day	Yes	
Wastewater pollution incidents:				67%
Category 1-2	0	1	No	
Category 3-4	145	296	No	
Average duration of interruptions to supply	0.162 hours per property	0.158 hours per property	Yes	
Water and wastewater asset reliability	Stable	Stable	Yes	
Waste metrics				
ERF availability ⁽ⁱ⁾	89%	90%	Yes	
ERF gate fee (£/T)	*	*	Yes	
ERF volume inputs (mT)	2	2	Yes	
ERF electricity revenue (£m)	*	*	No	
ERF power output (million MWh)	1.2	1.1	No	56%
Landfill volumes traded (mT)	1.3	1.25	No	
Landfill gas power output (million MWh)	371.4	401.8	Yes	
Recyclate revenue (£/T)	*	*	Yes	
Recycling volumes traded (mT)	1.2	0.99	No	

(i) Weighted by capacity. Includes joint ventures at 100%, excludes GRREC due to different technology.

* Target and outturn not disclosed for reasons of commercial confidentiality.

Individual objectives (20% of Part A)

Objectives	Achievements	Bonus outturn (% of max)
CEO and CFO – joint objectives		
Deliver the South West Water business plan metrics for K6 (2015-20) including customer, operational and environmental targets. Ensure the foundations are in place for delivery of the K7 business plan (2020-25)	<ul style="list-style-type: none"> Close out of South West Water's confirmed position as sector leading with a cumulative RoRE of 11.8% All operational targets were met with the exception of pollutions South West Water starts the K7 regulatory period as the only company to have achieved fast-track status for its business plan in two consecutive five-year price reviews CEO continued to fulfil the role of Managing Director, South West Water. 	CEO: 70%
Continue to embed HomeSafe across the entire Group and drive further improvement in health & safety performance	<ul style="list-style-type: none"> Improvement in headline performance target (lost time injury frequency rate) by 34% to 0.90 against a target of 1.09 Increased senior leadership visibility. 	CFO: 75%
Build on the trust and engagement of our 5,000 employees to support the delivery of our strategy	<ul style="list-style-type: none"> 1% improvement in Group's Trust Index Highest ever response rate at 83% Year-on-year improvements in both trust and engagement. 	
CFO only		
Lead the review of the modernisation of the Group's pensions arrangements	<ul style="list-style-type: none"> Most extensive ever employee consultation across the Group Modernised pension arrangements due to be implemented from 1 July 2020. 	

Of the objectives set out above, a quarter of the individual objectives were linked to objectives relating to safety. Although good progress was made in relation to the personal objectives linked to safety, and the overall trend in safety metrics remains positive, the Committee determined that the outcome under this element should be reduced to nil.

Strategic review – Part B (30% of overall bonus)

Objective	Bonus outcome (% of max)
<p>Conduct a full review of the strategic focus, growth options and capital allocation policy for the Group to maximise value for shareholders</p> <ul style="list-style-type: none"> Review commenced given the strong financial performance and operational progress of Viridor and South West Water, coupled with the imminent start of the new K7 regulatory delivery period for South West Water and the near and medium-term growth opportunities at Viridor. In March 2020, we announced the proposed sale of Viridor to KKR for an enterprise value of £4.2 billion, which will accelerate the realisation of significant value for our shareholders. The share price rose by 42% from the announcement of the strategic review to the announcement of the sale of Viridor. In March 2020 Pennon also joined the FTSE 100 index. The transaction enables our shareholders to accelerate the realisation of value from Viridor. On completion of the sale, the Board intends to use the net cash proceeds to reduce Pennon's company borrowings and make a return to shareholders, while retaining some funds for future opportunities. 	100%

Summary of bonus outcome

	Weighting	Bonus outcome	
		Chief Executive Officer	Chief Financial Officer
<i>Part A: Financial, strategic and individual</i>	70%		
Group financial measures		29.6%	29.6%
Customer and operational measures		8.6%	8.6%
Individual objectives		9.8%	10.5%
<i>Part B: Strategic review</i>	30%		
Total outcome	100%	78.0%	78.7%

In the interest of full transparency, it is noted that without the exercise of discretion to vary the basis of performance assessment, the bonus outcomes for the Chief Executive Officer and the Chief Financial Officer would have been 68.5% and 69.5% of maximum respectively.

Malus and clawback provisions apply in relation to the bonus awards in respect of the year.

Long-term incentive outcome for 2019/20

The awards in the single figure table relate to the 2017/18 share awards granted on 25 August 2017, which are due to vest on 24 August 2020.

The 2017/18 share awards were subject to the satisfaction of EPS growth, a sustainable dividend measure and RoCE performance conditions. These conditions were set at the time that the awards were granted.

	Threshold (25% of maximum vests)	Maximum (100% of maximum vests)	Achievement	Vesting outcome (% of max)
EPS growth (40% of award)	6% p.a.	10% p.a.	9.50% p.a.	90.5%
Sustainable dividend measure (dividend growth and dividend cover) (40% of award)	2.6x	3.6x	3.4x	82.9%
RoCE (average) ⁽¹⁾ (20% of award)	8%	10%	9.62%	85.9%
Total				86.6%

(1) Average of opening and closing capital employed.

Straight-line vesting between points.

For below threshold performance for either performance condition, 0% vests in respect of that performance condition.

Vesting of the award is subject to an 'underpin' relating to overall Group performance including environmental, social and governance factors and safety performance, as well as financial performance. The Committee has determined, to the date of this report, that this underpin has been satisfied.

If awards were to vest, they would be subject to a two-year holding period during which clawback may be applied if the Committee considers it appropriate in certain circumstances. The holding period ends on 24 August 2022.

Annual report on remuneration continued

Retirement benefits and entitlements (audited information)

Both Executive Directors were appointed prior to April 2013 and participate in legacy pension arrangements. Details of the Directors' pension entitlements and pension-related benefits during the year are as follows:

	Value of defined benefit pension ⁽ⁱ⁾ (£000)	Company contributions to defined contribution arrangements (£000)	Cash allowances in lieu of pension (£000)	Total value for the year (£000)	Normal retirement age and date (for pension purposes)	Accrued pension at 31 March 2020 ⁽ⁱⁱ⁾ (£000)
Chris Loughlin	–	–	162	162	67 (20 August 2019)	–
Susan Davy	29	–	88	117	65 (17 May 2034)	26 ⁽ⁱⁱ⁾

(i) The value of the defined benefit pension accrued over the period comprises the total pension input amount (which has been calculated in line with regulatory requirements) less the pension contributions paid by the Director.

(ii) Accrued pension is based on service to the year end and final pensionable salary at that date.

Chris Loughlin is not a member of any of the Pennon Group's pension schemes and receives a sum in lieu of pension entitlement equivalent to 30% of salary.

Susan Davy receives an overall pension benefit from the Company equivalent to 25% of her salary which in 2019/20 comprised an employer's contribution of £14,958 and a cash sum of £87,992. She is a member of Pennon Group's defined benefit pension arrangements and is entitled to normal retirement pension payable from age 65 of broadly 1/80th of pensionable remuneration for each year of pensionable service completed.

The employer's contribution to the pension for Susan Davy is deducted from the overall pension allowance.

Pensions in payment are guaranteed to increase at a rate of 5% p.a. or RPI if lower for service accrued in the period up to 30 June 2014 and at a rate of 2.5% p.a. or CPI if lower for service accrued in the period after this date. If a Director dies within five years of retiring, a lump sum equal to the balance of five years' pension payments is paid plus a spouse's pension of one half of the member's pension. Pensions may also be payable to dependants and children.

No additional benefits will become receivable by a Director in the event that the Director retires early.

Outside appointments

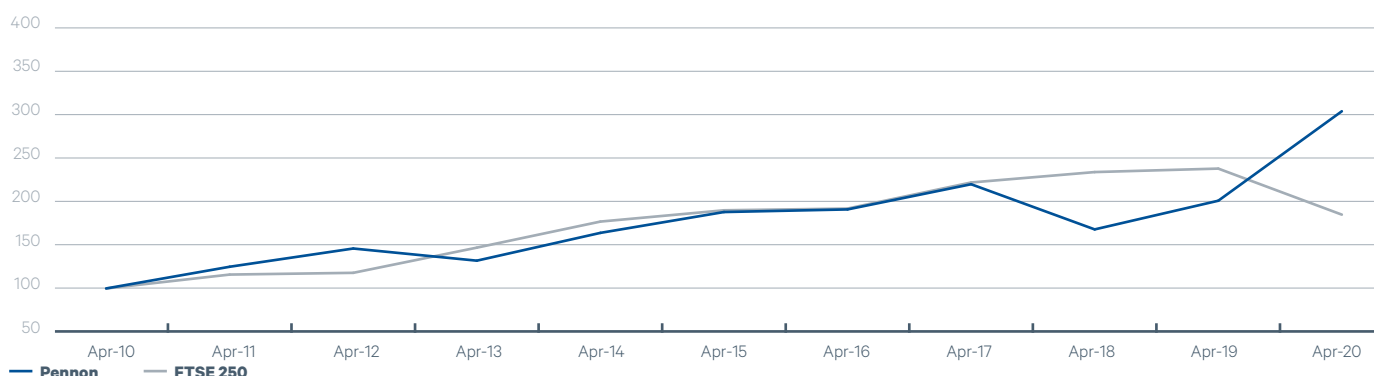
Executive Directors may accept one board appointment in another company. Board approval must be sought before accepting an appointment. Fees may be retained by the Director. Chris Loughlin was appointed as a non-executive director of Mears Group PLC on 17 August 2019 and Susan Davy continued as a non-executive director of Restore plc throughout 2019/20. No other outside company appointments are held by the Executive Directors other than with industry bodies or governmental or quasi-governmental agencies.

Additional contextual information

Historical TSR

The graph below shows the value, over the ten-year period ended on 31 March 2020, of £100 invested in Pennon Group on 1 April 2010 compared with the value of £100 invested in the FTSE 250 Index. The FTSE 250 index is a broad equity market index of which the Company was a constituent until the end of the period.

Total shareholder return – Since April 2010



Historical chief executive officer remuneration

As the Company did not have a Chief Executive Officer until 1 January 2016, the table below provides historical single figure information in the form of the average remuneration of the Executive Directors for years up to and including 2014/15. Their remuneration was considered to be the most appropriate to use as they were the most senior executives in the Company.

From 2015/16 onwards, the Chief Executive Officer's remuneration for the year is shown.

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16 ⁽ⁱ⁾	2016/17	2017/18	2018/19	2019/20
Average Executive Director single figure of remuneration (£000)	1,091	1,221	894	962	762	–	–	–	–	–
Chief Executive Officer single figure of remuneration (£000)	–	–	–	–	–	1,119	1,318	1,153	1,351	2,188
Annual bonus payout (% of maximum)	94.69	72.87	47.00	67.56	68.20	83.98	84.05	87.00	91.00	78.0
LTIP vesting (% of maximum)	50.00	79.30	50.00	30.20	0.00	37.90	20.40	0.00	32.00	86.6

(i) Group Chief Executive Officer for the year, including remuneration received between 1 April 2015 and 31 December 2015 when in position as Chief Executive of South West Water.

Comparison of Chief Executive Officer remuneration to employee remuneration

The table below shows the percentage change between 2018/19 and 2019/20 in base salary, benefits and annual bonus for the Chief Executive Officer, and all employees.

	Percentage change in salary	Percentage change in benefits	Percentage change in annual bonus
Chief Executive Officer remuneration	2.0%	8.8%	(12.5%)
All employees	4.6%	7.3%	11.6%

The percentage increase in average remuneration for employees is calculated using wages and salaries (excluding share-based payments) of £180.9 million (2018/19 £184.3 million), analysed into the three components in the table and the average number of employees of 4,853 (2018/19 5,239) both as detailed in note 13 to the Group financial statements.

Relative importance of spend on pay

	2019/20 (£ million)	2018/19 (£ million)	Percentage change
Overall expenditure on pay ⁽ⁱ⁾	205.3	205.8	(0.2)
Distributions to ordinary shareholders	172.6	162.0	6.5
Distributions to perpetual capital security holders	8.6	8.6	0.0
Purchase of property, plant and equipment (cash flow)	337.7	356.0	(5.1)

(i) Excludes non-underlying items.

The above table illustrates the relative importance of spend on pay compared with distributions to equity holders. The purchase of property, plant and equipment (cash flow) has also been included as this was the most significant outgoing for the Company in the past financial year.

Annual report on remuneration continued

Chief Executive Officer pay ratio

The table below discloses the ratio of the Chief Executive Officer's pay for 2019/20, using the single total figure of remuneration (as disclosed on page 107) to the comparable earnings of employees at the 25th, 50th & 75th percentiles.

Year	Method	25th percentile (P25) pay ratio	Median (P50) pay ratio	75th percentile pay ratio
2019/20	Option A	87:1	68:1	50:1

Option A has been used for the calculations as per the disclosure regulations. The employees at the lower quartile, median and upper quartile (P25, P50, and P75, respectively) have been determined based on a calculation of total remuneration for the financial year 1 April 2019 to 31 March 2020.

- Basic salary for part-time employees and new joiners within the applicable period have been converted to full-time equivalents for the purpose of the calculations
- Estimated values for employee P11D data have been used to establish the ordering of employees, given the timing of publication. This will be validated and amended in due course to account for any variances.

The total remuneration of 2019/20 for the employees identified at P25, P50 and P75 is £25,184, £32,221, and £43,388, respectively. The base salary of 2019/20 for the employees identified at P25, P50 and P75 is £22,737, £29,500, and £28,483, respectively. Employee identified at P75 has a higher component of variable pay (shift premiums and overtime) relative to other employees at a similar level.

The remuneration arrangements for senior executives, including the Chief Executive Officer, fluctuate year-on-year as a significant portion of the package is linked to performance-related incentive plans. This variation will impact the pay ratios reported in future years.

The reporting requirements required by the BEIS came into effect for the reporting of financial years starting on or after 1 January 2019. As a result this is the first year of reporting within the annual report.

Share awards and shareholding disclosures (audited information)

Share awards granted during 2019/20

The table below sets out details of share awards made in the year to Executive Directors.

Executive Director	Type of interest	Basis of award	Face value £000	Percentage vesting at threshold performance	Performance/restricted period end date
Chris Loughlin	LTIP	150% of salary	808	25% of maximum	3 July 2022
Susan Davy			618		
Chris Loughlin	Deferred bonus	50% of bonus awarded	240	n/a	23 July 2022
Susan Davy			185		

LTIP awards were calculated using the share price of £7.5272 being the average closing price over the five dealing days preceding the date of grant, which was 4 July 2019. LTIP awards are also subject to an additional two-year holding period. Deferred bonus awards were calculated using the average share price at which shares were purchased on the market on 23 July 2019 in order to satisfy the award, which was £7.555386.

Directors' shareholding and interest in shares

The Remuneration Committee believes that the interests of Executive Directors and senior management should be closely aligned with the interests of shareholders.

To support this the Committee operates shareholding guidelines of 200% of salary for both the Chief Executive Officer and Chief Financial Officer. In line with best practice guidelines, deferred bonuses and LTIP awards subject to a holding period only may count towards the guidelines on a net of tax basis. As noted on page 105, a new post-employment shareholding requirement will come into effect following the AGM.

The beneficial interests of the Executive Directors in the ordinary shares (40.7p each) of the Company as at 31 March 2020 and 31 March 2019 together with their shareholding guideline obligation and interest are shown in the table below:

	Share interests (including connected parties) at 31 March 2020	Share interests (including connected parties) at 31 March 2019	Vested LTIP awards in holding period ⁽¹⁾	Deferred bonus shares ⁽¹⁾	SAYE	Performance shares (subject to performance conditions)	Shareholding guideline	Shareholding guideline met?
Chris Loughlin	394,102	359,265	20,343	87,876	2,196	304,293	200%	Yes
Susan Davy	78,834	71,844	15,557	67,698	2,834	232,687	200%	Yes

(1) These share awards are not subject to further performance criteria and may therefore count towards the guideline on a net-of-tax basis.

Since 31 March 2020, 6,277 additional ordinary shares in the Company have been acquired by Chris Loughlin as a result of participation in the Company's Dividend Reinvestment Plan (DRIP) and the Company's Share Incentive Plan; and 68 additional ordinary shares in the Company have been acquired by Susan Davy as a result of participation in the Company's Share Incentive Plan. There have been no other changes in the beneficial interests or the non-beneficial interests of the above Directors in the ordinary shares of the Company between 1 April 2020 and 2 June 2020.

Non-Executive Directors' shareholding

The beneficial interests of the Non-Executive Directors, including the beneficial interests of their spouses, civil partners, children and stepchildren, in the ordinary shares (40.7p) of the Company are shown in the table below:

Director	Shares held at 31 March 2020	Shares held at 31 March 2019
Sir John Parker	27,027	27,027
Gill Rider	2,500	2,500
Neil Cooper	–	–
Iain Evans	–	–
Claire Ighodaro	–	–

There have been no changes in the beneficial interests or the non-beneficial interests of the above Directors in the ordinary shares of the Company between 1 April 2020 and 2 June 2020.

There is no formal shareholding guideline for the Non-Executive Directors; however, they are encouraged to purchase shares in the Company.

Shareholder dilution

The Company can satisfy awards under its share plans with new issue shares or shares issued from treasury up to a maximum of 10% of its issued share capital in a rolling 10-year period to employees under its share plans. Within this 10% limit the Company can only issue (as newly issued shares or from treasury) 5% of its issued share capital to satisfy awards under discretionary or executive plans. The percentage of shares awarded within these guidelines and the headroom remaining available as at 2 June 2020 is as set out below:

	Awarded	Headroom	Total
Discretionary schemes	1.50%	3.50%	5%
All schemes	3.73%	6.27%	10%

Details of share awards

(a) Long-term Incentive Plan

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

Director and date of award	Conditional awards held at 1 April 2019	Conditional awards made in year	Market price upon award in year	Vesting in year ⁽ⁱ⁾	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2020	Date of end of period for qualifying conditions to be fulfilled	Expected date of release ⁽ⁱⁱⁱ⁾
Chris Loughlin								
01/07/16	55,434	–	920.00p	20,343	151	20,343 ⁽ⁱⁱ⁾	30/06/19	30/06/21
25/08/17	96,733	–	802.70p	–	–	96,733	24/08/20	24/08/22
02/07/18	100,239	–	790.12p	–	–	100,239	01/07/21	01/07/23
04/07/19	–	107,321	752.72p	–	–	107,321	03/07/22	03/07/24
Susan Davy								
01/07/16	42,391	–	920.00p	15,557	115	15,557 ⁽ⁱⁱ⁾	30/06/19	30/06/21
25/08/17	73,972	–	802.70p	–	–	73,972	24/08/20	24/08/22
02/07/18	76,653	–	790.12p	–	–	76,653	01/07/21	01/07/23
04/07/19	–	82,062	752.72p	–	–	82,062	03/07/22	03/07/24

(i) 32% of the award shares granted on 1 July 2016 vested on 1 July 2019 at a market price of £741.2p per share. The total number of shares that vested included additional shares equivalent in value to such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on the vested shares during the three-year performance period. The balance of the award lapsed.

(ii) Vested award; no longer subject to performance conditions.

(iii) Awards granted from 2015 onwards are subject to a two-year holding period following vesting.

Annual report on remuneration continued

(b) Annual Incentive Bonus Plan – deferred bonus shares (long-term incentive element)

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

Director and date of award	Restricted awards held at 1 April 2019	Restricted awards made in year	Market price of each share upon award in year	Released in year	Value of shares upon release (before tax) £000	Restricted awards held at 31 March 2020	Date of end of restricted period
Chris Loughlin							
04/07/16	18,759	–	950.14p	18,759 ⁽ⁱ⁾	142	–	03/07/19
30/08/17	26,504	–	808.691p	–	–	26,504	29/08/20
25/07/18	29,575	–	761.36p	–	–	29,575	24/07/21
24/07/19	–	31,797	755.5386p	–	–	31,797	23/07/22
Susan Davy							
04/07/16	12,524	–	950.14p	12,524 ⁽ⁱ⁾	95	–	03/07/19
30/08/17	20,503	–	808.691p	–	–	20,503	29/08/20
25/07/18	22,746	–	761.36p	–	–	22,746	24/07/21
24/07/19	–	24,449	755.5386p	–	–	24,449	23/07/22

(i) These shares were released on 25 July 2019 at 758.0p per share.

During the year the Directors received dividends on the above shares in accordance with the conditions of the bonus plan as follows: Chris Loughlin £34,408*; Susan Davy £26,266.

* Chris Loughlin received his dividend in the form of ordinary shares (40.7p each) in the Company as a result of participation in the Company's DRIP. These shares are included in the figure given for the additional ordinary shares (40.7p each) in the Company that he acquired since 31 March 2019 given on page 112.

(c) Sharesave scheme

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

Date of award	Options held at 1 April 2019	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 2020	Options held at 31 March 2020	Exercise period/ maturity date
Chris Loughlin								
24/06/15	2,196	–	–	683.00p	–	1085.5p	2,196	01/09/20-28/02/21
Susan Davy								
03/07/18	2,834	–	–	635.00p	–	1085.5p	2,834	01/09/21-28/02/22

The Remuneration Committee and its advisers

Gill Rider, Neil Cooper and Iain Evans were members of the Remuneration Committee throughout the year.

During the year the Committee received advice or services which materially assisted the Committee in the consideration of remuneration matters from Sir John Parker (Chairman of the Board), Adele Barker (Group Director of Human Resources) and from Deloitte LLP.

During 2018/19, Deloitte LLP was reappointed directly by the Committee with a refreshed advisory team, following a comprehensive retendering process. Deloitte LLP's fees in respect of advice which materially assisted the Committee during 2019/20 were £103,950 (arrived at from an hourly rate basis of charging). During the year, Deloitte LLP also provided tax services to the Group. Deloitte LLP is a member of the Remuneration Consultants Group and as such voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. The Committee is satisfied that the advice it has received from Deloitte LLP has been objective and independent.

Statement of voting at general meeting

The table below sets out the voting by the Company's shareholders on the resolutions to approve the Directors' remuneration report at the 2019 AGM and the remuneration policy at the 2017 AGM, including votes for, against and withheld.

Annual report on remuneration (2019 AGM)	
For % (including votes at the Chairman's discretion)	99.31
Against %	0.69
Withheld number	1,236,442
Remuneration policy (2017 AGM)	
For % (including votes at the Chairman's discretion)	97.92
Against %	2.08
Withheld number	237,155

A vote withheld is not counted in the calculation of the proportion of votes for and against a resolution.

Directors' remuneration report compliance

This Directors' remuneration report has been prepared in accordance with the provisions of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. It also complies with the requirements of the Financial Conduct Authority's Listing Rules and the Disclosure and Transparency Rules. The UK Corporate Governance Code also sets out principles of good governance relating to directors' remuneration, and this report describes how these principles are applied in practice. The Committee confirms that throughout the financial year the Company has complied with these governance rules and best practice provisions. The above regulations also require the external auditor to report to shareholders on the audited information within the annual report on remuneration which is part of the Directors' remuneration report. The external auditor is obliged to state whether, in its opinion, the relevant sections have been prepared in accordance with the Companies Act 2006. The external auditor's opinion is set out on page 124 and the audited sections of the annual report on remuneration are identified in this report.

On behalf of the Board



Gill Rider

Chairman of the Remuneration Committee

3 June 2020

Directors' report – other statutory disclosures

Introduction

This Directors' report is prepared in accordance with the provisions of the Companies Act 2006 and regulations made thereunder. It comprises pages 72 to 93 and 116 to 120 as well as the following matters which the Board considers are of strategic importance and, as permitted by legislation, has chosen to include in the strategic report rather than the Directors' report:

- Particulars of important events affecting the Company and/or its subsidiaries which have occurred since the year end (page 10 of the strategic report)
- Likely future developments of the Company (pages 13 and 35 of the strategic report)
- Risk management systems (pages 58 to 60 of the strategic report)
- Certain employee and employee engagement matters (pages 38 to 41 of the strategic report and pages 72 and 73 of the governance statement), as well as the disclosures below
- Business relationships/engagement with suppliers, customers and others (pages 26 to 29 of the strategic report and pages 72 and 73 of the governance statement).

In addition, there are a number of disclosures which are included in the Directors' report by reference, including:

- Financial risk management (note 3 of the notes to the financial statements)
- Financial instruments (pages 50 to 57 of the strategic report and notes 2(o) and 18 of the notes to the financial statements).

Board of Directors

The Directors in office as at the date of this report are named on pages 76 and 77. No other Directors served during the year.

Financial results and dividend

The Directors recommend a final dividend of 30.11 pence per ordinary share to be paid on 2 September 2020 to shareholders on the register on 24 July 2020, making a total dividend for the year of 43.77 pence per share, the cost of which will be £184 million, resulting in a transfer to reserves of £16 million. The strategic report on pages 50 to 57 analyses the Group's financial results in more detail and sets out other financial information.

Directors' insurance and indemnities

The Directors have the benefit of the indemnity provisions contained in the Company's Articles of Association (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 that comply with the requirements of the Companies Act 2006 and which were in force throughout the year and remain in force.

Employment policies and employee involvement

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

The Group has policies in place covering health & safety, equal opportunities, diversity and inclusion, ethics and employee relations. Further detail of the contents of the diversity and inclusion policy are set out in the report of the Nomination Committee on page 91. Also, information regarding the diversity of the workforce is provided on pages 38 and 39.

Pennon respects the right to freedom of association and employees are consulted regularly about changes which may affect them either through their trade union-appointed representatives or consultation groups or by means of their elected representatives at the Employee Engagement Forum which operates in South West Water and the Employee Voice Forum which operates

in Viridor. These forums, together with regular meetings with particular groups of employees, are used to ensure that employees are kept up to date with the business performance of their employer and the financial and economic factors affecting the performance of the Group. The Group also cascades information monthly to all employees to provide them with important and up-to-date information about key events and to obtain feedback from them. Further details of workforce engagement and employment matters relating to the Group are set out on pages 38 to 41 of the strategic report.

The Group encourages share ownership among its employees by operating an HM Revenue & Customs approved Sharesave scheme and Share Incentive Plan. Following shareholder approval at the 2014 AGM, this scheme and plan were amended to provide for the increased savings limits approved by the Government. At 31 March 2020, around 36% (2019 38%) of the Group's employees were participating in these plans.

Modern Slavery Act

We have in place policies and procedures to assess, monitor and reduce the risk of forced labour and human trafficking occurring in our businesses and supply chains. Risk assessments of any high risk supply partners are completed to ensure compliance with the Modern Slavery Act across the Group and our anti-slavery and human trafficking web-based statement is available at www.pennon-group.co.uk.

Greenhouse gas emissions

Methodology and approach

Our approach follows the UK Government's Environmental Reporting Guidelines: including streamlined energy and carbon reporting guidance and the Greenhouse Gas Protocol Corporate Standard (collectively referred to here as the reporting guidelines). In calculating our emissions, we have used the 2019 UK Government conversion factors for greenhouse gas (GHG) reporting.

Organisational boundary

The emissions listed here cover the Pennon Group of companies, each of which uses the financial control approach, whereby the emissions are reported on the basis of the equity share held by the Pennon Group of companies in a company. This means that emissions from joint venture operations can be accurately attributed to the company in proportion to the percentage of Pennon Group of companies' holding.

Operational scopes

We report our Scope 1, 2 and 3 emissions where relevant and material.

Market and location-based methodology

The reporting guidelines allow for the reporting of both 'market-based' and 'location-based' Scope 2 emissions from imported energy. For some of our supply we contract with third party renewable energy suppliers and ensure this supply is backed by Renewable Energy Guarantees of Origin (REGOs) allowing the contracted green tariff supply to qualify as zero carbon market-based emissions. We have chosen to report our market-based emissions separately from the location-based supply and this is set out in our Group GHG emissions table opposite.

Self-generated renewable energy export

In accordance with the 2009 Defra Guidance, we may report an emissions reduction in our reported net CO₂e figure for any renewable electricity we have generated and exported to the national grid or a third party. In order to meet the good quality criteria set out in 2009 Guidance, especially concerning double counting and additionality, we have only reported REGO-backed supply which for which REGOs have been retired. Supply for which the associated REGOs have been sold to third parties have not been included.

Base year

For GHG reporting we compare the current financial year against the previous financial-year performance. As part of the Group climate change and carbon management strategy we will use a 2019/20 baseline for setting of carbon reduction targets.

Targets

As part of the climate change and carbon management strategy the Group is intending to set a science-based target in 2020. South West Water supports the UK water industry's commitment to achieve net zero carbon emissions by 2030. Carbon reduction opportunities and mechanisms are set out in Pennon's climate change and carbon management strategy.

Intensity measurement

We report an intensity measure of Scope 1 and 2 gross emissions in tCO₂e per £100,000 revenue.

External assurance statement

Our GHG data has been independently assured by DNV GL. Certain aspects that relate to the disclosure of emissions from South West Water have been subject to a separate and independent audit of regulatory data conducted by Jacobs. The assumptions, methods and procedures that are followed in the development of the reported data have been tested and the data audited for accuracy and consistency. DNV GL's statement can be found at www.pennon-group.co.uk/sustainability.

Pennon Group plc GHG emissions⁽¹⁾

	2019/20 (market based)	2019/20 (location based)	2018/19 (market based)	2018/19 (location based)
Scope 1 GHG emissions (tCO ₂ e) ⁽¹⁾	2,042,672	2,042,672	1,572,996	1,572,996
Scope 2 GHG emissions (tCO ₂ e)	83,535	96,846	100,472	101,661
Total gross Scope 1 & 2 GHG emissions (tCO₂e)	2,126,207	2,139,518	1,673,468	1,674,657
Scope 3 GHG emissions (estimated) ⁽²⁾	617,132	617,132	60,547	60,547
Total gross Scope 1, 2 & 3 GHG emissions (tCO₂e)	2,743,339	2,756,650	1,734,015	1,735,204
GHG emissions saved through purchases of REGO-backed renewable electricity import (tCO ₂ e)	~	(13,311)	~	(1,190)
GHG emissions saved by exporting self-generated electricity (tCO ₂ e)	(2,218)	(2,218)	(100,472)	(100,472)
Total annual net GHG emissions (tCO₂e)	2,741,121	2,741,121	1,633,543	1,633,543

Notes:

~ Included in market-based Scope 2 GHG emissions above.

(1) GHG emission figures expressed in tonnes of carbon dioxide equivalence (tCO₂e) whereby emissions of carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), the fluorinated gases (HFC, PFC, SF₆) are shown in terms of the equivalent emissions from CO₂. A breakdown of emissions by GHG is available at www.pennon-group.co.uk/sustainability/greenhouse-gas-emissions.

(2) 2019/20 data includes comprehensive estimate of Scope 3 GHG emissions for the first time.

Scope 1 (direct GHG emissions) GHG activities owned or controlled by our organisation that release emissions straight into the atmosphere. For Pennon, key Scope 1 GHG emission sources include combustion related emissions from ERFs, fugitive emissions from landfill, GHG emissions from stationary plant, fugitive emissions from air conditioning plant and transport related GHG emissions from our own vehicles and fleet.

Scope 2 (indirect GHG emissions) GHG emissions released into the atmosphere associated with our consumption of imported electricity.

Scope 3 (other GHG indirect emissions) GHG emissions that are a consequence of our actions, which occur at sources which we do not own or control. Further details of our 2019/20 Scope 3 GHG emissions estimate are provided below.

Other Group carbon and energy reporting

	2019/20 (market based)	2019/20 (location based)	2018/19 (market based)	2018/19 (location based)
Energy consumption used to calculate Scope 1 and 2 GHG emissions (MWh) (see energy usage section)	620,409	620,409	Not reported	Not reported
GHG emissions intensity measure: tCO ₂ e (gross Scope 1+2/£100,000 revenue) ⁽³⁾	152.8	153.8	113.2	113.3
Biogenic GHG emissions outside of Scopes (tCO ₂ e)	1,756,029	1,769,365	1,588,882	1,588,882

(3) Based on Group pro forma revenue for 2019/20.

Operational Pennon Group plc GHG emissions by business

	Waste (Viridor)	Water (South West Water and Bournemouth Water)	Group total*
Scope 1 GHG emissions	2,023,726	18,713	2,042,672
Scope 2 GHG emissions (market based)	16,941	66,568	83,535
Total gross Scope 1 & Scope 2 GHG emissions (tCO₂e)	2,040,667	85,281	2,126,207

Note:

The water business figure provided here includes the impact of emissions from our two hydroelectric power stations which do not form part of our annual reporting to the water regulator Ofwat since these sites are outside of the Ofwat regulated contract.

* Total includes 259 tCO₂e from Pennon Water Services and Group shared services.

Change in GHG emissions

Operational (Scope 1 and 2) GHG emissions for the Group increased by 27% from 2018/19. This was primarily due to the new energy recovery facilities (ERFs) coming online within our waste business. Overall, our waste business contributed around 96% of Group GHG emissions.

Measures to manage and reduce GHG emissions in order to achieve our science-based targets, as well as the context of the essential sanitary treatment of residual waste by ERFs and the out-of-scope carbon benefits of recycling, are set out in our climate change and carbon management strategy.

All Group companies benefited from a continued reduction in the UK's average electricity grid emissions conversion factor, which fell by 10% from 0.3072 to 0.2773 kgCO₂e/kWh⁽⁴⁾ over the reporting period. This resulted in a reduction in the Group's overall Scope 2 GHG emissions while the purchase of REGO-backed power has helped our water business to reduce its operational emissions (market based) by around 17%.

The intensity metric has increased from 113 to 153 tCO₂e/£100,000 turnover⁽³⁾. This reflects the increase in emissions from our waste business, as described above, alongside a reduced turnover compared with 2018/19.

Scope 3 GHG emissions

As part of our commitment to fuller GHG disclosure and to enable science-based target setting, the business undertook detailed analysis of our wider value chain activities in 2019 in order to estimate Scope 3 GHG emissions. Scope 3 categories were evaluated in line with the GHG Protocol Scope 3 Calculation Guidance. The assessment is based on the latest data available at the time of the assessment which, for most categories, was 2018/19 activity data. Where more recent 2019/20 data is available, this has been used.

With the inclusion of these additional emissions sources, our estimated Scope 3 footprint is 617,132 tCO₂e. As part of the climate change and carbon management strategy the Group is committed to better understanding our Scope 3 GHG emissions and investigating opportunities to reduce GHG emissions. This includes working with our suppliers to help them understand and manage their GHG emissions and implementing smarter travel/transport policies.

(4) Aggregation of Scope 2 and Scope 3 grid electricity conversion factors.

Directors' report – Other statutory disclosures

continued

Estimated Scope 3 GHG emissions breakdown (2018/19 activity data except where indicated* which use 2019/20 data)

Sources of Scope 3 GHG emissions	Evaluation status	Viridor	South West Water	Total
Category 1 – Purchased goods and services	Material, calculated	60,975	51,204	112,179
Category 2 – Capital goods	Material, calculated	30,699	70,478	101,177
Category 3 – Fuel- and energy-related (not Scope 1&2)*~	Not material, calculated	17,386^	19,834	37,235
Category 4 – Upstream transportation and distribution	Material, calculated	177,398	7,979	185,377
Category 5 – Waste generated in operations	Not material, calculated	9,400	9,102	18,502
Category 6 – Business travel*~	Not material, calculated	1,390^	334	1,817
Category 7 – Employee commuting~	Not material, calculated	Included in total	Included in total	4,095
Category 8 – Upstream leased assets	Relevant, not calculated**			
Category 9 – Downstream transportation and distribution	Material, calculated	133,314	–	133,314
Category 10 – Processing of sold products	Not relevant			
Category 11 – Use of sold products	Not relevant			
Category 12 – End of life treatment of sold products	Material, calculated	23,437	–	23,437
Category 13 – Downstream leased assets	Not relevant			
Category 14 – Franchises	Not relevant			
Category 15 – Investments	Not relevant			
Total estimate Scope 3 GHG emissions		453,999	158,931	617,133

Scope 3 emissions data notes:

^ Included in DNV GL 2019/20 Assurance.

* Figures updated based on 2019/20 activity data.

~ Totals include estimated impact for whole Group (i.e. including Pennon Water Services, Group shared services activity data). All other categories based on Viridor and South West Water impact only as rest of Group impact is considered immaterial (i.e. <1% of total Group total Scope 3 emissions).

Category 8 – Upstream leased assets. Based on the 2018/19 data assessed there were some landlord locations within the portfolio. At present some are included under Scope 1 and 2 and some are excluded due to lack of available data. This will be further evaluated and where possible included in future disclosures.

'Not relevant' – categories currently assessed as 'not relevant' in line with GHG Protocol Scope 3 Calculation Guidance. Further information on our Scope 3 emissions and explanation of the methodology can be found in our CDP climate change disclosure available on the CDP website.

Energy usage

Including self-supplied energy, our water business used 354GWh of energy in 2019/20, while our waste business used 379GWh. A breakdown of Group energy usage and associated data assessment methodologies is shown below. In 2018/19, the Group used a total of 709GWh of energy; details of this and previous years' data are provided at www.pennon-group.co.uk/sustainability/environmental-leadership.

	Water business (MWh)	Waste business (MWh)	Total Group* (MWh)	Methodology (South West Water/Bournemouth Water)	Methodology (Viridor)
Imported grid electricity^	307,813	66,278	374,191*	Verifiable metered data except some nHH supply~	Verifiable metered data
Imported private wire electricity (renewable)	4,734	–	4,734	Verified metered data	n/a
Self-supplied renewable electricity	11,873	89,946	101,819	Verified metered data	Estimated based on verifiable data
Self-supplied heat	6,946	–	6,946	Estimated that 60% of heat generated by sewage gas CHP is beneficially used, the rest (40%) is lost to atmosphere	n/a
Natural gas^	2,689	13,028	15,717	Verified metered data – from billing (some element of estimates)	Verified metered data
Liquid fuels (for stationary applications)^	5,014	114,481	119,495	Estimated based on verifiable data (i.e. fuel expenditure)	Estimated based on verifiable data
Energy used by fleet transport^	15,258	94,932	111,106*	Estimated based on verifiable data (i.e. fuel expenditure)	Estimated based on verifiable data
Total energy usage	354,327	378,664	734,008		
Intensity measure: MWh/£100,000 revenue			52.8		

Energy usage data notes:

No heat, steam or cooling was purchased by any Group company in 2019/20.

'Self-supplied renewable electricity' includes power from South West Water's two hydroelectric power stations.

^ Energy consumption used to calculate Scope 1 and 2 emissions.

* Includes small amount of electricity and transport related energy use for Pennon Water Services/Group shared services totalling an estimated 1GWh or around 0.1% of Group total.

~ Estimate used for non-half hourly electricity supply (c.7% of total imported electricity) based on supplier renewal quotation estimate.

Energy efficiency action taken

South West Water and Viridor are accredited to the ISO 50001 energy management system standard. A summary of improvement activities undertaken in 2019/20 is provided below.

South West Water

Pumping represents around 80% of South West Water's energy consumption and so we have continued to invest in energy efficiency projects under our pump efficiency programme, as well as funding energy efficiency projects under our powerdown programme.

Projects completed during the year include further investment in our advanced metering project to constantly monitor some of our largest energy using assets. These new monitors have helped identify where pumps were performing below their optimal efficiencies. Intervention has resulted in a cost saving of almost £0.5 million in avoided electricity usage across the business by identifying and refurbishing underperforming pumps to their 'as new' condition and by making fine adjustments to the parameters that automatically control the pumps.

Major project work was undertaken at Bolham raw water pumping station (£25,000 savings), Restormel water treatment works low-lift and high-lift pumps (£236,000 savings), Roadford raw water pumping station (£43,000 savings), Hayle sewage treatment works (£150,000 savings) and at Ilsham Valley sewage pumping station (£15,000 savings). Further work included the implementation of new variable speed drives to improve the control of pump motors at Pynes (Exeter) water treatment works, saving £10,000 in pumping water to Belvidere reservoir and £4,000 in pumping water to Parsonage reservoir in Exeter.

Viridor

The successful engagement and increased number of on-site energy champions at Viridor's highest energy consuming facilities allowed for strong progress in energy management across the business this year, with the implementation of a number of practical energy-saving projects.

Behaviour change projects such as operation 'out of the red rate' also resulted in benefits across key sites through organised shift changes and maintenance routines. The energy management team focused on effective communications to share energy learnings across the business. Scheduled ongoing training continues to onboard energy champions at as many sites as possible.

As part of the business-wide roll out of electrical submetering, Rochester plastics recycling facility has observed a 7.5% reduction in site energy consumption. Submeters have also been installed and live dashboards setup at Crayford, Ford, Salmon Pastures and St Helens. Further installations are planned at six sites in the coming year. The business is also moving forward with rooftop solar installations with 13 sites having passed the preliminary feasibility stage, with a planned portfolio expected to have a generation capacity of 1MW.

Research and development

Research and development within the Group involving water and wastewater treatment processes amounted to £0.1 million during the year (2018/19 £0.2 million).

Overseas branches

The Company has no overseas branches.

Pennon Group donations

During 2019/20, the Group provided a total of £65,000 in charitable donations (2018/19 £197,000).

No political donations were made or political expenditure incurred and no contributions were made to a non-EU political party (2018/19 nil).

Purchase of own ordinary shares

The Company has authority from shareholders to purchase up to 10% of its own ordinary shares (as renewed at the Annual General Meeting (AGM) in 2019), which was valid as at 31 March 2020 and remains currently valid. No purchases were made during the year and no shares were made subject to a lien or charge. As at 1 April 2019, 8,443 shares were held in treasury, with a nominal value of £3,436 and representing 0.002% of issued share capital. No treasury shares were reissued during the year.

Disclosures required by publicly traded companies

The following disclosures are made pursuant to Part 6 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and Rule 7.2.6.R of the UK Listing Authority's Disclosure Guidance and Transparency Rules (DTR).

As at 31 March 2020:

a) Details of the Company's issued share capital, which consists of ordinary shares of nominal value 40.7 pence each, are set out in note 33 to the financial statements on page 176. 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, copies of which can be obtained from Companies House in the UK or by writing to the Group Company Secretary at the Company's registered office;

- b) There are no restrictions on the transfer of issued shares of the Company or on the exercise of voting rights attached to them, except where the Company has exercised its right to suspend their voting rights or to prohibit their transfer following the omission of their holder or any person interested in them to provide the Company with information requested by it in accordance with Part 22 of the Companies Act 2006 or where their holder is precluded from exercising voting rights by the Financial Conduct Authority's Listing Rules or the City Code on Takeovers and Mergers. There are no persons with special rights regarding control of the Company. No shares issued under the employee share schemes have rights with regard to control of the Company that are not exercisable directly by the employees;
- c) Details of significant direct or indirect holdings of securities of the Company are set out in the shareholder analysis on page 198. The Company is not aware of any agreements between shareholders which may result in restrictions on the transfer of securities or on voting rights;
- d) The Company's rules about the appointment and replacement of Directors are contained in the Articles and accord with usual English company law provisions. The powers of Directors are determined by UK legislation and the Articles in force from time to time. Changes to the Articles must be approved by the Company's shareholders by passing a special resolution;
- e) The Directors have the power to make purchases of the Company's own shares in issue as set out above. The Directors also have the authority to allot shares up to an aggregate nominal value of:
- (i) £57,049,557 (such amount to be reduced by any shares allotted or rights granted under (ii) below in excess of £57,049,557); and
 - (ii) £114,099,113 by way of a rights issue (such amount to be reduced by any shares allotted or rights granted from (i) above), which was approved by shareholders at the 2019 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;

As resolved by shareholders at the 2019 AGM, the Directors have the authority to allot a single non-cumulative redeemable preference share of one penny nominal value (the WaterShare+ Share), the rights and restrictions in relation to which are set out in Article 5A of the Company's Articles of Association. The authority will expire at the 2021 AGM.

- f) There are a number of agreements that take effect, alter or terminate upon a change of control of the Company following a takeover bid, such as bank loan agreements, Eurobond documentation, hybrid capital securities documentation, private placement debt and employees' share plans. This may result in certain funding agreements being altered or repaid early. The impact on employees' share plans is not considered significant; and
- g) There are no agreements between the Company and its Directors or employees providing for compensation for loss of office or employment that occurs because of a takeover bid.

There is no information to be disclosed under Listing Rule (LR) 9.8.4R. The Company has no long-term incentive arrangements in place under LR 9.4.2R (2) where the only participant is a Director and the arrangement is established specifically to facilitate, in unusual circumstances, the recruitment or retention of the individual.

Going concern

At 31 March 2020 the Group has access to undrawn committed funds and cash and cash deposits totalling £1.6 billion (£1.4 billion after restricted cash). Having considered the Group's strong funding position, the potential use of proceeds from the proposed sale of Viridor and prudent financial projections, which take into account a range of possible impacts, as described in this report, from the COVID-19 pandemic, the Directors have a reasonable expectation that the Group has adequate resource to continue in operational existence for the period of at least 12 months from the date of the approval of the financial statements and that there are no material uncertainties to disclose. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Directors' report – Other statutory disclosures

continued

Board Committee overseeing the sale of Viridor

Immediately following the announcement in September 2019 of the Group's strategic review, the Board established a dedicated Board Committee to undertake the strategic review and report back to the Board with recommendations for the Group's future strategic focus, growth options and capital allocations policy.

Committee composition for the first stage of the strategic review, involving oversight of the Viridor transaction, was as follows:

- Sir John Parker (Chair of the Committee).
- Gill Rider
- Iain Evans
- Chris Loughlin
- Susan Davy
- Simon Pugsley (General Counsel and Secretary to the Committee)

Terms of reference were adopted to set and regulate the Committee's remit from the Board, covering matters which included scope of delegated authority, quorum, frequency of meetings, reporting responsibilities, record keeping and minutes, establishment of project teams and working groups, and appointment of external advisers.

The Committee met every two weeks throughout the initial period of the strategic review ending with a contract being executed for the sale of Viridor. The Committee's main remit during that period covered the management and coordination of the workstreams and outputs. Decisions on strategic focus and major items of expenditure and risk were reserved for the Board.

From the outset the Board indicated its commitment to ensuring and maintaining the highest level of corporate governance throughout the strategic review. The Committee's remit was therefore written around this requirement. Through the permanent attendance of the Group General Counsel at all its meetings, the Committee had assurance that there was appropriate oversight of all relevant legal and regulatory requirements. Financial assurance and integrity was supported through attendance at the Committee of the Pennon Director of Treasury, Tax and Group Finance. Retained financial and legal advisers provided continuous advice and guidance to the Committee, and where appropriate, to the Board. The project team working to the Committee likewise worked with the financial and legal advisers across all areas of activity. The Group's auditor, Ernst & Young were kept regularly informed of developments and of the state of play of the strategic review. Regular meetings of the Group's Disclosure Committee took place to ensure adherence with market disclosure rules throughout the process.

Throughout the review, robust assurance processes were implemented to ensure accurate and complete data and financial inputs, and detailed and objective verification procedures were established in order to substantiate the financial and technical data underpinning the review's outputs and conclusions.

Ultimately, the Committee recommended that the Board accept an offer from KKR for the acquisition of Viridor. The Committee and its advisers presented extensive findings and recommendations to the Board together with all information and assurance required by the Board to make a fully informed decision.

Following signature of the transaction, the Committee continued to operate in order to ensure that all relevant activities required to achieve completion of the transaction were appropriately concluded. These activities included the proper preparation, verification and submission of a Class 1 Shareholder Circular.

The wider Group strategic review continues and the Committee continues to operate.

Statement of Directors' responsibilities

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 (EU).

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 EU 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 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 76 and 77, confirms that, to the best of his or her knowledge:

- The financial statements, which have been prepared in accordance with IFRSs 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.
- The strategic report (pages 1 to 69 and 121) and the Directors' report, include a fair review of the development and performance of the business during the year and the position of the Company and the Group at the year end, together with a description of the principal risks and uncertainties they face.
- Following receipt of advice from the Audit Committee, the annual report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the shareholders to assess the Group's position and performance, business model and strategy.

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

Statement as to disclosure of information to the auditor

- So far as each of the Directors in office at the date of the signing of the report is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- Each of the Directors has taken all the steps each Director ought to have taken individually as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

The Directors' report consisting of pages 72 to 93 and 116 to 120 was approved by the Board on 3 June 2020.

By order of the Board



Simon A F Pugsley
Group General Counsel and Company Secretary

3 June 2020

Section 172 statement

Legislation is now in place requiring companies to report on how directors have discharged their duty to promote the success of the company, while having regard to the matters set out in section 172(1)(a) to (f) of the Companies Act 2006 (CA2006).

Each director is required to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so directors must have regard (among other matters) to:

- The likely long-term consequences of any decision
- The interests of the company's employees
- The need to foster the company's business relationships with suppliers, customers and others
- The impact of the company's operations on our communities and environment
- Maintenance of the company's reputation for the highest standards of business conduct
- The need to act fairly as between members of the company.

The Board welcomes the reporting requirement introduced by section 172, and sees it as an opportunity to explain how these considerations have informed and helped shape strategy and decision making.

Stakeholder engagement is embedded within the detailed corporate governance framework operated by the Board, and the long-term consequences of its strategic decision making are reviewed and assessed at each Board meeting, through its Committees, and through its oversight of decision making delegated to executive management. The Board takes its section 172 obligations very seriously, and applies section 172 in the context of its strategic direction of the Group at its meetings, including in the following specific ways:

Strategic priorities

At every Board meeting the Directors review progress against our strategic priorities with the executive management team.

Health, safety and environment

The Board and its Committees conduct regular reviews of safety matters and environmental performance, with the aim of continually improving safety and minimising environmental impact.

Financial discipline and shareholder returns

Board meetings review executive management's focus around fiscal discipline, and delivery of solid and stable earnings and shareholder returns.

People

The Board approaches all its decisions which may affect employees by reference to our corporate values of 'trusted, responsible, collaborative and progressive'. The Board has focused this year on fostering a leadership culture which stresses the importance of good mental health, diversity and inclusion.

Governance

Our governance requires consistently high standards of business conduct and the Board and the Audit Committee review all decisions in the light of this strategic priority. Strong cultural leadership and governance are seen by the Board as critical elements underpinning the continuing success of the Company.

Operational availability and reliability

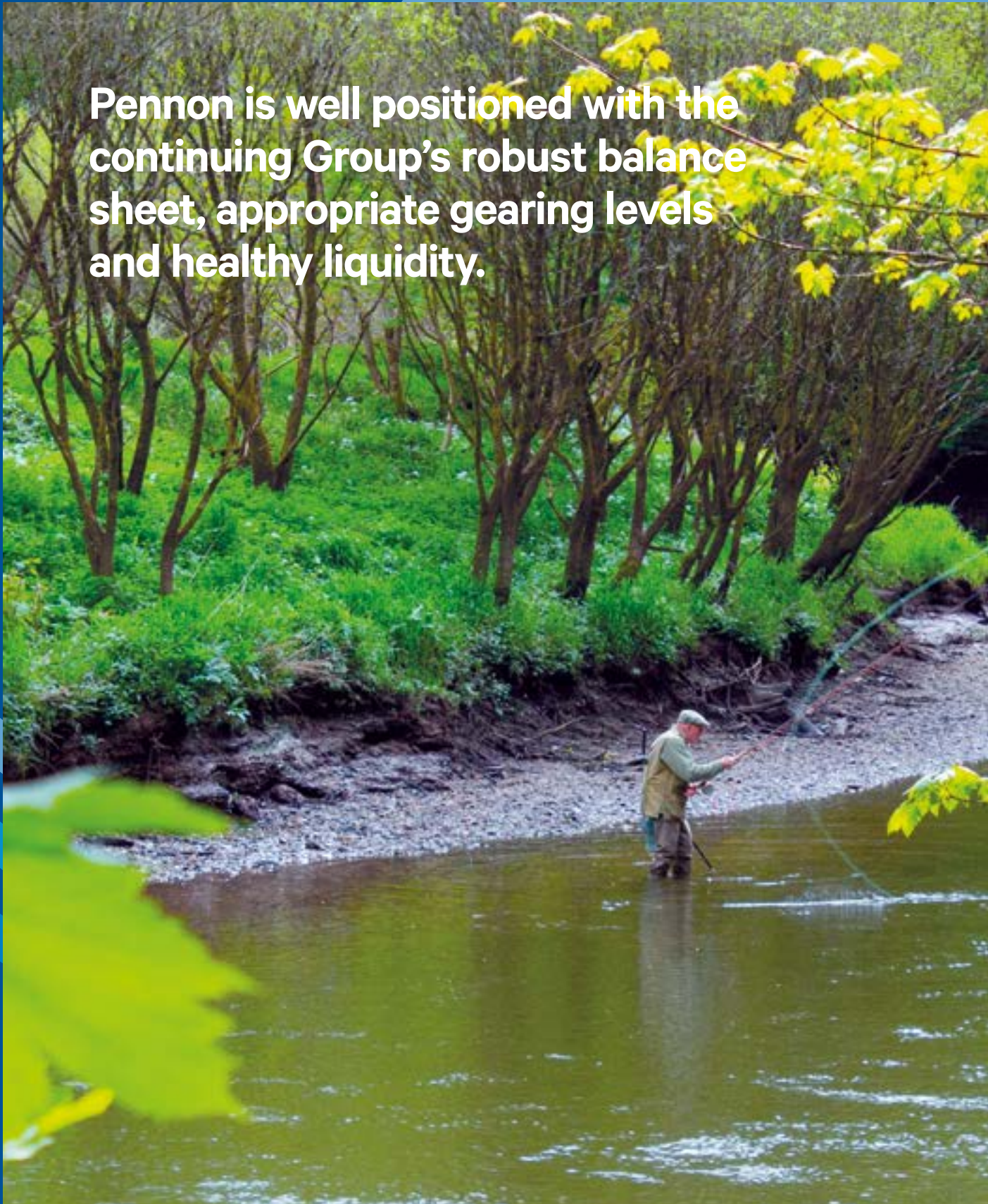
Executive management is charged by the Board with maintaining the strong operational resilience expected by our customers, suppliers and others, with reports on these areas provided to each Board meeting.

Ultimately Board decisions are taken in a way which further both the long-term financial success of the Group and the interests of our stakeholders.

The table below provides the context behind the Board's approach to decision making in view of its obligations under section 172 and to ensure wider stakeholder engagement, with cross references to where more information can be found in this Annual Report. Examples of how the section 172 factors influenced the significant decisions taken by the Board during the year are set out on page 73.

Matters considered by the Board	Further information
The likely consequences of any decision in the long term	Our strategic objectives, which are set and monitored through a rolling long-term strategic planning process, and delivered through our focus on customer service and satisfaction, employee training, development and wellbeing, our Sustainable Financing Framework and sustainable procurement policy, ensure we work towards achieving long-term growth in a sustainable way (see pages 17 to 19).
The interests of the Company's employees	We pride ourselves on being a responsible employer, focused on employee engagement and communication, promoting a diverse and inclusive workforce and the continued development of our people in a safe working environment (see pages 38 to 41).
The need to foster the company's business relationships with suppliers, customers and others	Continued commitment to delivering quality of service, value for money and satisfaction to our customers, with regular engagement through focus groups, workshops and surveys (see pages 26 and 69). We continue to foster key strategic and commercial relationships with our supply chain partners – with a focus on quality and sustainability-focused delivery across the entire supply chain (see page 28). Open dialogue and transparent engagement with our regulatory bodies, policy makers and other stakeholders who shape our social contract (see page 29).
The impact of the Company's operations on the community and the environment	Committed to providing educational programmes and community sponsorships and engaging in charity support initiatives and outreach events across our regions of operation (see pages 27, 40 and 47). Regular engagement and close relationships with our environmental stakeholders, partners and interest groups in the areas in which we operate (see page 28). Our Sustainable Financing Framework supports investment across our key activities, namely: pollution prevention and control; sustainable water and wastewater management; and climate change adaptation (see page 23).
The desirability of the company maintaining a reputation for high standards of business conduct	We ensure a transparent approach to conducting business in a responsible manner, with a focus on maintaining good governance. The codes of conduct and policies which apply across our group are regularly updated to ensure the highest of standards are adhered to (see pages 40 and 83).
The need to act fairly as between members of the company	Regular engagement with our shareholders to ensure that they are well informed of our business strategy and key developments (see page 29).

Pennon is well positioned with the continuing Group's robust balance sheet, appropriate gearing levels and healthy liquidity.





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Independent auditor's report to the members of Pennon Group plc

Opinion

In our opinion:

- Pennon Group plc's group financial statements and parent company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 March 2020 and of the Group's profit 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 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.

We have audited the financial statements of Pennon Group plc which comprise:

Group	Parent Company
Consolidated Balance sheet as at 31 March 2020	Balance sheet as at 31 March 2020
Consolidated income statement for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of comprehensive income for the year then ended	Cash flow statement for the year then ended
Consolidated statement of changes in equity for the year then ended	Related notes 1 to 47 to the financial statements, including a summary of significant accounting policies
Consolidated cash flow statement for the year then ended	
Related notes 1 to 47 to the financial statements, including a summary of significant accounting policies	

The financial reporting framework that has been applied in their preparation is applicable law and International 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.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to principal risks, going concern and viability statement

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs(UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 58 to 67 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 59 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 119 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements
- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 68 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	<ul style="list-style-type: none"> • Revenue recognition, specific to accrued income and IFRIC 12 revenue – Group • Valuation of landfill related provisions – Viridor • Valuation of the provision for doubtful debts – SWW • Valuation of the receivable related to the Interserve claim – Viridor
Audit scope	<ul style="list-style-type: none"> • We performed an audit of the complete financial information of three components and audit procedures on specific balances for one component. • The components where we performed full or specific audit procedures accounted for 100% of Profit before taxation before non-underlying items, 100% of Revenue and 95% of Total assets.
Materiality	<ul style="list-style-type: none"> • We set overall group materiality at £14.3 million, which represents 5% of the sum of the profit before taxation before non-underlying items and profit before taxation before non-underlying items from discontinued operations.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p>Revenue recognition, specific to accrued income and IFRIC 12 revenue – Group statutory (£636.7 million, PY comparative £632.6 million, discontinued £753.2 million, PY comparative £845.6 million)</p> <p>Risk direction</p>  <p>Refer to the Audit Committee Report (page 86); Accounting policies (pages 138 to 140); and Note 5 of the Consolidated Financial Statements (page 150)</p> <p>The Group's material revenue streams relate to the provision of water and sewerage services by South West Water and Pennon Water Services and revenue generated from the renewable energy, recycling and waste management services provided by Viridor. ISAs (UK) presume that there is a risk of fraud relating to revenue recognition. For the Group, given targets associated with financial performance and pressures to meet market expectations, there is an incentive to overstate revenue. This risk over revenue recognition specifically arises in the following judgemental areas, where there is opportunity to overstate revenue:</p> <p>South West Water and Pennon Water Services Group - statutory (£636.7 million, PY comparative £632.6 million)</p> <p>Income from measured water services requires an estimation of the amount of unbilled charges at the year end. This is calculated using a combination of system generated information, based on previous customer volume usage, together with management judgement as to the likely impact on usage of factors such as recent weather patterns. The accrued income balance at 31 March 2020 is £83.9 million (2019: £89.8 million) for South West Water and £26.3 million (2019: £28.9 million) for Pennon Water Services.</p> <p>Viridor – discontinued (£753.2 million, PY comparative £845.6 million)</p> <p>Calculations of accrued income on waste management contracts and powergen revenue to be received involve estimation by management. The accrued income balance at 31 March 2020 is £51.2 million (2019: £53.3 million).</p> <p>Accounting for revenue from long term service concession arrangements under IFRIC 12 requires revenue to be recognised on construction, during service delivery and as a capital return on the asset. The determination of the margin allocated during the different phases of each service concession involves management judgement. At 31 March 2020 the Group has recognised contract receivables of £202.4 million (2019: £188.3 million) and other intangible assets of £86.9 million (2019: £90.6 million), related to service concession arrangements (refer to Note 46).</p>	<p>Our procedures included:</p> <p>South West Water and Pennon Water Services</p> <ul style="list-style-type: none"> • We obtained an understanding of the process for the supply of measured services, meter reading and related billing in order to assess the completeness of the accrual for revenue at the year end; • We tested key controls linked to system generated information and around the estimation process for measured revenue; • We corroborated the key assumptions and estimates made by management in recognising revenue, by obtaining internal and external data on factors that influence demand from customers, such as weather patterns and leaks in infrastructure networks; • We performed analytical procedures by comparing revenue balances for the year against expectations and obtained support for significant variances; and • In performing our journal testing, we paid increased attention to entries impacting revenue, focusing on non-system postings and those raised in the last two weeks of the year. <p>Viridor</p> <ul style="list-style-type: none"> • We compared the key assumptions and estimates made by management in recognising accrued revenue in the current year to those applied in the prior year to identify significant changes; • We analysed revenue trends and evaluated unusual movements to assess the accuracy of the accrued income balance; • We obtained customer confirmations for a sample of revenue; • For material items, within accrued income, we reperformed the calculation of the income that had been earned on waste management contracts and powergen revenue to confirm the accuracy of the accrued income recorded by management; • We tested the application of the IFRIC 12 revenue recognised and assessed the allocation of consideration between the construction and operating services provided; • We considered whether the revenue recognition policies adopted comply with IFRS, in particular the requirements of IFRIC 12. Specifically, we considered whether the margins used to recognise revenue were appropriate, through testing that costs were allocated to the correct contracts and that revenue recognised, based on those costs, was reasonable and aligned with the individual contract models. We also compared the margins to those generated in prior years and to the latest projections for future years; and • In performing our journal testing, we paid increased attention to entries impacting revenue, particularly those raised close to the balance sheet date. <p>We performed full and specific scope audit procedures over this risk area for three components, which covered 100% of the risk amount.</p>	<p>South West Water and Pennon Water Services</p> <p>We concluded that the estimation process undertaken by management to calculate the measured income accrual reflected latest operational factors in the key assumptions that the income accrual was appropriately determined.</p> <p>Viridor</p> <p>We concluded that accrued income had been recognised appropriately in accordance with IFRS and Viridor's accounting policy, and that IFRIC 12 had been applied appropriately.</p>

Independent auditor's report to the members of Pennon Group plc

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Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p>Valuation of landfill related provisions – Viridor (£201.2 million, PY comparative £209.6 million)</p> <p>Risk direction</p>  <p><i>Refer to the Audit Committee Report (page 86); Accounting policies (page 144); and Notes 32 and 46 of the Consolidated Financial Statements (pages 175 and 190)</i></p> <p>Landfill related provisions of £201.2 million (2019: £209.6 million) are disclosed in Notes 32 and 46 and consist of aftercare, restoration and remediation provisions. Calculation of the aftercare provision involves significant judgement in respect of the expected period of aftercare, the level of costs to be incurred and the discount rates to be used.</p> <p>Key areas of estimation for the restoration provision include the expected restoration costs, the void space to be filled and timing of site closure.</p> <p>Judgement over the remedial action required to comply with current environmental legislation, where breaches have been identified, is a key estimate for the remediation provision.</p> <p>We focused on this area given there is a risk that provisions could be misstated due to the complexity of factors to be assessed and assumptions, such as discount rates, applied by management being inappropriate, including the impact of any management bias.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • We tested the aftercare, restoration and remediation provision models, and verified that the models were arithmetically and logically accurate; • We evaluated the forecast costs in the models, agreeing these to supporting evidence such as budgets and supplier cost quotations and current performance, including prices charged by contractors in the current year for significant sites; • We assessed the material estimates made for evidence of management bias, including agreeing anticipated cost savings to detailed plans and current performance; • We benchmarked the discount and inflation rates applied, using our internal valuation experts to assist in our consideration of whether management's assumptions are within an acceptable range based on comparative market data; • We compared the key assumptions used in the calculation of the provisions, including the discount rates, inflation rates, void space and remaining lives of the sites, to available market information; • We compared the key assumptions used in the current models to those used in the prior year, and sought evidence that changes were appropriate. This included obtaining evidence to support the impact of future planned technological changes; • We performed sensitivity analysis on these key assumptions; and • We tested the appropriateness of journal entries impacting landfill related provisions, particularly those raised close to the balance sheet date. <p>We performed full scope audit procedures over this risk area at Viridor, which covered 100% of the risk amount.</p>	<p>We concluded that management's real risk free rate of 2.175% applied to the most significant provision (aftercare) lies outside of an acceptable range (1.80% to 2.16%), but this has an immaterial effect on the provision balance.</p> <p>We concluded that the key assumptions supporting the landfill related provisions reflected management's reasonable best estimates, informed by latest external and internal data, and resulted in appropriately measured and recognised landfill-related provisions.</p>

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p>Valuation of the provision for doubtful debts – South West Water & Pennon Water Services (£105.5 million, PY comparative £95.5 million)</p> <p>Risk direction</p>  <p>Refer to the Audit Committee Report (page 86); Accounting policies (page 142); and included within the total Group balance per Note 22 of the Consolidated Financial Statements (page 164)</p> <p>Both the South West Water provision of £91.0 million (2019: £86.8 million) and Pennon Water Services provision of £14.5 million (2019: £8.7 million) are calculated using a combination of system generated information on historic debt recovery rates and management’s judgement of the future likely recovery rates.</p> <p>Within the current year the provisions were calculated using the normal methodology, and then a further assessment was made to reflect on the risks arising from the ability to collect in future as a result of the economic impact of the COVID-19 pandemic. This resulted in an additional provision of £2.8 million for South West Water and £5.0 million for Pennon Water Services (these amounts are included in the total figures noted above). There is a risk that the assumptions used by management in calculating the bad debt provision may be susceptible to management bias and the valuation of the provision against trade receivables may be misstated. We have therefore focused on this key audit matter.</p> <p>We have shown the risk direction as increasing, reflecting the issues arising from COVID-19 and have also expanded the risk to the PWS component, as the PWS customer base is non household and has been impacted to a greater extent by COVID-19.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • We performed a walkthrough of the process for calculating the bad debt provision and assessed the design effectiveness of relevant key controls; • We tested the operating effectiveness of the relevant key controls over the integrity of data and the report utilised to generate the ageing and categorisation of debt within South West Water’s and Pennon Water Services’s billing systems; • We tested historic data on collection rates and evaluated how this data was used in the preparation of the bad debt provision; • We validated the assumptions used by management in determining the amounts provided against the different categories and age of debt, by comparing these assumptions to historic collection rates and by considering the impact of changes in the methods adopted operationally by management to collect debt, and in the external environment; • For South West Water, we utilised collection information over the past three years, to determine a range of the likely ultimate collection of debts existing at the balance sheet date and compared this to the provision recorded by management, including assessing assumptions for evidence of management bias; • We tested management’s scenario analysis of the impact of COVID-19 on collection of trade receivables to supporting evidence. This included consideration of information on collections performance in previous recessions, the segmentation of customer base by employment group for household customers and business group for non household customers, together with information on actual collections since the balance sheet date; and • We tested the appropriateness of journal entries and adjustments impacting the doubtful debt provision, particularly those raised close to the balance sheet date. <p>We performed full scope audit procedures over this risk area at South West Water and Pennon Water Services, which covered 100% of the risk amount for these components components and covered 100% of the Group debtors balance shown in Note 22 which excludes receivables relating to Viridor which are shown in Note 46.</p>	<p>We have concluded that the South West Water doubtful debt provision of £91.0 million is within an acceptable range and reflects the recent history of collection of outstanding debts and considerations of the impact on future collections of the economic environment arising from COVID-19.</p> <p>We have also concluded that the Pennon Water Services’s provision, including the additional provision relating to COVID-19 of £5.0 million, is appropriate.</p>
<p>Valuation of the receivable related to the Interserve claim – Viridor</p> <p>Risk direction</p>  <p>Refer to the Audit Committee Report (page 86); Critical accounting judgements (page 149); and Note 46 of the Consolidated Financial Statements (page 190)</p> <p>Viridor contracted with Glasgow City Council to construct a Recycling and Renewable Energy Centre in Glasgow. Viridor terminated the contract with the original principal contractor in November 2016 and has overseen the remaining construction.</p> <p>Expenditure to complete construction is expected to exceed the original target and management has accounted for what it believes its contractual rights are. Contract claims as at 31 March 2020 amounted to £72.0 million (2019: £72.0 million). Management recognised a provision against the claims as at 31 March 2020 of £28.3 million (2019: £28.7 million), resulting in a net receivable of £43.7 million (2019: £43.3 million).</p> <p>We focused on this area given there is risk of challenge of the legal position taken and greater judgement involved in assessing the collectability of amounts recorded.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"> • We obtained an understanding of the key assumptions and estimates made by management in accounting for the claim, assessing whether there was evidence of management bias and concluding on whether we concurred with the accounting estimates made by management; • We obtained an update, from management and Group legal, to understand the latest position of the claim as at the year end date; • We inspected the contractual documentation and relevant clauses of the contract for evidence of the entitlement to receive financial compensation; • We inspected the external legal advice/opinion management had obtained in relation to contract positions, quantum of costs and amounts recoverable; • We inspected any available external data, market announcements, financial reports and correspondence between Viridor and Interserve, to assess the recoverability of amounts due from Interserve and whether the reserve recognised reflects an appropriate level of provision; • We inquired of management and assessed other evidence, including board minutes, to test the completeness of amounts recorded in relation to contract claims; and • We read the disclosures made by management in Note 4 ‘Critical accounting judgements and estimates’ in the Annual Report and Accounts, and evaluated the adequacy of these. <p>We performed full scope audit procedures over this risk area in one location, which covered 100% of the risk amount.</p>	<p>We have concluded that the accounting criteria for asset recognition have been met and that the position taken by management, including the recoverability of amounts due from Interserve, is appropriate and is based on supporting legal and financial analysis.</p> <p>We concluded that the disclosures in this key judgement, including the possible range of outcomes, in the Annual Report and Accounts are appropriate.</p>

The key audit matters for the current year are consistent with matters included in our prior year auditor’s report, with the exception of the extension of the provision for doubtful debts also to relate to PWS as well as SWW in light of COVID-19.

Independent auditor's report to the members of Pennon Group plc

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An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of group-wide controls, changes in the business environment and other factors such as recent Internal audit results when assessing the level of work to be performed at each entity.

In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements, of the six reporting components of the Group, we selected four components covering Pennon Group plc, Viridor, South West Water and Pennon Water Services, which represent the principal business units within the Group.

Of the four components selected, we performed an audit of the complete financial information of three components ("full scope components") which were selected based on their size or risk characteristics. For the remaining one component ("specific scope component"), we performed audit procedures on specific accounts within that component that we considered had the potential for the greatest impact on the significant accounts in the financial statements either because of the size of these accounts or their risk profile.

The reporting components where we performed audit procedures accounted for 100% (2019: 100%) of the Group's Profit before taxation before non-underlying items from both continuing and discontinued operations, 100% (2019: 100%) of the Group's Revenue from continuing and discontinued operations and 95% (2019: 95%) of the Group's Total assets. For the current year, the full scope components contributed 100% (2019: 100%) of the Group's Profit before taxation before non-underlying items from both continuing and discontinued operations, 87% (2019: 88%) of the Group's Revenue from continuing and discontinued operations and 95% (2019: 95%) of the Group's Total assets. The specific scope component contributed 0.4% (2019: -0.6%) of the Group's Profit before taxation before non-underlying items, 13% (2019: 12%) of the Group's Revenue from continuing and discontinued operations and 1% (2019: 1%) of the Group's Total assets. The audit scope of these components may not have included testing of all significant accounts of the component but will have contributed to the coverage of significant accounts tested for the Group.

Of the remaining two components that together represent less than 1% of the Group's profit before taxation before non-underlying items from continuing operations, none is individually greater than 1% of the Group's profit before taxation before non-underlying items from continuing operations. For these components, we performed other procedures, including analytical review procedures, testing of consolidation journals and intercompany eliminations to respond to any potential risks of material misstatement to the Group financial statements.

Involvement with component teams

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken at each of the components by us, as the primary audit engagement team, or by component auditors operating under our instruction. There are three key locations where we perform audit procedures for the Group and its components, being Exeter, Taunton and Bournemouth. The Pennon Group plc and South West Water accounting functions are based in Exeter and the audit teams of these components are led by the Senior Statutory Auditor. Separate teams audit the full scope component, Viridor, in Taunton, and the specific scope component, Pennon Water Services, based in Exeter and Bournemouth. Where the work was performed by component auditors, we determined the appropriate level of involvement to enable us to determine that sufficient audit evidence had been obtained as a basis for our opinion on the Group as a whole.

The primary team interacted regularly with the component teams where appropriate during various stages of the audit, reviewed key audit working papers on risk areas, attended key meetings with local management and were responsible for the scope and direction of the audit process. We maintained continuous and open dialogue with all component audit teams in addition to holding formal meetings to ensure that we were fully aware of their progress and results of their procedures. The Senior Statutory Auditor discussed the planned audit approach with the component teams and any issues arising from their work, attended meetings with local management, attending closing meetings and reviewing key audit working papers on risk areas. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

Subsequent to the development of COVID-19 pandemic, we revisited our risk assessment and planning to re-assess the risks in this context and held a planning session with Group and component teams. The primary team continued to interact regularly with the component teams during the post year end procedures.

The Senior Statutory Auditor continued to discuss the audit approach with the component teams and any issues arising from their work, attended meetings with local management, attended closing meetings and reviewed key audit working papers on risk areas. All of the above interactions were held remotely using audio-visual technology.

For all components, year-end review of relevant audit work papers was facilitated by the EY's electronic audit file platform, screen sharing or the provision of copies of work papers direct to the Group audit team.

Based upon the above approach we are satisfied that we have been able to perform sufficient and appropriate oversight of our component teams.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined overall materiality for the Group to be £14.4 million (2019: £13.4 million), which is 5% (2019: 5%) of the sum of profit before taxation before non-underlying items and profit before taxation before non-underlying items from discontinued operations. We believe that profit before taxation before non-underlying items provides us with an appropriate measure of the underlying performance of the Group. We excluded non-underlying items on the basis that profit before taxation after non-underlying items is not indicative of the underlying performance of the Group. We also note that market and analyst commentary on the performance of the Group uses the same measure. We therefore considered profit before taxation before non-underlying items to be the most relevant performance metric on which to base our materiality calculation.

We determined overall materiality for the Parent Company to be £21.4 million (2019: £19.3 million), which is 1% of Equity. For balances relevant to the Group financial statements we have performed our procedures to a materiality to be in-line with the Group materiality.

Starting basis

Reported profit before taxation
£193.1 million (2019: £260.3 million)



Adjustments

- Profit before taxation on discontinued operations (Refer to Note 46) – £108.4 million (2019: £58.9 million)
- Non-underlying items (Refer to Note 6 decrease basis by £13.9 million (2019: £19.9 million increase))

Materiality

Totals £287.6 million (2019: £280.2 million)
profit before taxation before
non-underlying items.

Materiality of £14.4 million (5% of
profit before taxation before
non-underlying items)

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2019: 75%) of our planning materiality, namely £10.8 million (2019: £10.5 million). We have set performance materiality at this percentage based on our assessment of the Group's internal control environment and the extent and nature of audit findings identified in the prior period. This basis is consistent with the prior year.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £3.7 million to £8.1 million (2019: £3.2 million to £9.5 million).

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.7 million (2019: £0.7 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Impact of the COVID-19 pandemic

As a result of the ongoing COVID-19 pandemic, we have revisited our procedures in respect of the Directors' going concern assessment, taking into account the nature of the Group, its business model and related risks. We evaluated the Directors' assessment of the Group's ability to continue as a going concern, including the consistency of the cash flow forecasts, the key assumptions within the scenarios modelled and the available sources of liquidity with the findings from other areas of the audit. We assessed both the impact of additional sensitivities and the availability of mitigating future actions on the going concern assessment. We have also reviewed the disclosures contained within the Annual Report and consolidated financial statements in relation to this issue and consider them to describe adequately the impact of COVID-19 on the Group as at 31 March 2020.

The COVID-19 outbreak and lockdown restrictions occurred late in the Group's financial year and, as such, any audit procedures dependent on physical verification had either been completed, with the exception of stockcounts, and were subject to roll forward procedures or alternative procedures were performed. For stockcounts at the Viridor component, we performed virtual stockcounts. Subsequent to the travel restrictions being put in place, our post year end procedures for the Group and its components were completed remotely. We completed these procedures holding regular discussions with management to discuss the evidence, judgements and accounting. Where evidence comprised reports from systems, we utilised secure software collaboration facilities with management to observe the configuration used and repeat the extraction of reports from systems.

Other information

The other information comprises the information included in the annual report set out on pages 1 to 123, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Independent auditor's report to the members of Pennon Group plc

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In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- **Fair, balanced and understandable set out on page 120** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit Committee reporting set out on pages 84 to 87** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code set out on page 73** – the parts of the directors' statement required under the Listing Rules relating to the company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements and those reports have been prepared in accordance with applicable legal requirements;
- the information about internal control and risk management systems in relation to financial reporting processes and about share capital structures, given in compliance with rules 7.2.5 and 7.2.6 in the Disclosure Rules and Transparency Rules sourcebook made by the Financial Conduct Authority (the FCA Rules), is consistent with the financial statements and has been prepared in accordance with applicable legal requirements; and
- information about the company's corporate governance code and practices and about its administrative, management and supervisory bodies and their committees complies with rules 7.2.2, 7.2.3 and 7.2.7 of the FCA Rules.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Group and the Parent Company and its environment obtained in the course of the audit, we have not identified material misstatements in:

- the strategic report or the directors' report; or
- the information about internal control and risk management systems in relation to financial reporting processes and about share capital structures, given in compliance with rules 7.2.5 and 7.2.6 of the FCA Rules

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

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

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 120, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the group and determined that the most significant are:
 - Companies Act 2006
 - Financial Reporting Council (FRC) and the UK Corporate Governance Code
 - Tax legislation (governed by HM Revenue & Customs)
 - Health and Safety legislation
 - Environment Agency environmental permits
 - Ofwat regulations
 - UK listing rules
- We understood how Pennon Group plc is complying with those frameworks by reading internal policies and codes of conduct and assessing the entity level control environment, including the level of oversight of those charged with governance. We made enquiries of the Group's legal counsel, regulatory team and internal audit of known instances of non-compliance or suspected non-compliance with laws and regulations. We corroborated our enquiries through review of correspondence with regulatory bodies. We designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraph above. As well as enquiry and attendance at meetings, our procedures involved a review of the reporting to the above committees and a review of board meetings and other committee minutes to identify any non-compliance with laws and regulations. Our procedures also involved journal entry testing, with a focus on journals meeting our defined risk criteria based on our understanding of the business.
- We assessed the susceptibility of the Group's financial statements to material misstatement, including how fraud might occur by making enquiries of senior management, including the Chief Executive Officer, Chief Financial Officer, Head of Internal Audit and Audit Committee Chairman. We planned our audit to identify risks of management override, tested higher risk journal entries and performed audit procedures to address the potential for management bias, particularly over areas involving significant estimation and judgement. Further discussion of our approach to address the identified risks of management override are set out in the key audit matters section of our report.

- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved making enquiries of key management and legal counsel, reviewing key policies, inspecting legal registers and correspondence with regulators and reading key management meeting minutes. We also completed procedures to conclude on the compliance of significant disclosures in the Annual Report and Accounts with the requirements of the relevant accounting standards, UK legislation and the UK Corporate Governance Code.
- We communicated regularly with the component teams and attended key meetings with the component teams, management and legal counsel in order to identify and communicate any instances of non-compliance with laws and regulations.
- The Group operates in the water and waste sectors, which are highly regulated environments. As such the Senior Statutory Auditor reviewed the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of an expert where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

Other matters we are required to address

- We were appointed by the company at its annual general meeting on 31 July 2014 to audit the financial statements for the year ending 31 March 2015 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 6 years, covering the years ended 31 March 2015 to 31 March 2020.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the Parent Company and we remain independent of the group and the Parent Company in conducting the audit.
- Our audit opinion is consistent with our additional report to the Audit Committee explaining the results of our audit.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Christabel Cowling (Senior statutory auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor
Leeds

3 June 2020

Notes:

1. The maintenance and integrity of the Pennon Group plc web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement

For the year ended 31 March 2020

	Notes	Statutory 2020 £m	Discontinued operations (note 46) 2020 £m	Pro forma Total ⁽²⁾ 2020 £m	Statutory 2019 (restated ⁽¹⁾) £m	Discontinued operations (note 46) 2019 (restated ⁽¹⁾) £m	Pro forma Total 2019 ⁽²⁾ £m
Revenue	5	636.7	753.2	1,389.9	632.6	845.6	1,478.2
Operating costs	7						
Employment costs		(70.0)	(130.4)	(200.4)	(67.2)	(138.6)	(205.8)
Raw materials and consumables used		(14.9)	(87.2)	(102.1)	(15.0)	(94.3)	(109.3)
Other operating expenses		(186.5)	(337.5)	(524.0)	(183.1)	(433.8)	(616.9)
Underlying earnings before interest, tax, depreciation and amortisation	5	365.3	198.1	563.4	367.3	178.9	546.2
Operating non-underlying items	6	(7.9)	3.8	(4.1)	3.9	(29.6)	(25.7)
Depreciation and amortisation	7	(119.8)	(82.1)	(201.9)	(117.2)	(78.0)	(195.2)
Operating profit		237.6	119.8	357.4	254.0	71.3	325.3
Finance income	8	4.1	22.5	26.6	3.5	20.0	23.5
Finance costs: Underlying	8	(66.6)	(48.7)	(115.3)	(61.9)	(44.8)	(106.7)
Finance costs: Non-underlying	6	18.0	–	18.0	5.8	–	5.8
Finance costs		(48.6)	(48.7)	(97.3)	(56.1)	(44.8)	(100.9)
Net finance costs	8	(44.5)	(26.2)	(70.7)	(52.6)	(24.8)	(77.4)
Share of post-tax profit from joint ventures	20	–	14.8	14.8	–	12.4	12.4
Underlying profit before tax		183.0	104.6	287.6	191.7	88.5	280.2
Non-underlying operating and finance costs		10.1	3.8	13.9	9.7	(29.6)	(19.9)
Profit before tax	5	193.1	108.4	301.5	201.4	58.9	260.3
Taxation charge	9	(70.6)	(24.6)	(95.2)	(32.8)	(4.9)	(37.7)
			83.8	206.3		54.0	222.6
Profit from continuing operations		122.5			168.6		
Profit from discontinued operations	46	83.8			54.0		
Profit for the year		206.3			222.6		
Attributable to:							
Ordinary shareholders of the parent		200.4			214.3		
Non-controlling interests		(1.1)			(0.3)		
Perpetual capital security holders		7.0			8.6		
Earnings per ordinary share (pence per share)	11						
From continuing operations							
– Basic		27.7			38.2		
– Diluted		27.6			38.1		
From continuing and discontinued operations							
– Basic		47.7			51.1		
– Diluted		47.5			50.9		

(1) The prior year income statement has been restated to reflect the impact of classifying our waste management activities provided by Viridor as a discontinued operation (see note 46).

(2) Pro forma results represent non-GAAP measures presented to provide sufficient detail to enable certain users of the financial statements to assess the combined results of the continuing and discontinued operations of the Group during the current and prior financial years.

Consolidated statement of comprehensive income

For the year ended 31 March 2020

	Notes	2020 £m	2019 £m
Profit for the year		206.3	222.6
Other comprehensive income/(loss)			
<i>Items that will not be reclassified to profit or loss</i>			
Remeasurement of defined benefit obligations	30	17.7	(17.2)
Income tax on items that will not be reclassified	9, 31	0.1	3.2
Total items that will not be reclassified to profit or loss		17.8	(14.0)
<i>Items that may be reclassified subsequently to profit or loss</i>			
Share of other comprehensive income from joint ventures	20	0.2	0.5
Cash flow hedges		(14.3)	(6.4)
Income tax on items that may be reclassified	9, 31	3.1	0.6
Total items that may be reclassified subsequently to profit or loss		(11.0)	(5.3)
Other comprehensive income/(loss) for the year net of tax	36	6.8	(19.3)
Total comprehensive income for the year		213.1	203.3
Total comprehensive income attributable to:			
Ordinary shareholders of the parent		207.2	195.0
Non-controlling interests		(1.1)	(0.3)
Perpetual capital security holders		7.0	8.6

The notes on pages 138 to 190 form part of these financial statements.

Balance sheets

At 31 March 2020

	Notes	Group		Company	
		2020 £m	2019 £m	2020 £m	2019 £m
Assets					
Non-current assets					
Goodwill	15	42.3	385.0	–	–
Other intangible assets	16	1.2	921	–	–
Property, plant and equipment	17	3,171.8	4,509.4	0.2	0.3
Other non-current assets	19	–	256.4	1,223.5	1,044.6
Deferred tax assets	31	–	–	1.8	1.2
Derivative financial instruments	23	4.1	70.5	4.1	3.7
Investments in subsidiary undertakings	20	–	–	845.2	1,980.8
Investments in joint ventures	20	–	51.1	–	–
Retirement benefit obligations	30	6.6	–	–	–
		3,226.0	5,364.5	2,074.8	3,030.6
Current assets					
Inventories	21	4.9	28.8	–	–
Trade and other receivables	22	185.8	484.8	24.7	21.6
Current tax receivable	27	1.9	–	–	–
Derivative financial instruments	23	2.7	11.8	2.5	2.8
Cash and cash deposits	25	665.9	569.6	367.9	284.8
		861.2	1,095.0	395.1	309.2
Assets held for sale	46	2,675.3	–	1,135.6	–
		3,536.5	1,095.0	1,530.7	309.2
Liabilities					
Current liabilities					
Borrowings	28	(59.9)	(150.4)	(290.5)	(335.7)
Financial liabilities at fair value through profit	24	(1.5)	(3.8)	(0.5)	(0.4)
Derivative financial instruments	23	(7.1)	(11.1)	(0.9)	(0.2)
Trade and other payables	26	(115.3)	(298.0)	(19.8)	(15.8)
Current tax liabilities	27	–	(19.1)	(2.5)	(3.6)
Provisions	32	(0.6)	(28.7)	–	–
		(184.4)	(511.1)	(314.2)	(355.7)
Liabilities directly associated with assets classified as held for sale	46	(756.3)	–	–	–
Net current assets/(liabilities)		2,595.8	583.9	1,216.5	(46.5)
Non-current liabilities					
Borrowings	28	(3,654.9)	(3,498.7)	(1,135.4)	(989.7)
Other non-current liabilities	29	(122.9)	(147.9)	(8.6)	(8.6)
Financial liabilities at fair value through profit	24	(43.1)	(43.1)	(1.1)	(1.4)
Derivative financial instruments	23	(27.2)	(9.9)	(2.8)	(0.7)
Retirement benefit obligations	30	–	(60.8)	(0.1)	(3.4)
Deferred tax liabilities	31	(261.6)	(305.1)	–	–
Provisions	32	–	(203.1)	–	–
		(4,109.7)	(4,268.6)	(1,148.0)	(1,003.8)
Net assets		1,712.1	1,679.8	2,143.3	1,980.3
Shareholders' equity					
Share capital	33	171.3	171.1	171.3	171.1
Share premium account	34	227.0	223.6	227.0	223.6
Capital redemption reserve	35	144.2	144.2	144.2	144.2
Retained earnings and other reserves	36	872.8	843.0	1,304.1	1,144.7
Total shareholders' equity		1,415.3	1,381.9	1,846.6	1,683.6
Non-controlling interests		0.1	12	–	–
Perpetual capital securities	37	296.7	296.7	296.7	296.7
Total equity		1,712.1	1,679.8	2,143.3	1,980.3

The profit for the year attributable to ordinary shareholders' equity dealt with in the accounts of the Parent Company is £330.6 million (2019 £194.8 million).

The notes on pages 138 to 190 form part of these financial statements.

The financial statements on pages 132 to 190 were approved by the Board of Directors and authorised for issue on 3 June 2020 and were signed on its behalf by:

Chris Loughlin, Chief Executive Officer Pennon Group plc

Registered Office: Peninsula House, Rydon Lane, Exeter, Devon, England EX2 7HR. Registered in England Number 2366640.

Statements of changes in equity

For the year ended 31 March 2020

	Share capital (note 33) £m	Share premium account (note 34) £m	Capital redemption reserve (note 35) £m	Retained earnings and other reserves (note 36) £m	Non-controlling interests £m	Perpetual capital securities (note 37) £m	Total equity £m
Group							
At 1 April 2018	170.8	218.8	144.2	807.1	1.5	296.7	1,639.1
Profit for the year	–	–	–	214.3	(0.3)	8.6	222.6
Other comprehensive loss for the year	–	–	–	(19.3)	–	–	(19.3)
Total comprehensive income for the year	–	–	–	195.0	(0.3)	8.6	203.3
<i>Transactions with equity shareholders:</i>							
Dividends paid	–	–	–	(162.0)	–	–	(162.0)
Adjustment in respect of share-based payments (net of tax)	–	–	–	4.4	–	–	4.4
Distributions to perpetual capital security holders	–	–	–	–	–	(8.6)	(8.6)
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	–	–	–	(1.5)	–	–	(1.5)
Proceeds from shares issued under the Sharesave Scheme	0.3	4.8	–	–	–	–	5.1
Total transactions with equity shareholders	0.3	4.8	–	(159.1)	–	(8.6)	(162.6)
At 31 March 2019	171.1	223.6	144.2	843.0	1.2	296.7	1,679.8
Opening adjustment on adoption of IFRS 16	–	–	–	(8.0)	–	–	(8.0)
At 1 April 2019 (adjusted for IFRS 16)	171.1	223.6	144.2	835.0	1.2	296.7	1,671.8
Profit for the year	–	–	–	200.4	(1.1)	7.0	206.3
Other comprehensive income for the year	–	–	–	6.8	–	–	6.8
Total comprehensive income for the year	–	–	–	207.2	(1.1)	7.0	213.1
<i>Transactions with equity shareholders:</i>							
Dividends paid	–	–	–	(172.6)	–	–	(172.6)
Adjustment in respect of share-based payments (net of tax)	–	–	–	4.8	–	–	4.8
Distributions to perpetual capital security holders	–	–	–	–	–	(8.6)	(8.6)
Current tax relief on distribution to perpetual capital security holders	–	–	–	–	–	1.6	1.6
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	–	–	–	(1.6)	–	–	(1.6)
Proceeds from shares issued under the Sharesave Scheme	0.2	3.4	–	–	–	–	3.6
Total transactions with equity shareholders	0.2	3.4	–	(169.4)	–	(7.0)	(172.8)
At 31 March 2020	171.3	227.0	144.2	872.8	0.1	296.7	1,712.1

The notes on pages 138 to 190 form part of these financial statements.

Statements of changes in equity

For the year ended 31 March 2020

continued

	Share capital (note 33) £m	Share premium account (note 34) £m	Capital redemption reserve (note 35) £m	Retained earnings and other reserves (note 36) £m	Perpetual capital securities (note 37) £m	Total equity £m
Company						
At 1 April 2018	170.8	218.8	144.2	1,111.1	296.7	1,941.6
Profit for the year (note 10)	-	-	-	194.8	8.6	203.4
Other comprehensive income for the year	-	-	-	0.2	-	0.2
Total comprehensive income for the year	-	-	-	195.0	8.6	203.6
<i>Transactions with equity shareholders:</i>						
Dividends paid	-	-	-	(162.0)	-	(162.0)
Distributions to perpetual capital security holders	-	-	-	-	(8.6)	(8.6)
Adjustment in respect of share-based payments (net of tax)	-	-	-	1.5	-	1.5
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	-	-	-	(0.9)	-	(0.9)
Proceeds from shares issued under the Sharesave Scheme	0.3	4.8	-	-	-	5.1
Total transactions with equity shareholders	0.3	4.8	-	(161.4)	(8.6)	(164.9)
At 31 March 2019	171.1	223.6	144.2	1,144.7	296.7	1,980.3
Profit for the year (note 10)	-	-	-	330.6	7.0	337.6
Other comprehensive income for the year	-	-	-	0.5	-	0.5
Total comprehensive income for the year	-	-	-	331.1	7.0	338.1
<i>Transactions with equity shareholders:</i>						
Dividends paid	-	-	-	(172.6)	-	(172.6)
Distributions to perpetual capital security holders	-	-	-	-	(8.6)	(8.6)
Current tax relief on distribution to perpetual capital security holders	-	-	-	-	1.6	1.6
Adjustment in respect of share-based payments (net of tax)	-	-	-	2.0	-	2.0
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	-	-	-	(1.1)	-	(1.1)
Proceeds from shares issued under the Sharesave Scheme	0.2	3.4	-	-	-	3.6
Total transactions with equity shareholders	0.2	3.4	-	(171.7)	(7.0)	(175.1)
At 31 March 2020	171.3	227.0	144.2	1,304.1	296.7	2,143.3

The notes on pages 138 to 190 form part of these financial statements.

Cash flow statements

For the year ended 31 March 2020

	Notes	Group		Company	
		2020 £m	2019 £m	2020 £m	2019 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	38	516.3	399.8	(180.3)	(223.0)
Interest paid	38	(97.7)	(83.9)	(37.4)	(36.8)
Tax paid		(52.6)	(29.2)	(3.7)	(22.1)
Net cash generated/(outflow) from operating activities		366.0	286.7	(221.4)	(281.9)
Cash flows from investing activities					
Interest received		3.4	10.3	45.1	44.5
Dividends received	44	6.0	5.5	335.6	196.7
Investment in joint venture		–	(54.8)	–	–
Loan repayments received from joint ventures		13.4	0.5	–	–
Deposit of restricted deposits		(23.3)	(21.6)	–	–
Purchase of property, plant and equipment		(332.8)	(356.0)	–	–
Purchase of intangible assets		(0.6)	–	–	–
Proceeds from sale of property, plant and equipment		10.6	6.3	–	–
Net cash (used in)/received from investing activities		(323.3)	(409.8)	380.7	241.2
Cash flows from financing activities					
Proceeds from issuance of ordinary shares		3.6	5.1	3.5	5.1
Proceeds from derivatives early settlement		87.2	–	–	–
Purchase of ordinary shares by the Pennon Employee Share Trust		(1.6)	(1.5)	–	–
Proceeds from new borrowing		268.2	384.5	151.7	334.5
Repayment of borrowings		(84.8)	(181.6)	(51.8)	(149.6)
Cash inflows from lease financing arrangements		115.0	74.9	–	–
Lease principal repayments (2019 Finance lease principal repayments)		(142.8)	(27.8)	–	–
Dividends paid		(172.6)	(162.0)	(172.6)	(162.0)
Perpetual capital securities periodic return	37	(8.6)	(5.8)	(7.0)	(5.8)
Net cash received from/(used in) financing activities		63.6	85.8	(76.2)	22.2
Net increase/(decrease) in cash and cash equivalents					
Cash and cash equivalents at beginning of the year	25	365.7	403.0	284.8	303.3
Cash and cash equivalents at end of the year	25	472.0	365.7	367.9	284.8

The cash flow statement above includes the entire Group, including cash flows relating to the Viridor business. Disaggregated information relating to the Viridor business is provided in note 46. The notes on pages 138 to 190 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 199. Through the year, Pennon Group's business has been operated through two main subsidiaries. South West Water Limited includes the integrated water businesses of South West Water and Bournemouth Water, providing water and wastewater services in Devon, Cornwall and parts of Dorset and Somerset and water only services in parts of Dorset, Hampshire and Wiltshire. Viridor Limited is a recycling and residual waste processing and transformation business. Pennon Group is also the majority shareholder of Pennon Water Services Limited, a company providing water and wastewater retail services to non-household customer accounts across Great Britain. On 18 March 2020 Pennon agreed to sell Viridor Limited for £3.7 billion, subject to a number of conditions. The sale is expected to complete in early summer 2020 (see note 46).

2. Principal accounting policies

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

(a) Basis of preparation

These financial statements have been prepared on the historical cost accounting basis (except for fair value items, principally acquisitions, transfers of assets from customers and certain financial instruments as described in accounting policy notes (b), (v) and (n) respectively) and in accordance with International 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. At 31 March 2020 the Group has access to undrawn committed funds and cash and cash deposits totalling £1.6 billion (£1.4 billion after restricted cash). Having considered the Group's strong funding position, the potential use of proceeds from the proposed sale of Viridor and prudent financial projections, which take into account a range of possible impacts, as described in this report, from the COVID-19 pandemic, the Directors have a reasonable expectation that the Group has adequate resource to continue in operational existence for the period of at least 12 months from the date of the approval of the financial statements and that there are no material uncertainties to disclose. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Other than the adoption of IFRS 16, which is explained in note 45, new standards or interpretations which were mandatory for the first time in the year beginning 1 April 2019 did not have a material impact on the net assets or results of the Group.

New standards or interpretations due to be adopted from 1 April 2020 are not expected to have a material impact on the Group's net assets or results. Existing borrowing covenants are not impacted by changes in accounting standards.

(b) Basis of consolidation

The Group financial statements include the results of Pennon Group plc and its subsidiaries and joint ventures.

The results of subsidiaries and joint ventures are included from the date of acquisition or incorporation, and excluded from the date of disposal. The results of subsidiaries are consolidated where the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The results of joint ventures are accounted for on an equity basis.

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

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

Assets held for sale and discontinued operations

In accordance with IFRS 5 'Non-current assets held for sale and discontinued operations', non-current assets and disposal groups are classified as held for sale only if available for immediate sale in their present condition and a sale is highly probable and expected to be completed within one year from the date of classification. Such assets are measured at the lower of carrying amount and fair value, less the costs of disposal, and are not depreciated or amortised. Accordingly the net results of the waste management segment (Viridor Group) are presented within discontinued operations in the Group income statement (for which the comparatives have been restated) and the assets and liabilities of these operations are presented separately in the Group Balance Sheet. Further information is provided in note 46.

(c) Revenue recognition

Group revenue is recognised following delivery of performance obligations and an assessment of when control over the product or service is transferred to the customer. Revenue is only recognised when collection of consideration is highly probable.

Revenue is recognised either when the performance obligation in the contract has been performed (point in time recognition) or 'over time' as the performance obligations to the customer are satisfied. For each obligation satisfied over time, the Group applies a revenue recognition method that accurately reflects performance in transferring control of the services to the customer.

Where a contract with a customer includes more than one performance obligation, revenue is allocated to each obligation in proportion to a fair value assessment of the total contract sales value split across the services provided.

At the inception of a contract the total transaction price is estimated, being the fair value to which the Group expects to be entitled under the contract, including any variable consideration. Variable consideration is based on the most likely outcome of the performance obligations.

Revenue excludes value added tax, trade discounts and revenue arising from transactions between Group companies.

2. Principal accounting policies continued

Water (domestic and non-household retail)

For most of the services provided to domestic customers, contract terms are implied through statute and regulation in the absence of formal, written contracts. South West Water has a duty under legislation to provide domestic customers with services regardless of payment and is not permitted to disconnect domestic customers for non-payment of bills. Charges are set via the periodic review price-setting process, regulated by Ofwat.

In respect of ongoing, continuous services to customers, such as the provision of drinking water and wastewater services, revenue is recognised over time in line with customer usage of those services.

Customers with an unmeasured supply are billed at the start of the year for the full amount of the annual charge but typically take advantage of a choice of payment arrangements to pay by regular instalments.

Customers with a metered supply are sent up to four bills per year, based either on actual meter readings or estimated usage. For these customers, revenue includes an estimation of the amount of unbilled usage at the period end. Payment options for domestic customers include an annual meter payment plan where customers agree to pay a fixed amount per month which is adjusted to reflect actual consumption at the end of the year.

A range of regulated services is offered to property developers and owners who require connection to the water and sewerage networks or need the networks to be extended or altered. Typically, these customers pay an estimate of the charges in advance as a deposit, which is treated as a contract liability and are billed or refunded the difference between the estimate and actual costs on completion of the work.

Where the performance obligation relates solely to a connection to the network, revenue is recognised at the point of connection when the customer is deemed to obtain control.

Where assets are constructed or provided by the Group or assets transferred to the Group, it is considered that there is an explicit or implied performance obligation to provide an ongoing water and/or wastewater service, with the result that revenue is recognised over a time no longer than the economic life of assets provided by or transferred to the Group.

Pennon Water Services provides specialist retail water and wastewater services to business customers. It raises bills and recognises revenue in accordance with its contracts with customers and in line with the limits established for the non-household periodic price-setting process where applicable.

Energy sales

The Group receives revenue from the sale of electricity from generating assets. These assets include solar, anaerobic digestion, gas from landfill and energy recovery facilities (ERFs). Revenue from the sale of electricity from the Group's generating assets is measured based upon metered output delivered at rates specified under contract terms or prevailing market rates. Revenue is recognised at a 'point in time', being the point of distribution. Typically, invoices are raised monthly with standard payment terms.

Waste management services

In respect of single services with fixed fees, such as the receipt of gate and collection fees, revenue is recognised at the time the service is provided.

The Group also delivers other waste management services for which revenue is recognised 'over time' in accordance with contracts with customers. The nature of contracts and/or performance obligations includes management fees to operate local authority recycling centres and ERFs, multi service contracts including collections and gate fees.

Revenue from other services can be fixed (i.e. management fees) or variable (i.e. gate fees).

Gate fee revenue, derived from the Group's operational assets, is recognised as customer waste is deposited and is based on tonnage received.

In respect of waste collection services, revenue is recognised at the point of collection from customer premises.

In respect of its landfill business, revenue is set to cover total costs, including landfill tax (LFT), and to achieve a desired profit margin. Viridor, as the operator, has a direct obligation to pay LFT, which represents a significant waste disposal cost of production for the business.

A majority of waste management customers are invoiced monthly for services provided within the monthly billing period. Payments are typically due on an end of month following invoice basis. Alternative billing and/or payment terms are agreed in exceptional circumstances.

The Group transfers control of such waste management services prior to invoicing. Receipt of payment following invoice is based solely on the passage of time. A trade receivable is recognised until payment is made and/or refund issued.

Where the Group has entered into service concession arrangements it accounts for these contracts in accordance with IFRIC 12. Consideration is treated as contract assets or other intangible assets, depending upon the right to receive cash from the asset. Consideration is split between construction of assets, operation of the service and provision of finance recognised as interest receivable.

Revenue in respect of construction services is recognised over time and is based on the fair value of work performed, with reference to the total sales value and the stage of completion of those services, as this best reflects the manner in which control passes to the customer. While construction is in progress the consideration is disclosed as a contract asset within non-current financial assets. On entry into operational service, in accordance with IFRIC 12, the contract asset is reclassified as either costs recoverable from construction activities disclosed within other intangible assets when the concession grantor has not provided a contractual guarantee in respect of the recoverable amount regardless of the service use by customers, and/or within other non-current financial assets when the concession grantor contractually guarantees the payment of amounts determined in the contract or the shortfall, if any, between amounts received from users of the public service and amounts specified or determined in the contract. No payments are received during construction.

In respect of operating services, revenue is recognised over time in line with delivery of operational services in accordance with the contract with the local authority.

Once the operational phase commences the Group has a right to receive consideration for the construction and operational services delivered. Invoicing typically occurs monthly and payments are due by the end of the month following date of invoice.

Notes to the financial statements

continued

2. Principal accounting policies continued

Recyclate

The Group transforms waste into recyclate ready for resale. Revenue is measured at the agreed transaction price per tonne of recyclate under the contract with the customer. Revenue recognition occurs when control over the recyclate assets has been transferred to the customer.

In respect of UK sales, the Group's performance obligation is satisfied at the point of collection by the customer. This is the point in time when an invoice is issued and revenue is recognised. Payment terms are typically end of month following invoice date. Overseas sales are predominantly agreed under a letter of credit. Goods are despatched at the point the letter of credit is accepted by the customer's bank. Payment is released when the customer confirms satisfactory receipt of the recyclate. This is the point legal title (i.e. control) passes to the customer and revenue is recognised.

Contract assets and liabilities

A trade receivable is recognised when the Group has an unconditional right to receive consideration in exchange for performance obligations already fulfilled. A contract asset is recognised when the Group has fulfilled some of its performance obligations but has not yet obtained an unconditional right to receive consideration, such as in the construction phase of a service concession agreement, as described above. The amounts for contract assets are disclosed within note 19 (Other non-current assets) and note 22 (Trade and other receivables) as appropriate. A contract liability is recognised when consideration is received in advance of the Group performing its performance obligations to customers, including, when appropriate, transfers of assets from customers (per paragraph (v) below). The value of contract liabilities is disclosed within note 26 (Trade and other payables) and note 29 (Other non-current liabilities) as appropriate.

(d) Segmental reporting

Each of the Group's business segments provides services which are subject to risks and returns which are different from those of the other business segments. The Group's internal organisation and management structure and its system of internal financial reporting are based primarily on business segments. Following the formal agreement to sell Viridor, which represents the waste management business segment, the comparative period segmental information has been restated to remove the waste management business from the continuing operations segmental reporting. The Waste management business was a significant segment of the Group throughout the financial year ended 31 March 2020 as such the results of the waste business have been included in the segmental disclosure as a discontinued operation. Further Information relating to income, expenses, cash flows and net assets of Viridor's waste management business is provided in note 46.

The remaining business segments of the Continuing Group include the water business, comprising the regulated water and wastewater services undertaken by South West Water, and the non-household retail business, comprising the services provided by Pennon Water Services in the non-household water and wastewater retail market which, while regulated, is open to competition. Other segments, including Pennon Group plc, are not reportable segments as they are not reported to Chief Decision makers. Segmental revenue and results include transactions between businesses. Inter-segmental transactions are eliminated on consolidation.

(e) Goodwill

Goodwill arising on consolidation from the acquisition of subsidiary undertakings represents the excess of the purchase consideration over the fair value of net assets acquired, less any subsequent impairment charges.

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

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

(f) Other intangible assets

Other intangible assets are recognised in relation to long-term service concessions contracts to the extent that future amounts to be received are not contracted.

Other intangible assets include assets acquired in a business combination and 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 lives, with the expense charged to the income statement through operating costs.

(g) Property, plant and equipment

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

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

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

Dams and impounding reservoirs	200 years
Water mains	40 – 120 years
Sewers	40 – 120 years

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

2. Principal accounting policies continued

ii) Landfill sites

Landfill sites are included within land and buildings at cost less accumulated depreciation. Cost includes acquisition and development expenses. The cost of a landfill site is depreciated to its residual value 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 ERFs, property, overground plant and equipment)

Other assets are included at cost less accumulated depreciation.

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

Land and buildings – freehold buildings	30 – 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
ERFs (including major refurbishments)	25 – 40 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).

The assets' residual values and useful lives are reviewed annually.

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

(h) Leased assets

All are accounted for by recognising a right-of-use asset and a lease liability except for:

- Low value assets; and
- Leases with a duration of 12 months or less.

Contracts previously classified as 'operating leases' under IAS 17 are measured at the present value of contractual payments due to the lessor over the lease term, with the discount rate determined by reference to the rate inherent in the lease unless this is not readily determinable, in which case the Group's incremental borrowing rate on commencement of the lease is used. After initial measurement, lease payments are allocated between the liability and finance cost. The finance cost is charged to profit and loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The interest element of cash payments in respect of these leases is included within interest payments in determining net cash generated from operating activities. The capital element of the cash payment is included within cash flows from financing activities. Right-of-use assets are amortised on a straight-line basis over the remaining term of the lease or the remaining economic life of the asset if shorter. When the Group revisits its estimate of lease term (because, for example, it reassesses an extension option), it adjusts the carrying amount of the lease liability to reflect the payments to make over the revised term, which is discounted at the same discount rate that applied on lease commencement. In these circumstances an equivalent adjustment is made to the carrying value of the right-of-use asset, with the revised carrying amount being amortised over the remaining (revised) lease term.

Measurement and recognition of assets and liabilities previously accounted for as 'finance leases' under IAS 17 continue to apply following the adoption of IFRS 16. Assets continue to be included as property, plant and equipment as right-of-use assets at the lower of their fair value at commencement or the present value of the minimum lease payments, and are depreciated over their estimated economic lives or the finance lease period, whichever is the shorter. The corresponding liability is recorded as borrowings. The interest element of the rental costs is charged against profits using the actuarial method over the period of the lease.

The Group regularly uses sale and lease back transactions to finance its capital programme. A sale and leaseback transaction is where the Group sells an asset and immediately reacquires the use of the asset by entering into a lease with the buyer. Each transaction is assessed as to whether it meets the criteria within IFRS 15 'Revenue from contracts with customers' for a sale to have occurred. As a result, a lease liability is recognised, the associated property, plant and equipment asset is derecognised, and a right-of-use asset is recognised at the proportion of the carrying value relating to the right retained. Any gain or loss arising relates to the rights transferred to the buyer.

The impact of the adoption of IFRS 16 'Leases' on 1 April 2020 is set out in note 45.

IFRS 16 policy applied from 1 April 2020

The impact of the adoption of IFRS 16 'Leases' on 1 April 2020 is discussed in paragraph (a) above and note 45.

Notes to the financial statements

continued

2. Principal accounting policies continued

(i) Impairment of non-financial assets

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

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

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

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

Where a previously impaired asset or CGU's recoverable amount is in excess of its carrying amount, previous impairments are reversed to the carrying value that would have expected to be recognised had the original impairment not occurred.

(j) Investment in subsidiary undertakings

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

(k) Investment in joint ventures

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

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

(l) Inventories

Inventories are stated at the lower of cost and net realisable value. The cost of finished goods and work in progress includes raw materials and the cost of bringing stocks to their present location and condition. It excludes borrowing costs. Net realisable value is the estimated selling price less cost to sell. The costs of items of inventory are determined using weighted average costs.

(m) Cash and cash deposits

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

(n) Financial instruments

Financial instruments are recognised and measured in accordance with IFRS 9. The Group classifies its financial instruments in the following categories:

i) Debt instruments at amortised cost

All loans and borrowings are initially recognised at fair value, net of transaction costs incurred. Following initial recognition, interest-bearing loans and borrowings are subsequently stated at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when instruments are derecognised or impaired. Premia, discounts and other costs and fees are recognised in the income statement through amortisation.

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

ii) Trade receivables

Trade receivables do not carry any interest receivable and are recognised initially at fair value and subsequently at amortised cost using the effective interest method, less provision for expected credit losses (ECLs). In accordance with the terms and conditions of IFRS 9, since 1 April 2019, each Group entity performs an impairment analysis at each reporting date to measure the ECLs. Each entity does not track changes in credit risk but instead recognises a loss allowance based on lifetime ECLs at each reporting date. Each subsidiary has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the receivables and the economic environment.

2. Principal accounting policies continued

iii) Trade payables

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

iv) Financial assets arising from service concession arrangements

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.

v) Derivative financial instruments and hedging activities

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

The Group designates certain hedging derivatives as either:

- A hedge of a highly probable forecast transaction or change in the cash flows of a recognised asset or liability (a cash flow hedge); or
- A hedge of the exposure to change in the fair value of a recognised asset or liability (a fair value hedge).

The gain or loss on remeasurement is recognised in the income statement except for cash flow hedges which meet the conditions for hedge accounting, when the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised directly in equity, and the ineffective portion in the income statement. The gains or losses deferred in equity in this way are subsequently recognised in the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

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

The full fair value of a hedging derivative is apportioned on a straight-line basis between non-current and current assets and liabilities based on the remaining maturity of the hedging derivative.

Derivative financial instruments deemed held for trading, which are not subject to hedge accounting, are classified as a current asset or liability with any change in fair value recognised immediately in the income statement.

The Group uses cross-currency swaps for some of its foreign currency denominated private placement borrowings. The swaps either have the effect of (i) converting variable rate foreign currency borrowings into fixed rate sterling borrowings, (ii) converting fixed rate foreign currency borrowings into fixed rate sterling borrowings, or (iii) converting fixed rate foreign currency borrowings into floating rate sterling borrowings.

In January 2020, the IASB's interest rate benchmark reform amendments IFRS 7 'Financial Instrument (FI) disclosures' and to IFRS 9 'FI recognition and measurement' were endorsed by the EU. The amendments modify hedge accounting requirements to allow hedge accounting to continue for affected hedges during the period of uncertainty before the hedged items or hedging instruments are affected when current interest rate benchmarks are amended due to the ongoing interest rate benchmark reforms.

The amendments are relevant to the Group given that it applies hedge accounting to its benchmark interest rate exposures.

The application of the amendments impacts the Group's accounting policies in the following ways:

The Group has floating rate debt, linked to the UK's benchmark rate GBP London Inter-Bank Offered Rate (GBP LIBOR), which it fixes through cash flow hedges using interest rate swaps. The amendments permit continuation of hedge accounting even though there is uncertainty about the timing and amount of the hedged cash flows due to the interest rate benchmark reforms.

The Group uses cross-currency interest rate swaps to hedge the foreign currency risk, where applicable, within its financial instruments. The amendments permit continuation of hedge accounting even though there is uncertainty about the replacement of the floating interest rates included in its cross-currency interest rate swaps.

The Group will retain the cumulative gain or loss in the hedging reserve for designated cash flow hedges that are subject to interest rate benchmark reforms even though there is uncertainty arising from the reform with respect to the timing and amount of the cash flows of the hedged items. If the hedged future cash flows are no longer expected to occur due to reasons other than interest rate benchmark reform, the cumulative gain or loss will be immediately reclassified to profit or loss.

The Group has chosen to early adopt the amendments to IFRS 7 and IFRS 9 for the reporting period ended 31 March 2020, which are mandatory for annual reporting periods commencing after 1 January 2020.

vi) Financial instruments at fair value through profit

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

vii) Receivables due from subsidiary undertakings

Amounts owed by subsidiaries are classified and recorded at amortised cost and reduced by allowances for ECLs. Estimated future credit losses are first recorded on initial recognition of a receivable and are based on estimated probability of default. Individual balances are written off when management deems them not to be collectible.

Notes to the financial statements

continued

2. Principal accounting policies continued

(o) Taxation including deferred tax

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

Current tax is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date. Management periodically evaluates tax items subject to interpretation and establishes provisions on individual tax items, where in the judgement of management, the position is uncertain. The Group includes a number of companies, including the parent company, which are part of a tax group for certain aspects of the tax legislation. One of these aspects relates to group relief whereby current tax liabilities can be offset by current tax losses arising in other companies within the same tax group. Payments for group relief are included within the current tax disclosures.

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

(p) Provisions

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

The Group's policies on specific provisions are:

i) Landfill restoration costs

Provisions for the cost of restoring landfill sites are made when the obligation arises. Where the obligation recognised as a provision is an integral part of a landfill site's future economic benefit, 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) Underperforming contracts

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

(q) Share capital and treasury shares

Ordinary shares are classified as equity.

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

The Group balance sheet includes the shares held by the Pennon Group plc Employee Benefit Trust, relating to employee share-based payments, which have not vested at the balance sheet date. These are shown as a deduction from shareholders' equity until such time as they vest. The Trust, which is registered in the United Kingdom, was formed on 18 December 2019 to supersede the Pennon Employee Share Trust which was registered in Guernsey.

(r) Dividend distributions

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

(s) Employee benefits

i) Retirement benefit obligations

The Group operates defined benefit and defined contribution pension schemes.

Defined benefit pension schemes

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the year less the fair value of plan assets. If the value of a plan's assets exceeds the present value of its obligations, the resulting surplus is only recognised if the Group has an unconditional right to that surplus.

The defined benefit obligation is calculated by independent actuaries who advise on the selection of Directors' best estimates of assumptions, using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds, and that have terms to maturity approximating to the terms of the related pension obligation. The increase in liabilities of the Group's defined benefit pension schemes, expected to arise from employee service in the year, is charged against operating profit.

Changes in benefits granted by the employer are recognised immediately as a past service cost in the income statement.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in the statement of comprehensive income in the period in which they arise.

2. Principal accounting policies continued

Defined contribution scheme

Costs of the defined contribution pension scheme are charged to the income statement in the year in which they arise. The Group has no further payment obligations once the contributions have been paid.

ii) Share-based payment

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

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

(t) Pre-contract and development costs

Pre-contract and development costs, including bid costs are expensed as incurred, except where it is probable that the contract will be awarded or the development completed, in which case they are recognised as an asset which is amortised to the income statement over the life of the contract. These costs are included within other receivables as shown in note 19.

(u) Fair values

The fair value of interest rate swaps is based on the market price to transfer the asset or liability at the balance sheet date in an ordinary transaction between market participants. The fair values of short-term deposits, loans and overdrafts with a maturity of less than one year are assumed to approximate to their book values.

In the case of non-current bank loans and other loans, the fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

(v) Transfers of assets from customers

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

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

(w) Foreign exchange

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

(x) Perpetual capital securities

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

(y) Non-underlying items

Non-underlying items are those that in the Directors' view should be separately disclosed by virtue of their size, nature or incidence to enable a full understanding of the Group's financial performance.

3. Financial risk management

(a) Financial risk factors

The Group's activities expose it to a variety of financial risks: liquidity risk; market risk (interest rate and foreign currency risk); and credit risk.

The Group's treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs and to maintain reasonable headroom for contingencies, and manages inflation and interest rate risk.

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

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

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

i) Liquidity risk

The Group actively maintains a mixture of long-term and short-term committed facilities which are designed to ensure the Group has sufficient available funds for operations and planned expansions equivalent to at least one year's forecast requirements at all times. Details of undrawn committed facilities and short-term facilities are provided in note 28.

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

The Group and water business have entered into covenants with lenders. While terms vary, these typically provide for limits on gearing (primarily based on the water business's regulatory capital value and Viridor Limited's EBITDA plus interest receivable on service concession arrangements) and interest cover. Existing covenants are not impacted by subsequent changes to accounting standards.

Notes to the financial statements

continued

3. Financial risk management continued

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 2020					
Non-derivative financial liabilities					
Borrowings excluding lease liabilities	40.7	244.4	511.9	1,479.3	2,276.3
Interest payments on borrowings	59.1	56.3	135.8	618.2	869.4
Lease liabilities including interest	39.5	94.4	150.9	1,750.6	2,035.4
Trade and other payables	115.3	–	–	–	115.3
Guarantees	197.1	–	–	–	197.1
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	7.0	7.3	20.3	0.7	35.3
31 March 2019					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	86.8	41.1	672.8	1,288.0	2,088.7
Interest payments on borrowings	60.5	59.4	156.4	681.0	957.3
Lease liabilities including interest	92.2	55.5	242.1	2,153.9	2,543.7
Trade and other payables	298.0	–	–	–	298.0
Guarantees	201.7	–	–	–	201.7
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	3.8	(3.7)	(12.0)	(65.1)	(77.0)
Company					
31 March 2020					
Non-derivative financial liabilities					
Borrowings excluding intercompany borrowings	6.1	204.4	393.1	537.9	1,141.5
Interest payments on borrowings	33.1	30.9	61.3	64.8	190.1
Trade and other payables	19.8	–	–	–	19.8
Guarantees	658.0	–	–	–	658.0
Derivative financial liabilities					
Derivative contracts – net payments	0.6	0.7	1.5	0.3	3.1
31 March 2019					
Non-derivative financial liabilities					
Borrowings excluding intercompany borrowings	51.8	6.1	551.7	431.9	1,041.5
Interest payments on borrowings	33.6	32.8	77.9	81.5	225.8
Trade and other payables	15.8	–	–	–	15.8
Guarantees	763.2	–	–	–	763.2
Derivative financial liabilities					
Derivative contracts – net payments	0.2	0.2	0.3	–	0.7

No liability is expected to arise in respect of the guarantees noted above. Guarantees are analysed in note 42.

ii) Market risk

Of the Group's interest-bearing liabilities at the year end 55% (2019 63%) were at fixed rates after the impact of financial derivatives in order to manage the risk of fluctuating interest rates impacting the financial performance of the Group. While this level is below our policy of maintaining at least 60% of interest-bearing liabilities at fixed rates, it reflects considerations regarding Pennon's debt levels following the Group's announcement of the strategic review and the subsequent announcement of the proposed sale of Viridor. 19% (2019 18%) of the Group's net borrowings are RPI index-linked. 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. Overall around 76% of the Group's debt is fixed or index-linked, the Group uses a combination of fixed rate, index-linked borrowings and fixed rate interest swaps as cash flow hedges of future variable interest payments to achieve this. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not therefore an exposure for the Group. These instruments are analysed in note 23.

The Group is primarily exposed to the UK's benchmark interest rate, GBP LIBOR, within its hedge accounting relationships, which are subject to interest rate benchmark reform. The Group also has a small amount of Euro denominated debt on which the foreign currency risk has been managed through cross currency swaps.

The Group has closely monitored the market and the output from the various industry working groups managing the transition to new benchmark interest rates. The Financial Conduct Authority (FCA) has made clear that, at the end of 2021, it will no longer seek to persuade, or compel, the banks to submit to LIBOR.

During 2019/20 the Group has converted a LIBOR revolving credit facility (RCF) to a Sterling Overnight Index Average (SONIA) linked RCF, this was to address the documentary changes and allow the Group to test the changes in the Treasury management system. Further work continues to ensure the Group is well placed to amend the debt portfolio and it is expected that later this year our relationship banks will no longer provide LIBOR-linked products.

3. Financial risk management continued

Below are the details of the hedging instruments and hedged items in scope of the amendments to IFRS 7 and 9 due to interest rate benchmark reform, by hedge type. The terms of the hedged items listed match those of the corresponding hedging instruments.

Hedge type	Instrument type	Maturing between	Nominal £m	Hedged item
Fair value hedges	Pay six-month UK benchmark rate (GBP LIBOR), receive sterling fixed cross currency swap	2020 – 2026	16	Fixed-rate Euro denominated financial instrument of the same maturity and nominal as the swap
Cash flow hedges	Receive three-month UK benchmark rate (GBP LIBOR), pay GBP fixed interest rate swap	2020 – 2027	958	UK benchmark rate (GBP LIBOR) issued financial instruments of the same nominals as the swaps
	Receive six-month UK benchmark rate (GBP LIBOR), pay GBP fixed interest rate swap	2020 – 2025	150	UK benchmark rate (GBP LIBOR) issued financial instruments of the same nominals as the swaps
	Receive six-month EURIBOR, pay GBP fixed cross currency swap	2021	26.4	Euro denominated financial instruments issued of the same maturity and nominals as the swaps

The Group will continue to apply the amendments to IFRS 9 until the uncertainty arising from the interest rate benchmark reforms with respect to the timing and the amount of the underlying cash flows that the Group is exposed ends. The Group has assumed that this uncertainty will not end until alternative language has been agreed with the counterparties and is dependent on the outcome of the introduction of fallback provisions and the clauses negotiated with lenders.

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

For 2020 if interest rates on variable net borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year and equity would have increased/decreased by £2.4 million (2019 £2.4 million), for the equity sensitivity fair value, with derivative impacts excluded.

For 2020 if RPI on index-linked borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year and equity would have decreased/increased by £2.0 million (2019 £2.0 million).

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

iii) Credit risk

Credit counterparty risk arises from cash and cash deposits, derivative financial instruments and exposure to customers, including outstanding receivables. Further information on the credit risk relating to trade and other receivables is given in notes 19 and 22.

Counterparty risk arises from the investment of surplus funds and from the use of derivative financial instruments. The Board has agreed a policy for managing such risk which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures.

The Group has no other significant concentration of credit risk. The Group's surplus funds are managed by the Group's treasury function and are usually placed in short-term fixed interest deposits or the overnight money markets. Deposit counterparties must meet Board approved minimum criteria based on their short-term credit ratings and therefore of good credit quality.

(b) Capital risk management

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

The Group's policy is to have a minimum of 12 months pre-funding of projected capital expenditure. At 31 March 2020 the Group had cash and facilities, including restricted funds, of £16 billion, meeting this objective.

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

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

The gearing ratios at the balance sheet date were:

	2020 £m	2019 £m
Net borrowings (note 39)	3,048.9	3,079.5
Total equity	1,712.1	1,679.8
Total capital	4,761.0	4,759.3
Gearing ratio	64.0%	64.7%

The water segment is also monitored on the basis of the ratio of its net borrowings to regulatory capital value. Ofwat's notional gearing target for the K7 (2020-25) regulatory period is set at 60.0%.

	Water business	
	2020 £m	2019 £m
Regulatory capital value	3,572.5	3,504.7
Net borrowings	2,307.2	2,062.6
Net borrowings/regulatory capital value	64.6%	58.9%

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

Notes to the financial statements

continued

3. Financial risk management continued

(c) Determination of fair values

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

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

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

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

The carrying values, less expected credit losses, of trade receivables and payables are assumed to approximate to their fair values.

4. Critical accounting judgements and estimates

The Group's principal accounting policies are set out in note 2. Management is required to exercise significant judgement and make use of estimates and assumptions in the application of these policies. Estimates are based on factors including historical experience and expectations of future events that management believe to be reasonable. However, given the judgemental nature of such estimates, actual results could be different from the assumptions used.

Estimates impacting continuing operations

Provision for doubtful debts

The Group has a material level of exposure to collection of trade receivables. Provisions in respect of these balances are calculated with reference to historical credit loss experience, adjusted for forward-looking factors which by their nature are subject to uncertainty. Analysis of actual recovery compared with provisioning levels have not, to date, resulted in material variances.

Under its regular review procedures at the balance sheet date, the Group applies a simplified approach in calculating ECLs for trade receivables and contract assets. Therefore, the Group does not track changes in credit risk but instead recognises a loss allowance based on lifetime ECLs at each reporting date. Each subsidiary has established a provision matrix that is informed by its historical credit loss experience, adjusted for forward-looking factors specific to the receivables and the economic environment.

In light of the broad economic challenges arising from the COVID-19 pandemic, part of the assessment of ECLs has been focused on the potential impact from the pandemic. Considerations in this assessment have included the type of customers, whether they conduct essential business operations, are linked to central or regional government and past experience of behaviours in challenging economic times. The precise quantum of the impact of the pandemic on both the Group's business and household customers is subject to significant estimate at the current time.

The actual level of debt collected may differ from the estimated levels of recovery. As at 31 March 2020 the Continuing Group's current trade receivables were £241.9 million, against which £106.1 million had been provided for ECLs (note 22). The provision for ECLs includes a non-underlying charge of £7.9 million in relation to the impact of COVID-19. At 31 March 2020, the Disposal Group's current trade receivables were £96.8 million, against which £2.9 million had been provided for ECLs. £1.1 million of the Disposal Group's provision represents a non-underlying charge in respect of COVID-19. As at 31 March 2019, the Group's current trade receivables were £360.2 million against which £99.0 million had been provided for ECLs.

Retirement benefit obligations

The Group operates defined benefit pension schemes for which actuarial valuations are carried out as determined by the trustees at intervals of not more than three years. The most recent triennial valuation of the main scheme was as at 31 March 2019 and has recently been concluded, the outcome of which is summarised in note 30.

The pension cost and liabilities under IAS 19 are assessed in accordance with Directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2019 actuarial tables with an allowance for future longevity improvement. The principal assumptions used to measure schemes' liabilities, sensitivities to changes in those assumptions and future funding obligations are set out in note 30.

Taxation

As at 31 March 2020, the Continuing Group is reporting a current tax receivable of £1.9 million, reduced from £19.1 million in 2018/19, which includes £1.2 million receivable related to prior year tax items. The balance at 31 March 2020 excludes a current tax liability of £1.0 million in respect of the Disposal Group and this amount is included within liabilities associated with assets classified as held for sale.

Judgements impacting continuing operations

Non-underlying items

In establishing which items are disclosed separately as non-underlying, to enable a full understanding of the Group's financial performance, the Directors exercise their judgement in assessing the size, nature or incidence of specific items. See note 6 for further details.

4. Critical accounting judgements and estimates continued

Estimates impacting measurement of assets and liabilities held for sale

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 are based on landfill site operating lives, taking account of the anticipated decline in landfill activity.

The provisions are based on latest assumptions reflecting recent historic data and future cost estimates.

The aftercare provision is particularly sensitive to the estimated volumes of leachate and their associated cost, together with the discount rate used to establish the provision.

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.

Viridor assume an aftercare period of 60 years in calculating provision values. This is considered reasonable by management, is comparable to peers in the waste business and is consistent with Environment Agency bond periods.

The impact of a 0.1% change in discount rate is estimated to be in the region of £2.5 million.

As at 31 March 2020, the Group's environmental and landfill restoration provisions were £201.2 million (2019 £209.6 million) (note 32), which has now been transferred to liabilities associated with assets classified as held for sale (note 46).

Where a restoration provision is an integral part of a landfill site's future economic benefits, an asset is recognised and depreciated in accordance with the Group's depreciation policy. As at 31 March 2020 these assets had a net book value of £27.3 million (2019 £30.8 million) (note 17), which has now been transferred to liabilities associated with assets classified as held for sale (note 46).

Service concession arrangements

Consideration from public sector entities for the operation of waste management service concessions is treated as contract receivables or other intangible assets, depending upon the right to receive cash from the asset. At the balance sheet date the Group recognised contract receivables of £202.4 million (2019 £188.3 million) and other intangible assets of £86.9 million (2019 £90.6 million) in relation to its service concession arrangements, which have been transferred to assets classified as held for sale (note 46).

Consideration relating to contract receivables is split between profit on the construction of assets, operation of the service and provision of finance recognised as interest receivable. Management's judgement is used in the allocation between these three elements, this assessment reflects external market conditions according to the type of service provided and project specific cash flow expectations, including the recovery of costs from the original contractor on our Glasgow concession.

Retirement benefit obligations

The Group operates defined benefit pension schemes for which actuarial valuations are carried out as determined by the trustees at intervals of not more than three years. The most recent triennial valuation of the main scheme was as at 31 March 2019 and has recently been concluded, the outcome of which is summarised in note 30.

The pension cost and liabilities under IAS 19 are assessed in accordance with Directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2019 actuarial tables with an allowance for future longevity improvement. The principal assumptions used to measure schemes' liabilities, sensitivities to changes in those assumptions and future funding obligations are set out in note 30.

Taxation

The Group continues to have a small number of ongoing uncertain tax items primarily relating to the interpretation of tax legislation regarding different tax aspects of its ERFs. This is part of the normal course of business and the Group has paid in full the tax HMRC interpret as due, and therefore would benefit by a cash refund of up to £24.0 million (2018/19 £26.2 million) should these tax items be concluded in the Group's favour. The Group is continuing to work towards resolution of these matters with HMRC. The amount of the cash refund reduces over time as the uncertain tax items mainly relate to timing issues of when the tax is due.

Judgements impacting assets and liabilities held for resale

Glasgow Recycling and Renewable Energy Centre (GRREC)

Total spend to bring the project into full operation was on the project since commencement has been £273.0 million, comprising the original target of £155.0 million, a further £21.0 million invested to provide additional throughput capacity and £97.0 million to address remediation and non-conformities. Viridor is contractually entitled to recover the incremental remediation and non-conformities spend, including from the original contractor, Interserve Construction Limited, under certain circumstances. The Group believes these circumstances have been met for a substantial element which is recoverable from Interserve. While Interserve disputes the amount due, dialogue with Interserve is ongoing, alongside the Group continuing to legally pursue the matter.

The associated contract with Glasgow City Council is accounted for in accordance with IFRIC 12 service concession arrangements and the spend on the project of £273.0 million has contributed £117.0 million to a financial asset, £84.0 million to an intangible asset and an amount contractually due from Interserve of £72.0 million (accounted for in accordance with IFRS 9). In line with IFRS 9, the Group has recorded credit related provisions recognising that Interserve's financial condition has been under stress. The Group has considered all relevant available public information concerning Interserve and at 31 March 2020 recognises a provision of £28.3 million, resulting in a net receivable due of £43.7 million (2019 £43.3 million). Due to uncertainty and the level of judgement associated with the provision related to the specific recovery from Interserve, it is possible the final outcome may differ from the net receivable recognised, with the boundaries for the possible outcome being zero and £72.0 million.

Non-underlying items

In establishing which items are disclosed separately as non-underlying, to enable a full understanding of the Group's financial performance, the Directors exercise their judgement in assessing the size, nature or incidence of specific items. See note 6 for further details.

Other estimates

During the year, management reassessed the critical estimates and resolved that the level of estimation for revenue recognition of accrued revenue relating to water, waste and sale of electricity was no longer considered critical as the estimates are largely calculated on a systematic basis and have not, to date, resulted in a material adjustment within the following 12-month period. However, management consider the total level of estimation of accrued revenue relating to water, waste and sale of electricity to be material and highlight this as a material other estimate.

Notes to the financial statements

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5. Segmental information

Operating segments are reported in a manner consistent with internal reporting provided to the Chief Operating Decision-Maker (CODM), which has been identified as the Pennon Group plc Board. The earnings measures below are used by the Board in making decisions.

The water business comprises the regulated water and wastewater services undertaken by South West Water. The non-household retail business comprises the services provided by Pennon Water Services in the non-household water and wastewater retail market which, while regulated, is open to competition. Segment assets include goodwill and other intangible assets, property, plant and equipment, inventories, trade and other receivables and cash and cash deposits. Segment liabilities comprise operating liabilities and borrowings and exclude taxation. The other segment liabilities include the Company's financing arrangements and Group taxation liabilities. Capital expenditure comprises additions to property, plant and equipment, including additions resulting from acquisitions through business combinations.

Following the Group entering into a formal sale agreement on 18 March 2020 to dispose of Viridor, the waste management business has been accounted for as a discontinued operation. In accordance with IFRS 5 'Non-current assets held for sale and discontinued operations', the net results of the waste management segment are presented within discontinued operations in the Group income statement (for which comparatives have been restated) and the assets and liabilities of these operations are presented separately as assets held for sale in the Group balance sheet. The waste management business has been a significant reporting segment during the year ended 31 March 2020 and will continue to be reported separately to the CODM until the expected completion of the disposal transaction in the summer of 2020 following approval by the Group's shareholders.

	2020 £m	2019 (restated) £m
Revenue from continuing operations		
Water	570.3	581.0
Non-household retail	173.5	173.7
Other	10.1	10.5
Less intra-segment trading ⁽¹⁾	(117.2)	(132.6)
	636.7	632.6
Revenue from discontinued operations		
Waste management	757.8	852.7
Other	9.4	10.9
Less intra-segment trading ⁽¹⁾	(14.0)	(18.0)
	753.2	845.6
Pro forma total revenue	1,389.9	1,478.2
Operating profit before depreciation, amortisation and non-underlying items (EBITDA) from continuing operations		
Water	364.2	367.1
Non-household retail	1.9	1.0
Other	(0.8)	(0.8)
	365.3	367.3
EBITDA from discontinued operations – Waste management	198.1	178.9
	563.4	546.2
Operating profit before non-underlying items from continuing operations		
Water	245.4	251.1
Non-household retail	1.2	0.3
Other	(1.1)	(1.3)
	245.5	250.1
Operating profit from discontinued operations – Waste management	116.0	100.9
	361.5	351.0
Profit before tax and non-underlying items from continuing operations		
Water	174.0	180.6
Non-household retail	(0.4)	(1.6)
Other	9.4	12.7
	183.0	191.7
Profit before tax from discontinued operations – Waste management	104.6	88.5
	287.6	280.2
Profit before tax from continuing operations		
Water	189.0	184.6
Non-household retail	(5.4)	(1.6)
Other	9.5	18.4
	193.1	201.4
Profit before tax from discontinued operations – Waste management	108.4	58.9
	301.5	260.3

(1) Intra-segment transactions between and to different segments is under normal market-based commercial terms and conditions. Intra-segment revenue of the other segment is at cost.

5. Segmental information continued

	Water £m	Non- household retail £m	Other £m	Total Continuing Group (pre- eliminations) £m	Disposal Group (pre- eliminations) £m	Eliminations £m	Group £m
Balance sheet							
31 March 2020							
Assets (excluding investments in joint ventures)	3,654.6	54.6	1,928.0	5,637.2	2,618.4	(1,553.2)	6,702.4
Investments in joint ventures	–	–	–	–	60.1	–	60.1
Total assets	3,654.6	54.6	1,928.0	5,637.2	2,678.5	(1,553.2)	6,762.5
Liabilities	(2,854.6)	(54.2)	(1,727.6)	(4,636.4)	(1,967.2)	1,553.2	(5,050.4)
Net assets	800.0	0.4	200.4	1,000.8	711.3	–	1,712.1
31 March 2019							
Assets (excluding investments in joint ventures)	3,690.2	64.6	1,659.0	5,413.8	2,464.8	(1,470.2)	6,408.4
Investments in joint ventures	–	–	–	–	51.1	–	51.1
Total assets	3,690.2	64.6	1,659.0	5,413.8	2,515.9	(1,470.2)	6,459.5
Liabilities	(2,762.2)	(58.7)	(1,685.8)	(4,506.7)	(1,743.2)	1,470.2	(4,779.7)
Net assets	928.0	5.9	(26.8)	907.1	772.7	–	1,679.8

Segment liabilities of the water and waste management segments comprise of operating liabilities and borrowings. The other segment includes company only assets and liabilities as well as Group taxation liabilities and should be considered in conjunction with the eliminations column. Note 46 provides details of this Disposal Group which excludes intercompany receivables of £3.2 million and intercompany payables of £1,210.9 million which will be settled on completion as part of the sale being completed on a debt free basis.

	Notes	Water £m	Non- household retail £m	Other and eliminations £m	Total from continuing operations £m	Discontinued operations Waste management £m	Group £m
Other information							
31 March 2020							
Amortisation of other intangible assets	7	0.4	0.2	–	0.6	4.1	4.7
Capital expenditure	17	161.1	–	0.1	161.2	165.7	326.9
Depreciation	7	118.3	0.5	0.4	119.2	78.0	197.2
Finance income	8	2.3	–	1.8	4.1	22.5	26.6
Finance costs (before non-underlying items)	8	73.4	0.3	(7.1)	66.6	48.7	115.3
31 March 2019							
Amortisation of other intangible assets	7	0.5	0.2	–	0.7	4.5	5.2
Capital expenditure	17	154.0	–	0.1	154.1	233.1	387.2
Depreciation	7	115.5	0.6	0.4	116.5	73.5	190.0
Finance income	8	2.3	–	1.2	3.5	20.0	23.5
Finance costs (before non-underlying items)	8	72.8	1.9	(12.8)	61.9	44.8	106.7

Finance income and costs above reflect the segment in which the amounts arise and exclude inter-company transactions.

The grouping of revenue streams by how they are affected by economic factors, as required by IFRS 15, is as follows:

	Non-household retail			Waste management (WM)						
	Water	Non-household retail	Other	Total from continuing operations	UK	Rest of EU	China	Rest of world	Total from discontinued operations	Total
Year ended 31 March 2020	UK total £m	UK total £m	UK total £m	£m	£m	£m	£m	£m	WM £m	£m
Segment revenue	570.3	173.5	10.1	753.9	741.3	11.8	3.8	10.3	767.2	1,521.1
Inter-segment revenue	(106.4)	(0.9)	(9.9)	(117.2)	(14.0)	–	–	–	(14.0)	(131.2)
Revenue from external customers	463.9	172.6	0.2	636.7	727.3	11.8	3.8	10.3	753.2	1,389.9
Significant service lines										
Water	463.9	–	–	463.9	–	–	–	–	–	463.9
Non-household retail	–	172.6	–	172.6	–	–	–	–	–	172.6
Waste management services	–	–	–	–	567.2	–	–	–	567.2	567.2
Energy	–	–	–	–	109.2	–	–	–	109.2	109.2
Recyclate	–	–	–	–	50.9	11.8	3.8	10.3	76.8	76.8
Other	–	–	0.2	0.2	–	–	–	–	–	0.2
	463.9	172.6	0.2	636.7	727.3	11.8	3.8	10.3	753.2	1,389.9

Notes to the financial statements

continued

5. Segmental information continued

	Water	Non-household retail	Other	Waste management (WM)					Total from discontinued operations WM	Total
				Total from continuing operations	UK	Rest of EU	China	Rest of world		
Year ended 31 March 2019	UK total £m	UK total £m	UK total £m	£m	£m	£m	£m	£m	£m	
Segment revenue	581.0	173.7	21.4	776.1	802.3	13.8	25.6	11.0	852.7	1,628.8
Inter-segment revenue	(124.9)	(4.0)	(21.4)	(150.3)	(0.3)	–	–	–	(0.3)	(150.6)
Revenue from external customers	456.1	169.7	–	625.8	802.0	13.8	25.6	11.0	852.4	1,478.2
Significant service lines										
Water	456.1	–	–	456.1	–	–	–	–	–	456.1
Non-household retail	–	169.7	–	169.7	–	–	–	–	–	169.7
Waste management services	–	–	–	–	655.8	–	–	–	655.8	655.8
Energy	–	–	–	–	88.9	–	–	–	88.9	88.9
Recyclate	–	–	–	–	57.3	13.8	25.6	11.0	107.7	107.7
	456.1	169.7	–	625.8	802.0	13.8	25.6	11.0	852.4	1,478.2

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

6. Non-underlying items

Non-underlying items are those that in the Directors' view should be separately disclosed by virtue of their size, nature or incidence to enable a full understanding of the Group's financial performance in the year and business trends over time. The presentation of results is consistent with internal performance monitoring.

	Notes	Continuing operations 2020	Discontinued operations 2020	Pro forma Total 2020	Continuing operations 2019	Discontinued operations 2019	Pro forma Total 2019
		£m	£m	£m	£m	£m	£m
Operating costs							
Pension past service credit ⁽¹⁾		–	4.9	4.9	–	–	–
COVID-19 provision for expected credit losses ⁽²⁾		(7.9)	(1.1)	(9.0)	–	–	–
Pension past service cost (GMP equalisation impact) ⁽³⁾		–	–	–	(2.1)	(0.9)	(3.0)
Provision for receivable (due from Interserve in respect of Glasgow Recycling and Renewable Energy Centre) ⁽⁴⁾		–	–	–	6.0	(28.7)	(22.7)
Earnings before interest, tax, depreciation and amortisation		(7.9)	3.8	(4.1)	3.9	(29.6)	(25.7)
Remeasurement of fair value movement in derivatives ⁽⁵⁾	8	18.0	–	18.0	5.8	–	5.8
Net tax credit arising on non-underlying items above		(1.9)	(0.7)	(2.6)	(0.7)	5.7	5.0
Deferred tax change in rate ⁽⁶⁾	9	(30.3)	(10.3)	(40.6)	–	–	–
Net non-underlying (charge)/credit		(22.1)	(7.2)	(29.3)	9.0	(23.9)	(14.9)

(1) Upon cessation of the Greater Manchester contract, Viridor employees delivering this contract transferred to the new contract provider. Accordingly, defined benefit pension commitments for these employees are in the process of being transferred. The past service credit of £4.9 million (2019 £nil) reflects curtailment and other gains resulting from transferring employees moving from an active to deferred status in these schemes.

(2) In response to the COVID-19 pandemic a detailed expected credit loss review has been undertaken. Economic and credit conditions are worsening, however the UK Government continues to implement economic measures to support the wider economy. As a result of the review a Group provision of £9.0 million has been recognised. The charge is considered non-underlying due to its size and nature.

(3) On 26 October 2018, the High Court of Justice of England and Wales issued a judgment in a claim regarding the rights of female members of certain pension schemes to equality of treatment in relation to pension benefits (GMP equalisation). The judgment concluded that the claimant is under a duty to amend the schemes in order to equalise benefits for men and women in relation to guaranteed minimum pension benefit. The issues determined by the judgment arise in relation to many other occupational pension schemes. The Group estimates, with advice from the Group's corporate actuary, that scheme liabilities will increase by an estimated £3.0 million as a result of the judgment. This cost was recognised as a past service cost in the income statement for the year ended 31 March 2019. These charges are considered non-underlying due to size and non-recurring nature.

(4) The financial statements recognise a gross receivable of £72.0 million from Interserve Construction Limited in relation to rectifications and completion costs for GRREC. During the financial year ended 31 March 2019, Interserve Plc (holding company of Interserve Construction Limited) entered into administration. The operating company, Interserve Construction Limited with whom we contracted, is currently continuing to trade. As a result of the lack of certainty around the future of Interserve's business, and in accordance with IFRS 9, we have sought to make an appropriate market-based credit assessment using the latest public information available. Consequently, a provision of £22.7 million was recognised in 2018/19 against the receivable, resulting in a total cumulative provision at 31 March 2019 of £28.7 million. The charge is considered non-underlying due to its size and non-recurring nature. The financial stability of Interserve Construction Limited is judged to be outside the control of Pennon Group.

(5) In the year a gain of £18.0 million has been recognised relating to non-cash derivative fair value movements associated with derivatives that are not designated as being party to an accounting hedge relationship (2019 credit of £5.8 million). In the year these instruments were early settled, as the instruments no longer met the Group's accounting hedging requirements, and this has locked in the mark to market gain. These movements are non-underlying due to the nature of the item being market dependent and potentially can be significant in value (size).

(6) Following the Chancellor's Budget on 11 March 2020, the UK headline corporation tax rate will remain at 19%. It was previously set to reduce to 17% from 1 April 2020 and that change has now been cancelled. All deferred tax assets and liabilities have therefore been recalculated to crystallise at 19%, resulting in a non-underlying deferred tax change in the year of £40.6 million. The change was substantively enacted on 17 March 2020. This charge is considered non-underlying due to it arising from a material legislative change, and its treatment is consistent with that applied in relation to previous changes in the corporation tax rate.

7. Operating costs

	Notes	2020 £m	2019 (restated) £m
Employment costs before non-underlying items	13	70.0	67.2
Raw materials and consumables		14.9	15.0
Other operating expenses before non-underlying items include:			
Profit on disposal of property, plant and equipment		(0.4)	(1.6)
Operating lease rentals payable		–	3.1
Short-term/low value asset lease expense		1.2	–
Research and development expenditure		0.1	0.2
Trade receivables impairment	22	11.4	2.9
Depreciation of property, plant and equipment:			
– Owned assets		73.2	77.0
– Under leases (2019 finance leases only)		46.0	39.5
Amortisation of other intangible assets	16	0.6	0.7

Operating costs include a charge of £7.9 million relating to non-underlying items, as detailed in note 6.

The costs above are exclusive of amounts relating to discontinued operations.

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

	2020 £000	2019 £000
Fees payable to the Company's auditor and its associates for the audit of parent company and consolidated financial statements	143	102
Fees payable to the Company's auditor and its associates for other services:		
The audit of Company's subsidiaries	784	621
Audit-related assurance services	50	50
Other non-audit services	85	118
Total fees	1,062	891
Fees payable to the Company's auditor in respect of Pennon Group pension schemes:		
Audit	52	50

Expenses reimbursed to the auditor in relation to the audit of the Group were £39,000 (2019 £63,000).

A description of the work of the Audit Committee is set out in its report on pages 84 to 87 which includes an explanation of how the auditor's objectivity and independence are safeguarded when non-audit services are provided by the auditor's firm.

8. Net finance costs

	Notes	2020			2019 (restated)		
		Finance cost £m	Finance income £m	Total £m	Finance cost £m	Finance income £m	Total £m
Cost of servicing debt							
Bank borrowing and overdrafts		(28.1)	–	(28.1)	(23.1)	–	(23.1)
Interest element of lease payments (2019 interest element of finance lease payments)		(35.6)	–	(35.6)	(35.4)	–	(35.4)
Other finance costs		(2.7)	–	(2.7)	(2.4)	–	(2.4)
Interest receivable		–	4.1	4.1	–	3.5	3.5
		(66.4)	4.1	(62.3)	(60.9)	3.5	(57.4)
Notional interest							
Retirement benefit obligations	30	(0.2)	–	(0.2)	(1.0)	–	(1.0)
Net finance cost before non-underlying items		(66.6)	4.1	(62.5)	(61.9)	3.5	(58.4)
Non-underlying items							
Fair value remeasurement of non-designated derivative financial instruments providing commercial hedges	6	18.0	–	18.0	5.8	–	5.8
Net finance cost after non-underlying items		(48.6)	4.1	(44.5)	(56.1)	3.5	(52.6)

In addition to the above, finance costs of £2 million have been capitalised on qualifying assets included in property, plant and equipment (2019 restated £2.9 million).

Excluded from the amounts above are net finance costs relating to discontinued operations of £26.2 million (2019 £24.8 million), consisting of finance income of £22.5 million (2019 £20.0 million) and finance costs of £48.7 million (2019 £44.8 million).

Notes to the financial statements

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9. Taxation

Notes	Before non-underlying items 2020 £m	Non-underlying items (note 6) 2020 £m	Total 2020 £m	Before non-underlying items 2019 £m	Non-underlying items (note 6) 2019 £m	Total 2019 £m
Analysis of charge in year						
Current tax charge/(credit)	18.8	15.3	34.1	29.4	(5.5)	23.9
Deferred tax – other	33.2	(12.7)	20.5	13.3	0.5	13.8
Deferred tax arising on change of rate of corporation tax	–	40.6	40.6	–	–	–
Total deferred tax charge	33.2	27.9	61.1	13.3	0.5	13.8
Tax charge/(credit) for year	52.0	43.2	95.2	42.7	(5.0)	37.7

Notes	Continuing operations 2020 £m	Discontinued operations 2020 £m	Pro forma Total 2020 £m	Continuing operations 2019 £m	Discontinued operations 2019 £m	Pro forma Total 2019 £m
Analysis of charge in year						
Current tax charge/(credit)	43.8	(9.7)	34.1	29.6	(5.7)	23.9
Deferred tax – other	(3.5)	24.0	20.5	3.2	10.6	13.8
Deferred tax arising on change of rate of corporation tax	30.3	10.3	40.6	–	–	–
Total deferred tax charge	26.8	34.3	61.1	3.2	10.6	13.8
Tax charge for year	70.6	24.6	95.2	32.8	4.9	37.7

UK corporation tax is calculated at 19% (2019 19%) of the estimated assessable profit for the year.

UK corporation tax for the pro forma total group, including discontinued operations is stated after a credit relating to prior year current tax of £9.2 million (2019 credit of £3.0 million) and a prior year deferred tax charge of £6.5 million (2019 credit of £9.9 million).

The tax for the year differs from the theoretical amount which would arise using the standard rate of corporation tax in the UK of 19% (2019 19%) as follows:

	Continuing operations 2020 £m	Pro forma Total 2020 £m	Continuing operations 2019 £m	Pro forma Total 2019 £m
Reconciliation of total tax charge				
Profit before tax for continuing operations	193.1	301.5	201.4	260.3
Profit multiplied by the standard rate of UK corporation tax of 19% (2019 19%)	36.7	57.3	38.3	49.5
Effects of:				
Expenses not deductible for tax purposes	0.4	1.0	0.4	1.7
Joint venture profits not taxed	–	(2.8)	–	(2.4)
Adjustments to tax charge in respect of prior years	3.2	(2.7)	(6.6)	(12.9)
Change in UK tax rates	30.3	40.6	–	–
Depreciation charged on non-qualifying assets	0.3	1.9	1.9	3.7
Other	(0.3)	(0.1)	(1.2)	(1.9)
Tax charge for year	70.6	95.2	32.8	37.7

9. Taxation continued

	Continuing operations 2020 £m	Pro forma Total 2020 £m	Continuing operations 2019 £m	Pro forma Total 2019 £m
Reconciliation of current tax charge				
Profit before tax	193.1	301.5	201.4	260.3
Profit multiplied by the standard rate of UK corporation tax of 19% (2019 19%)	36.7	57.3	38.3	49.5
Effects of:				
Relief for capital allowances in place of depreciation	(21.8)	(52.4)	(22.1)	(54.2)
Disallowance of depreciation charged in the accounts	19.5	32.1	18.8	31.0
Other timing differences	9.3	7.9	(2.9)	0.2
Expenses not deductible for tax purposes	0.4	1.1	0.4	1.7
Joint venture profits not taxed	–	(2.8)	–	(2.4)
Adjustments to tax charge in respect of prior years	(0.3)	(9.2)	(4.3)	(3.0)
Depreciation charged on non-qualifying assets	0.3	1.9	1.9	3.7
Relief for capitalised interest and foreign exchange gains/losses	(0.3)	(1.8)	(0.5)	(2.6)
Current tax charge for year	43.8	34.1	29.6	23.9

The pro forma Group's current tax charge is lower than the UK headline rate of 19%, primarily due to the availability of capital allowances. Capital allowances provide tax relief when a business incurs expenditure on qualifying capital items such as plant and machinery used by the business. As an infrastructure business, these allowances help the Group to plan major investment and consequently to maintain lower customers bills, as corporation tax relief is given against the investments made.

The headline UK tax rate will now be held at 19% (rather than reducing to 17% as previously enacted) following the Chancellor's Budget on 11 March 2020. The change to remain at 19% was substantively enacted on 17 March 2020.

Joint venture profits are not subject to any additional tax within the Group as these are included on a post-tax basis already, as the joint venture entity is subject to UK tax itself.

In addition to the amounts recognised in the income statement, the following tax charges and credits were recognised:

	Continuing operations 2020 £m	Pro forma Total 2020 £m	Continuing operations 2019 £m	Pro forma Total 2019 £m
Amounts recognised directly in other comprehensive income				
Deferred tax credit on defined benefit pension schemes	(1.5)	(0.1)	(1.3)	(3.2)
Deferred tax credit on cash flow hedges	(3.1)	(3.1)	(0.1)	(0.6)
Amounts recognised directly in equity				
Deferred tax credit on share-based payments	(0.8)	(1.4)	(0.4)	(0.5)
Current tax credit on perpetual capital securities periodic return	(1.6)	(1.6)	–	–

10. Profit of the parent company

	2020 £m	2019 £m
Profit attributable to ordinary shareholders' equity dealt within the accounts of the parent company	330.6	194.8

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

Notes to the financial statements

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11. Earnings per share

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

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

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

	2020	2019
Number of shares (millions)		
For basic earnings per share	420.2	419.6
Effect of dilutive potential ordinary shares from share options	1.9	1.3
For diluted earnings per share	422.1	420.9

Basic and diluted earnings per ordinary share

Earnings per ordinary share before non-underlying items, deferred tax and adjusted to annualise depreciation and amortisation in the Disposal Group are presented as the Directors believe that this measure provides a more useful year on year comparison of business trends and performance. Deferred tax is excluded as the Directors believe it reflects a distortive effect of changes in corporation tax rates and the level of long-term capital investment. Following the announcement on 18 March of the proposed sale of Viridor, the assets and liabilities of the Disposal Group have been transferred to assets held for sale and in accordance with IFRS 5, the property, plant and equipment and intangible assets have not been depreciated or amortised from that date. The Directors believe that to aid comparison of earnings year on year, it is appropriate to reflect a full year's depreciation and amortisation consistent with all other revenues and costs recognised for the full year in the Disposal Group. Earnings per share have been calculated as follows:

	2020			2019		
	Profit after tax £m	Earnings per share		Profit after tax £m	Earnings per share	
Continuing and discontinued operations		Basic p	Diluted p		Basic p	Diluted p
Statutory earnings attributable to ordinary shareholders of the parent	200.4	47.7	47.5	214.3	51.1	50.9
Deferred tax charge before non-underlying items	33.2	7.9	7.8	13.3	3.1	3.1
Non-underlying items (net of tax)	29.3	6.9	6.9	14.9	3.6	3.6
Non-controlling interests' share of non-underlying items	(1.0)	(0.2)	(0.2)	–	–	–
Full year depreciation charge in the Disposal Group	(2.6)	(0.6)	(0.6)	–	–	–
Adjusted earnings	259.3	61.7	61.4	242.5	57.8	57.6

	2020			2019		
	Profit after tax £m	Earnings per share		Profit after tax £m	Earnings per share	
Continuing operations		Basic p	Diluted p		Basic p	Diluted p
Statutory earnings attributable to ordinary shareholders of the parent	116.6	27.7	27.6	160.3	38.2	38.1
Deferred tax charge before non-underlying items	10.1	2.4	2.4	2.5	0.6	0.6
Non-underlying items (net of tax)	22.1	5.3	5.2	(9.0)	(2.1)	(2.2)
Non-controlling interests' share of non-underlying items	(1.0)	(0.2)	(0.2)	–	–	–
Full year depreciation charge in the Disposal Group	–	–	–	–	–	–
Adjusted earnings	147.8	35.2	35.0	153.8	36.7	36.5

	2020			2019		
	Profit after tax £m	Earnings per share		Profit after tax £m	Earnings per share	
Discontinuing operations		Basic p	Diluted p		Basic p	Diluted p
Statutory earnings attributable to ordinary shareholders of the parent	83.8	20.0	19.9	54.0	12.9	12.8
Deferred tax charge before non-underlying items	23.1	5.4	5.4	10.8	2.5	2.6
Non-underlying items (net of tax)	7.2	1.7	1.7	23.9	5.7	5.7
Non-controlling interests' share of non-underlying items	–	–	–	–	–	–
Full year depreciation charge in the Disposal Group	(2.6)	(0.6)	(0.6)	–	–	–
Adjusted earnings	111.5	26.5	26.4	88.7	21.1	21.1

12. Dividends

	2020 £m	2019 £m
Amounts recognised as distributions to ordinary equity holders in the year		
Interim dividend paid for the year ended 31 March 2019 12.84p (2018 11.97p) per share	54.0	50.2
Final dividend paid for the year ended 31 March 2019 28.22p (2018 26.62p) per share	118.6	111.8
	172.6	162.0
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2020: 13.66p per share	57.5	54.0
Proposed final dividend for the year ended 31 March 2020: 30.11p per share	126.8	118.7
	184.3	172.7

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

The proposed interim dividend for 2020 was paid on 3 April 2020 and the proposed final dividend is subject to approval by shareholders at the AGM.

13. Employment costs

	Notes	Continuing operations 2020 £m	Discontinued operations 2020 £m	Total 2020 £m	Continuing operations 2019 £m	Discontinued operations 2019 £m	Total 2019 £m
Wages and salaries		67.2	113.7	180.9	63.7	120.6	184.3
Social security costs		7.1	11.5	18.6	6.6	12.5	19.1
Pension costs – before non-underlying items	30	8.5	13.7	22.2	8.6	13.3	21.9
Pension (credit)/costs – non-underlying items	6	–	(4.9)	(4.9)	2.1	0.9	3.0
Share-based payments	33	2.9	0.9	3.8	2.5	1.1	3.6
Total employment costs		85.7	134.9	220.6	83.5	148.4	231.9
Charged:							
Employment costs (excluding non-underlying items) – consolidated income statement		70.0	135.3	205.3	67.2	138.6	205.8
Employment costs (non-underlying items) – consolidated income statement		–	(4.9)	(4.9)	2.1	0.9	3.0
Capital schemes – property, plant and equipment		15.7	4.5	20.2	14.2	8.9	23.1
Total employment costs		85.7	134.9	220.6	83.5	148.4	231.9

Details of Directors' emoluments are set out in note 14. There are no personnel, other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Group. Members of other executive committees assist the Directors in their duties but do not hold authority to control the activities of the Group.

	2020	2019
Employees (average full-time equivalent number)		
The average monthly number of employees (including Executive Directors) was:		
Water	1,623	1,616
Non-household retail	143	104
Other	101	93
Total continuing operations	1,867	1,813
Waste management	2,986	3,426
Total – continuing and discontinued operations	4,853	5,239

The total number of employees (full-time equivalent) of the continuing operations at 31 March 2020 was 1,937 (2019 1,834). The total number of employees of the continuing operations and discontinued operations at 31 March 2020 was 4,801 (2019 5,382).

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14. Directors' emoluments

	2020 £000	2019 £000
Executive Directors:		
Salary	951	932
Performance-related bonus paid or payable	372	425
Share-based payments	872	936
Other emoluments, including payments in lieu of pension provision	316	307
Non-Executive Directors	528	508
	3,039	3,108

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 £nil (2019 £nil). Total gains made by Directors on the exercise of share options were £nil (2019 £nil).

Total emoluments include £nil (2019 £nil) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2020 one Director (2019 one) is accruing retirement benefits under defined benefit pension schemes in respect of which the Group contributed £29,000 (2019 £29,000).

At 31 March 2020 no Director (2019 no) is a member of the Group's defined contribution pension scheme in respect of which the Group contributed £nil (2019 £nil).

At 31 March 2020 two Directors received payments in lieu of pension provision (2019 two).

More detailed information concerning Directors' emoluments (including pensions and the highest paid Director) and share interests is shown in the Directors' remuneration report on pages 92 to 115.

15. Goodwill

	£m
Cost:	
At 1 April 2018	385.0
At 31 March 2019	385.0
Disposals	(1.9)
Assets transferred to Disposal Group	(340.8)
At 31 March 2020	42.3
Carrying amount:	
At 1 April 2018	385.0
At 31 March 2019	385.0
At 31 March 2020	42.3

Goodwill acquired in a business combination is allocated at acquisition to the CGU expected to benefit from that business combination. Goodwill with a total carrying value of £340.8 million has been transferred to the Disposal Group. The remaining £42.3 million is allocated to the water business, representing the lowest level at which goodwill is monitored and tested.

Impairment testing of goodwill

The Group tests goodwill for impairment annually, or more frequently if there are any indications that impairment may have arisen.

The recoverable amount of the water business segment, for which goodwill was recognised on acquisition of Bournemouth Water in 2015, is assessed using level 2 fair value hierarchy techniques, with reference to the market value of the merged water business, using a market-based observable premium to regulated capital value.

The results of tests performed during the year demonstrate significant headroom in the water CGU, and it is judged that no reasonable change in the key assumptions would cause the carrying amount of the CGUs to exceed the recoverable amount.

16. Other intangible assets

	Service concession arrangements £m	Customer contracts £m	Patents £m	Other £m	Total £m
Cost:					
At 1 April 2018	69.6	34.3	0.2	3.6	107.7
Additions	24.7	–	–	–	24.7
At 31 March 2019	94.3	34.3	0.2	3.6	132.4
Additions	0.1	–	–	0.6	0.7
Disposals	–	(34.3)	–	(0.2)	(34.5)
Transferred to assets held for sale	(94.4)	–	–	–	(94.4)
At 31 March 2020	–	–	0.2	4.0	4.2
Accumulated amortisation:					
At 1 April 2018	0.4	32.7	0.2	1.8	35.1
Charge for year	3.3	1.2	–	0.7	5.2
At 31 March 2019	3.7	33.9	0.2	2.5	40.3
Charge for year	3.8	0.4	–	0.5	4.7
Disposals	–	(34.3)	–	(0.2)	(34.5)
Transferred to assets held for sale	(7.5)	–	–	–	(7.5)
At 31 March 2020	–	–	0.2	2.8	3.0
Carrying amount:					
At 1 April 2018	69.2	1.6	–	1.8	72.6
At 31 March 2019	90.6	0.4	–	1.1	92.1
At 31 March 2020	–	–	–	1.2	1.2

Assets that belong to Pennon Group plc's waste management business, Viridor, have been transferred to assets held for sale at 18 March 2020, at which point amortisation of its assets ceased.

Customer contracts were disposed in full during the year. Prior to disposal customer contracts were amortised over the useful life of each contract which at acquisition ranged between two and 15 years.

Patents have been amortised in full over their estimated useful lives which at acquisition was 13 years.

Other, including computer software, is amortised over the useful life of the assets which at acquisition was five years. The average remaining life is three years (2018 four 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.

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17. Property, plant and equipment

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Landfill restoration £m	Construction in progress £m	Total £m
Group							
Cost:							
At 31 March 2018	555.0	1,894.5	719.3	2,855.1	82.8	555.4	6,662.1
Additions	5.2	16.4	2.2	50.0	22.8	290.6	387.2
Assets adopted at fair value	–	10.0	–	–	–	–	10.0
Grants and contributions	–	(2.2)	–	–	–	–	(2.2)
Disposals	(0.7)	(1.2)	–	(16.4)	–	–	(18.3)
Transfers/reclassifications	1.0	36.1	20.0	409.4	–	(466.5)	–
At 31 March 2019	560.5	1,953.6	741.5	3,298.1	105.6	379.5	7,038.8
IFRS 16 transition adjustment	116.6	–	–	15.6	–	–	132.2
At 1 April 2019 (adjusted for IFRS 16)	677.1	1,953.6	741.5	3,313.7	105.6	379.5	7,171.0
Additions	11.6	27.8	1.8	59.6	5.3	220.8	326.9
Assets adopted at fair value	–	8.1	–	–	–	–	8.1
Grants and contributions	–	(1.8)	–	–	–	(0.9)	(2.7)
Disposals	(4.0)	(0.6)	–	(111.4)	–	–	(116.0)
Transfers/reclassifications	1.7	17.4	19.1	137.5	–	(175.7)	–
Transferred to assets held for sale	(560.6)	–	–	(1,439.4)	(110.9)	(304.6)	(2,415.5)
At 31 March 2020	125.8	2,004.5	762.4	1,960.0	–	119.1	4,971.8
Accumulated depreciation:							
At 31 March 2018	401.7	268.6	253.4	1,363.4	64.4	–	2,351.5
Charge for year	11.1	22.1	13.4	136.6	10.4	–	193.6
Disposals	(0.2)	(1.2)	–	(14.3)	–	–	(15.7)
At 31 March 2019	412.6	289.5	266.8	1,485.7	74.8	–	2,529.4
Charge for year	17.4	23.6	13.3	138.7	8.8	–	201.8
Disposals	(0.6)	(0.6)	–	(99.4)	–	–	(100.6)
Transferred to assets held for sale	(413.4)	–	–	(333.6)	(83.6)	–	(830.6)
At 31 March 2020	16.0	312.5	280.1	1,191.4	–	–	1,800.0
Net book value:							
At 31 March 2018	153.3	1,625.9	465.9	1,491.7	18.4	555.4	4,310.6
At 31 March 2019	147.9	1,664.1	474.7	1,812.4	30.8	379.5	4,509.4
At 31 March 2020	109.8	1,692.0	482.3	768.6	–	119.1	3,171.8

Assets that belong to Pennon Group plc's waste management business, Viridor, have been transferred to assets held for sale at a 18 March 2020 at which point depreciation of its assets ceased.

Of the total depreciation charge of £201.8 million (2019 £193.6 million), £2.6 million (2019 £1.6 million) has been charged to capital projects, £2.0 million (2019 £2.0 million) has been offset by deferred income and £197.2 million (2019 £190.0 million) has been charged against profits. Asset lives and residual values are reviewed annually. During the year borrowing costs of £10.6 million (2019 £15.2 million) have been capitalised on qualifying assets, at an average borrowing rate of 3.8% (2019 4.0%).

Groups of assets forming cash generating units are reviewed for indicators of impairment. No indicators of impairment were identified during the year.

Asset lives are reviewed annually. No significant changes were required in 2019/20.

17. Property, plant and equipment continued

Right-of-use assets held under leases included above were:

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Total £m
Group						
Cost:						
At 31 March 2019	3.3	428.4	471.1	672.9	5.2	1,580.9
IFRS 16 transition adjustment	116.6	–	–	15.6	–	132.2
At 1 April 2019 (adjusted for IFRS 16)	119.9	428.4	471.1	688.5	5.2	1,713.1
Additions	1.1	5.7	22.9	91.5	–	121.2
Disposals	(1.7)	(29.2)	(17.7)	(67.2)	–	(115.8)
Transfers/reclassifications	–	–	5.2	–	(5.2)	–
Transferred to assets held for sale	(84.2)	–	–	(193.8)	–	(278.0)
At 31 March 2020	35.1	404.9	481.5	519.0	–	1,440.5
Accumulated depreciation:						
At 31 March 2019	0.1	68.2	126.7	315.2	–	510.2
Charge for year	6.7	10.1	8.3	39.7	–	64.8
Disposals	(0.1)	–	–	(8.3)	–	(8.4)
Transferred to assets held for sale	(5.2)	–	–	(65.3)	–	(70.5)
At 31 March 2020 total	1.5	78.3	135.0	281.3	–	496.1
Net book amount:						
At 31 March 2019	3.2	360.2	344.4	357.7	5.2	1,070.7
At 31 March 2020	33.6	326.6	346.5	237.7	–	944.4

The net book value of right-of-use assets at 1 April 2019 was £1,202.9 million, comprising an adjustment upon transition to IFRS 16 of £132.2 million, and assets previously held under finance leases under IAS 17 of £1,070.7 million. Refer to note 45 for additional information relating to the Group's implementation of IFRS 16 'Leases'.

	Fixed and mobile plant, vehicles and computers £m
Company	
Cost:	
At 31 March 2018	0.4
Additions	0.1
At 31 March 2019	0.5
Additions	0.1
Disposals	(0.2)
At 31 March 2020	0.4
Accumulated depreciation:	
At 31 March 2018	0.2
Charge for year	–
At 31 March 2019	0.2
Charge for year	0.1
Disposals	(0.1)
At 31 March 2020	0.2
Net book value:	
At 31 March 2018	0.2
At 31 March 2019	0.3
At 31 March 2020	0.2

Asset lives and residual values are reviewed annually.

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18. Financial instruments by category

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

	Notes	Fair value			Amortised cost		Total £m
		Derivatives used for fair value hedging £m	Derivatives used for cash flow hedging £m	Derivatives not in a hedge accounting relationship £m	Debt Instruments at amortised cost £m	Trade receivables and trade payables £m	
Group							
31 March 2020							
Financial assets							
Trade receivables	22	–	–	–	–	135.8	135.8
Derivative financial instruments	23	3.4	3.4	–	–	–	6.8
Cash and cash deposits	25	–	–	–	665.9	–	665.9
Total		3.4	3.4	–	665.9	135.8	808.5
Financial liabilities							
Borrowings	28	–	–	–	(3,714.8)	–	(3,714.8)
Derivative financial instruments	23	–	(34.1)	(0.2)	–	–	(34.3)
Trade payables	26	–	–	–	–	(64.2)	(64.2)
Total		–	(34.1)	(0.2)	(3,714.8)	(64.2)	(3,813.3)
31 March 2019							
Financial assets							
Trade receivables	22	–	–	–	–	261.2	261.2
Other receivables	19,22	–	–	–	263.8	–	263.8
Derivative financial instruments	23	3.4	3.1	75.8	–	–	82.3
Cash and cash deposits	25	–	–	–	569.6	–	569.6
Total		3.4	3.1	75.8	833.4	261.2	1,176.9
Financial liabilities							
Borrowings	28	–	–	–	(3,649.1)	–	(3,649.1)
Derivative financial instruments	23	–	(20.5)	(0.5)	–	–	(21.0)
Trade payables	26	–	–	–	–	(127.6)	(127.6)
Other payables – amounts owed to joint ventures	26,29	–	–	–	–	(4.1)	(4.1)
Total		–	(20.5)	(0.5)	(3,649.1)	(131.7)	(3,801.8)
Company							
31 March 2020							
Financial assets							
Amounts owed by subsidiaries	19,22	–	–	–	1,241.8	–	1,241.8
Other receivables	22	–	–	–	0.2	–	0.2
Derivative financial instruments	23	3.4	3.2	–	–	–	6.6
Cash and cash deposits	25	–	–	–	367.9	–	367.9
Total		3.4	3.2	–	1,609.9	–	1,616.5
Financial liabilities							
Amounts due to subsidiaries	26	–	–	–	(0.4)	–	(0.4)
Borrowings	28	–	–	–	(1,425.9)	–	(1,425.9)
Derivative financial instruments	23	–	(3.7)	–	–	–	(3.7)
Trade payables	26	–	–	–	–	(2.8)	(2.8)
Total		–	(3.7)	–	(1,426.3)	(2.8)	(1,432.8)
31 March 2019							
Financial assets							
Amounts owed by subsidiaries	19,22	–	–	–	1,064.5	–	1,064.5
Other receivables	22	–	–	–	0.1	–	0.1
Derivative financial instruments	23	3.4	3.1	–	–	–	6.5
Cash and cash deposits	25	–	–	–	284.8	–	284.8
Total		3.4	3.1	–	1,349.4	–	1,355.9
Financial liabilities							
Amounts due to subsidiaries	26	–	–	–	(0.1)	–	(0.1)
Borrowings	28	–	–	–	(1,325.4)	–	(1,325.4)
Derivative financial instruments	23	–	(0.9)	–	–	–	(0.9)
Trade payables	26	–	–	–	–	(0.2)	(0.2)
Total		–	(0.9)	–	(1,325.5)	(0.2)	(1,326.6)

19. Other non-current assets

Non-current receivables

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Amounts owed by subsidiary undertakings	-	-	1,223.5	1,044.6
Amounts owed by related parties (note 44)	-	67.8	-	-
Service concession arrangements	-	188.3	-	-
Other receivables	-	0.3	-	-
	-	256.4	1,223.5	1,044.6

Non-current receivables were due:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Between 1 and 2 years	-	44.0	66.1	48.6
Over 2 years and less than 5 years	-	135.2	211.4	148.1
Over 5 years	-	77.2	946.0	847.9
	-	256.4	1,223.5	1,044.6

The fair values of non-current receivables were:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Amounts owed by subsidiary undertakings	-	-	1,205.2	1,160.4
Amounts owed by related parties	-	81.9	-	-
Service concession arrangements	-	188.3	-	-
Other receivables	-	0.3	-	-
	-	270.5	1,205.2	1,160.4

Excluded from the balances at 31 March 2020 above is £261.5 million relating to assets held for sale (see note 46 for further details).

20. Investments

Subsidiary undertakings

	£m
Company	
At 1 April 2018	1,980.8
At 31 March 2019	1,980.8
Transferred to assets held for sale	(1,135.6)
At 31 March 2020	845.2

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

Joint ventures

	Shares £m
Group	
At 1 April 2018	22.8
Additions	20.9
Share of post-tax profit	12.4
Share of other comprehensive income	0.5
Dividends received	(5.5)
At 31 March 2019	51.1
Share of post-tax profit	14.8
Share of other comprehensive income	0.2
Dividends received	(6.0)
Transferred to assets held for sale	(60.1)
At 31 March 2020	-

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20. Investments continued

The Group's joint ventures listed below all have share capital consisting solely of ordinary shares which is held directly by the Disposal Group.

Name of entity	Place of business/ country of incorporation	% of ownership	Measurement method
Lakeside Energy from Waste Holdings Limited ⁽¹⁾	England	50	Equity
INEOS Runcorn (TPS) Holdings Limited ⁽²⁾	England	40	Equity

(1) Lakeside Energy from Waste Holdings Limited provides energy recovery facility services.

(2) INEOS Runcorn (TPS) Holdings Limited provides energy recovery facilities. The Group's economic interest is 75%, as set out in note 40, and voting rights are only 40% giving joint control over the Runcorn I ERF. As such the investment is classified as a joint venture and equity accounting has been applied.

Both joint ventures, which have non-coterminous year ends, are being sold with the Viridor business and as at 31 March 2020 are classified as assets held for sale. The aggregate capital and reserves of INEOS Runcorn (TPS) Holdings Limited at 31 December 2019 was £70.3 million (2019 £59.9 million) and its profit before tax for the year was £10.1 million (2019 £5.6 million). The aggregate capital and reserves of Lakeside Energy from Waste Holdings Limited at 30 September 2019 was £18.7 million (2019 £12.3 million) and its profit before tax for the year was £18.4 million (2019 £19.2 million).

Details of the Group's principal subsidiary and joint venture undertakings are set out in note 40.

The Group's joint ventures are all private companies and there are no quoted market prices available for their shares.

21. Inventories

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Raw materials and consumables	4.9	28.8	–	–

Excluded from the balance at 31 March 2020 above is £29.9 million relating to assets held for sale (see note 46 for further details).

22. Trade and other receivables – current

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Trade receivables	241.9	360.2	–	–
Less: allowance for expected credit losses in respect of trade receivables	(106.1)	(99.0)	–	–
Net trade receivables	135.8	261.2	–	–
Amounts owed by related parties (note 44)	–	7.7	–	–
Amounts owed by subsidiary undertakings	–	–	18.3	19.9
Other receivables	10.0	5.9	0.2	0.1
Accrued income	29.3	123.3	0.2	0.1
Prepayments	10.7	86.7	6.0	1.5
	185.8	484.8	24.7	21.6

Excluded from the balances at 31 March 2020 above is £277.9 million relating to assets held for sale (see note 46 for further details).

Trade receivables include accrued income relating to customers with water budget payment plan. Decreased demand in the water business has resulted in a decrease in trade receivables balances.

Accrued income includes £26.9 million in respect of metered accrual revenue in the retail water business. Metered accrual revenue relates to performance obligations that have been fully extinguished in providing services to customers prior to the reporting date. Payment in respect of these services is a matter of time following issuance of invoices.

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

There is no concentration of credit risk in trade receivables. The Group has a large number of customers who are dispersed and there is no significant loss on trade receivables expected that has not been provided for.

The Group applies the simplified approach in calculating the expected credit losses for trade receivables allowing a provision matrix to be used which is based on the expected life of trade receivables, default rates for different customer categories within the collection process and forward-looking information.

22. Trade and other receivables – current continued

As at 31 March, an analysis of the ageing of trade receivables is as follows:

	2020 £m	2019 £m
Group		
Not due	33.7	152.2
Past due 1 – 30 days	15.8	22.5
Past due 31 – 120 days	17.2	25.2
More than 120 days	175.2	160.3
	241.9	360.2

The aged trade receivables above are taken directly from aged sales ledger records before deduction of credit balances and other adjustments.

The Group's operating businesses specifically review separate categories of debt to identify an appropriate allowance for expected credit losses as outlined in note 2(p). South West Water Limited has a duty under legislation to continue to provide domestic customers with services regardless of payment. The expected credit loss rate applied ranges from 0% (not due) to 100% (>120 days and untraced previous occupier).

No material expected credit loss provision has been recognised in respect of amounts owed by subsidiary undertakings.

The movement in the allowance for expected credit losses in respect of trade receivables was:

	2020 £m	2019 £m
At 1 April	99.0	104.3
Provision for expected credit losses	11.6	3.2
Receivables written off during the year as uncollectable	(1.6)	(8.5)
Transfer to assets held for sale	(2.9)	–
At 31 March	106.1	99.0

23. Derivative financial instruments

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Derivatives used for cash flow hedging				
Non-current assets	1.2	1.0	1.2	1.1
Current assets	2.2	2.1	2.0	2.0
Current liabilities	(6.9)	(10.7)	(0.9)	(0.2)
Non-current liabilities	(27.2)	(9.8)	(2.8)	(0.7)
Derivatives used for fair value hedging				
Non-current assets	2.9	2.6	2.9	2.6
Current assets	0.5	0.8	0.5	0.8
Current liabilities	–	–	–	–
Non-current liabilities	–	–	–	–
Derivatives not in a hedge accounting relationship				
Non-current assets	–	66.9	–	–
Current assets	–	8.9	–	–
Current liabilities	(0.2)	(0.4)	–	–
Non-current liabilities	–	(0.1)	–	–

The Group's financial risks and risk management policies are set out in note 3. The fair value of derivatives is split between current and non-current assets or liabilities based on the maturity of the cash flows. The ineffective portion recognised in the income statement arising from hedging relationships was £nil (2019 £nil).

During the year a £8.6 million charge (2019 £6.8 million) was recognised in profit and loss relating to cash flow hedges previously recognised through other comprehensive income and recorded in the hedging reserve. A £14.3 million charge (2019 £6.4 million charge) was recognised as an other comprehensive loss/income for cash flow hedges that may be classified subsequently to profit and loss.

Interest rate swaps, primarily cash flow hedges, and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 60% of Group net borrowings are at fixed rate. At 31 March 2020 55% of Group net borrowings were at fixed rate (2019 63%). While this level is below our policy of maintaining at least 60% of interest-bearing liabilities at fixed rates, it reflects considerations regarding Pennon's debt levels following the Group's announcement of the strategic review and the subsequent announcement of the proposed sale of Viridor.

At 31 March 2020 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £1,178 million and a weighted average maturity of 4.0 years (2019 £1,529 million, with 3.2 years). The weighted average interest rate of the swaps for their nominal amount was 1.4% (2019 1.7%).

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23. Derivative financial instruments continued

The periods for which the cash flow hedges are expected to affect future profit or loss are as follows:

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Due over 5 years £m	Total £m
Group					
31 March 2020					
Assets	2.2	0.8	0.4	–	3.4
Liabilities	(7.3)	(7.0)	(19.4)	(0.8)	(34.5)
31 March 2019					
Assets	2.1	0.5	0.5	–	3.1
Liabilities	(10.7)	(2.1)	(5.8)	(1.9)	(20.5)
Company					
31 March 2020					
Assets	2.0	0.8	0.4	–	3.2
Liabilities	(0.9)	(0.8)	(1.6)	(0.4)	(3.7)
31 March 2019					
Assets	2.0	0.5	0.6	–	3.1
Liabilities	(0.2)	(0.2)	(0.4)	(0.1)	(0.9)

Valuation hierarchy

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

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

The fair value of financial instruments not traded in an active market (level 2, for example over-the-counter derivatives) is determined by using valuation techniques. A variety of methods and assumptions are used based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows.

The Group's financial instruments are valued using level 2 measures:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Assets				
Derivatives used for cash flow hedging	3.4	3.1	3.2	3.1
Derivatives used for fair value hedging	3.4	3.4	3.4	3.4
Derivatives not in a hedge accounting relationship	–	75.8	–	–
Total assets	6.8	82.3	6.6	6.5
Liabilities				
Derivatives used for cash flow hedging	(34.1)	20.5	(3.7)	0.9
Derivatives not in a hedge accounting relationship	(0.2)	0.5	–	–
Total liabilities	(34.3)	21.0	(3.7)	0.9

24. Financial instruments at fair value through profit

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Current liabilities	1.5	3.8	0.5	0.4
Non-current liabilities	43.1	43.1	1.1	1.4

Financial instruments at fair value through profit reflect the fair value movement of the hedged risk on the hedged item which had been designated in a fair value hedging relationship.

The hedged item was the £150 million bond issued by South West Water Finance Plc in 2010 which matures in July 2040 (see note 28). The hedging relationship was de-designated in previous periods at which point the fair value amount recognised at that point ceased to be revalued. The fixed financial liability at the point of de-designation is released to the income statement over the remaining life of the debt. Due to the de-designation the Group held a fixed to floating interest rate swap which was classified as a derivative not in a hedging relationship as disclosed in note 23. This derivative arrangement was settled early in the first half of the year ended 31 March 2020.

25. Cash and cash deposits

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Cash at bank and in hand	64.9	110.5	17.8	109.7
Short-term bank deposits	175.0	45.0	150.0	45.0
Other deposits	426.0	414.1	200.1	130.1
Total cash and cash deposits	665.9	569.6	367.9	284.8

Excluded from the balances at 31 March 2020 above is £33.3 million relating to assets held for sale (see note 46 for further details).

Group short-term deposits have an average maturity of 1 working day.

Group other deposits have an average maturity of 50 days.

Group other deposits include restricted funds of £227.2 million (2019 £203.9 million) to settle long-term lease liabilities (note 28). Restricted funds are available for access, subject to being replaced by an equivalent valued security.

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

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Cash and cash deposits as above	665.9	569.6	367.9	284.8
Cash and cash deposits held in the Disposal Group	33.3	–	–	–
Less: deposits with a maturity of three months or more (restricted funds)	(227.2)	(203.9)	–	–
	472.0	365.7	367.9	284.8

26. Trade and other payables – current

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Trade payables	64.2	127.6	2.8	0.2
Contract liabilities	2.0	10.3	–	–
Amounts owed to subsidiary undertakings	–	–	0.4	0.1
Amounts owed to joint ventures (note 44)	–	4.1	–	–
Other tax and social security	2.8	32.5	0.8	0.8
Accruals	15.5	–	–	–
Other payables	30.8	123.5	15.8	14.7
	115.3	298.0	19.8	15.8

Excluded from the balances above is £141.7 million relating to liabilities directly associated with assets classified as held for sale (see note 46 for further details).

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

The movement in the contract liabilities was:

	2020 £m	2019 £m
Contract liabilities		
At 1 April	126.4	120.2
Revenue recognised in the year	(9.6)	(12.2)
Consideration received in advance of completion of performance obligations	24.7	18.4
Transfer to liabilities associated with assets held for sale	(16.6)	–
At 31 March	124.9	126.4

The analysis of contract liabilities between current and non-current is:

	2020 £m	2019 £m
Current	2.0	10.3
Non-current (note 29)	122.9	116.1
	124.9	126.4

Performance obligations related to the current contract liabilities balance above are expected to be satisfied, and revenue will be recognised, within the financial year ended 31 March 2020.

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27. Current tax assets/(liabilities)

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Current year debtor/(creditor)	0.7	(12.9)	(0.6)	(1.9)
Prior year tax items	1.2	(6.2)	(1.9)	(1.7)
	1.9	(19.1)	(2.5)	(3.6)

Excluded from the balances above is £1.0 million of current tax liabilities relating to liabilities directly associated with assets classified as held for sale (see note 46 for further details).

28. Borrowings

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Current				
Short-term loans	7.6	59.8	–	51.8
European Investment Bank	33.1	27.0	6.1	–
Amounts owed to subsidiary undertakings (note 44)	–	–	284.4	283.9
	40.7	86.8	290.5	335.7
Leases (IAS 17 finance)	18.2	63.6	–	–
Leases (IAS 17 operating)	1.0	–	–	–
Total current borrowings	59.9	150.4	290.5	335.7
Non-current				
Bank and other loans	702.1	443.1	520.4	370.9
Private placements	618.2	616.2	511.6	509.3
Bond 2040	134.5	134.2	–	–
RPI index-linked bonds	440.0	434.5	–	–
European Investment Bank	340.8	373.9	103.4	109.5
Amounts owed to subsidiary undertakings (note 44)	–	–	–	–
	2,235.6	2,001.9	1,135.4	989.7
Leases (IAS 17 finance)	1,384.2	1,496.8	–	–
Leases (IAS 17 operating)	35.1	–	–	–
Total non-current borrowings	3,654.9	3,498.7	1,135.4	989.7
Total borrowings	3,714.8	3,649.1	1,425.9	1,325.4

Excluded from the balances above is £19.0 million of current and £229.4 million of non-current borrowings relating to liabilities directly associated with assets classified as held for sale (see note 46 for further details).

Refer to note 45 for further details regarding the impact of IFRS 16 'Leases'. References above to IAS 17 finance and IAS 17 operating leases represent the classification of these lease balances under IAS 17 prior to implementation of IFRS 16.

The Group has leases for various assets as shown in note 17.

The Company issued a £100 million private placement in July 2007 maturing in 2022. Interest is payable at a fixed rate of 3.3%.

South West Water Finance Plc issued a £200 million RPI index-linked bond in July 2008 maturing in 2057 with a cash coupon of 1.99%. South West Water Finance Plc issued a £150 million bond in July 2010 maturing in 2040 with a cash coupon of 5.875%.

Bournemouth Water Limited issued a £65 million RPI index-linked bond in April 2005 maturing in 2033 with a cash coupon of 3.084%. This instrument was transferred to South West Water Limited in April 2017.

28. Borrowings continued

The fair values of non-current borrowings, valued using level 2 measures (as set out in note 23) were:

	2020		2019	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Group				
Bank and other loans	702.1	709.7	443.1	447.3
Private placements	618.2	689.8	616.2	657.7
Bond 2040	134.5	206.1	134.2	197.5
RPI index-linked bond	440.0	536.0	434.5	526.4
European Investment Bank	340.8	324.3	373.9	345.2
	2,235.6	2,465.9	2,001.9	2,174.1
Leases	1,419.3	–	1,496.8	1,431.6
	3,654.9	2,465.9	3,498.7	3,605.7
Company				
Bank and other loans	520.4	528.0	370.9	375.3
European Investment Bank	103.4	103.4	109.5	109.5
Private placements	511.6	583.1	509.3	557.7
Amounts owed to subsidiary undertakings (note 44)	–	–	–	–
	1,135.4	1,214.5	989.7	1,042.5

Following the application of IFRS 16 during the year ended 31 March 2020 the disclosure relating to the fair value of leases is no longer required.

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

The maturity of non-current borrowings was:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Between 1 and 2 years	315.1	68.3	204.4	51.8
Over 2 years and less than 5 years	590.1	834.5	393.0	557.7
Over 5 years	2,749.7	2,595.9	538.0	380.2
	3,654.9	3,498.7	1,135.4	989.7

The weighted average maturity of non-current borrowings was 17 years (2019 18 years).

The maturity of lease liabilities was:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Within 1 year	19.2	63.6	–	–
Over 1 year and less than 5 years	149.0	188.9	–	–
Over 5 years	1,270.3	1,307.9	–	–
	1,438.5	1,560.4	–	–

The discount rate used to calculate the lease liabilities above involves estimation. Where there is no rate implicit in the lease the Group uses an estimated incremental borrowing rate (IBR). At 31 March 2020 the range of IBR's used for the Continuing Group was between 2.93% and 4.5% and the weighted average IBR across all leases was 3.8%. If the weighted average rate used increased or decreased by 10bps, this would result in a c.3.8% increase or reduction in the present value of lease liabilities recognised at 31 March 2020.

Included above is a total present value of liabilities of £1,402.3 million representing amounts previously classified as finance leases under IAS 17 prior to implementation of IFRS 16.

Included above are accrued finance charges arising on obligations under agreements previously classified as finance leases under IAS 17 totalling £165.0 million (2019 £163.7 million), of which £1.1 million (2019 £3.7 million) is repayable within one year.

The period for repayment of certain leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £107.9 million at 31 March 2020 (2019 £97.5 million), are currently being held to settle the lease liability, subject to rights to release by negotiation with the lessor. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

The period for repayment of certain other 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, £118.0 million at 31 March 2020 (2019 £105.1 million), are currently being held to settle the lease liability, subject to rights to release by negotiation with the lessor. The deposits are subject to a registered charge given as security to the lessor for the outstanding balance.

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28. Borrowings continued

Undrawn committed borrowing facilities at the balance sheet date were:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Floating rate:				
Expiring within 1 year	–	–	–	–
Expiring after 1 year	940.0	600.0	705.0	405.0
	940.0	600.0	705.0	405.0

In addition, at 31 March 2020 the Group had undrawn uncommitted short-term bank facilities of £300.0 million (2019 £300.0 million) available to the Company.

29. Other non-current liabilities

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Amounts owed to subsidiary undertakings	–	–	8.6	8.6
Contract liabilities	122.9	116.1	–	–
Deferred income	–	7.5	–	–
Other payables	–	24.3	–	–
	122.9	147.9	8.6	8.6

Excluded from the balances above is £14.3 million relating to liabilities directly associated with assets classified as held for sale (see note 46 for further details).

Non-current contract liabilities relate to consideration received in advance of the Group performing its performance obligations to customers where performance obligations will not be completed within 12 months of the balance sheet date. The overall movement in total contract liabilities is disclosed in note 26. Contract liabilities reflect the fair value of assets transferred from customers in the water segment.

Included in other payables as at 31 March 2019 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. These amounts have been transferred to/from other non-current liabilities to provisions within liabilities associated with assets held for sale (see note 46 for further details).

30. Retirement benefit obligations

During the year the Group operated a number of defined benefit pension schemes and also a defined contribution scheme. The principal plan within the Group is the Pennon Group Pension Scheme, which is a funded defined benefit, final salary pension scheme in the UK. The Group's pension schemes are established under trust law and comply with all relevant UK legislation.

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

Defined contribution schemes

Pension costs for defined contribution schemes were £90 million (2019 £8.8 million), of which £2.5 million (2019 £2.5 million) relates to the Continuing Group.

Defined benefit schemes

Assumptions

The principal actuarial assumptions at 31 March were:

	2020 %	2019 %	2018 %
Rate of increase in pensionable pay	2.7	3.3	3.2
Rate of increase for current and future pensions	2.5	3.2	3.0
Rate used to discount schemes' liabilities and expected return on schemes' assets	2.30	2.40	2.70
Inflation	2.7	3.3	3.2

Mortality

Assumptions regarding future mortality experience are set based on actuarial advice in accordance with published statistics and experience. The mortality assumption uses a scheme-specific calculation based on CMI 2019 actuarial tables with an allowance for future longevity improvement.

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

	2020	2019	2018
Male	24.7	23.9	24.9
Female	26.9	26.3	27.3

30. Retirement benefit obligations continued

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

	2020	2019	2018
Male	25.4	25.0	26.3
Female	27.9	28.1	29.6

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%	+/- 1.4%
Rate of increase in current and future pensions	+/- 0.5%	+/- 6.9%
Rate used to discount schemes' liabilities	+/- 0.5%	+/- 9.3%
Inflation	+/- 0.5%	+/- 7.0%
Life expectancy	+/- 1 year	+/- 4.0%

The sensitivity analysis shows the effect of changes in the principal assumptions used for the measurement of the pension liability. The method used to calculate the sensitivities is approximate and has been determined taking into account the duration of the liabilities and the overall profile of each schemes' membership. This is the same approach as has been adopted in previous years.

The amounts recognised in the balance sheet, excluding amounts transferred to liabilities directly associated with assets classified as held for sale, were:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Present value of financial obligations	(685.3)	(974.2)	47.9	(58.5)
Fair value of plan assets	691.9	934.0	(48.0)	55.1
Surplus/(deficit) of funded plans	6.6	(40.2)	(0.1)	(3.4)
Impact of minimum funding asset ceiling	–	(20.6)	–	–
Net asset/(liability) recognised in the balance sheet	6.6	(60.8)	(0.1)	(3.4)

The movement in the net defined benefit obligation over the accounting period is as follows:

	2020			2019		
	Present value of obligation £m	Fair value of plan assets £m	Total £m	Present value of obligation £m	Fair value of plan assets £m	Total £m
At 1 April	(994.8)	934.0	(60.8)	(948.0)	898.5	(49.5)
Current service cost	(8.1)	–	(8.1)	(13.1)	–	(13.1)
Past service cost and gains and losses on settlements	2.0	–	2.0	(3.0)	–	(3.0)
Interest (expense)/income	(23.1)	22.3	(0.8)	(25.2)	23.8	(1.4)
	(29.2)	22.3	(6.9)	(41.3)	23.8	(17.5)
Remeasurements:						
(Loss)/return on plan assets excluding amounts included in interest expense	–	(16.1)	(16.1)	–	20.2	20.2
(Loss)/gain from change in demographic assumptions	(3.9)	–	(3.9)	41.6	–	41.6
Gain/(loss) from change in financial assumptions	51.9	(9.0)	42.9	(75.8)	–	(75.8)
Experience losses	(5.2)	–	(5.2)	(3.2)	–	(3.2)
	42.8	(25.1)	17.7	(37.4)	20.2	(17.2)
Contributions:						
Employers	–	41.5	41.5	–	23.4	23.4
Plan participants	(0.3)	0.3	–	(1.0)	1.0	–
Payments from plans:						
Benefit payments	38.7	(38.7)	–	32.9	(32.9)	–
	38.4	3.1	41.5	31.9	(8.5)	23.4
Transfer to liabilities directly associated with assets held for sale	257.5	(242.4)	15.1	–	–	–
At 31 March	(685.3)	691.9	6.6	(994.8)	934.0	(60.8)

Past service cost for the current year includes a non-underlying credit of £4.9 million representing the reduction in liabilities that result from the termination of the Greater Manchester contract (see note 6).

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30. Retirement benefit obligations continued

The movement in the Company's net defined benefit obligation over the accounting period is as follows:

	2020			2019		
	Present value of obligation £m	Fair value of plan assets £m	Total £m	Present value of obligation £m	Fair value of plan assets £m	Total £m
At 1 April	(58.5)	55.1	(3.4)	(56.5)	53.2	(3.3)
Current service cost	(0.2)	–	(0.2)	(0.3)	–	(0.3)
Past service cost and gains and losses on settlements	–	–	–	(0.2)	–	(0.2)
Interest (expense)/income	(0.4)	0.3	(0.1)	(1.5)	1.4	(0.1)
	(0.6)	0.3	(0.3)	(2.0)	1.4	(0.6)
Remeasurements:						
(Loss)/return on plan assets excluding amounts included in interest expense	–	(6.0)	(6.0)	–	2.1	2.1
(Loss)/gain from change in demographic assumptions	(0.2)	–	(0.2)	2.6	–	2.6
Gain/(loss) from change in financial assumptions	3.0	–	3	(4.5)	–	(4.5)
Experience gains/(losses)	6.1	–	6.1	(0.2)	–	(0.2)
	8.9	(6.0)	2.9	(2.1)	2.1	–
Contributions:						
Employers	–	0.7	0.7	–	0.5	0.5
Payments from plans:						
Benefit payments	2.2	(2.2)	–	2.1	(2.1)	–
	2.2	(1.5)	0.7	2.1	(1.6)	0.5
At 31 March	(48.0)	47.9	(0.1)	(58.5)	55.1	(3.4)

The Group has one smaller pension scheme which is in surplus and is deemed to have irrecoverable assets in accordance with IFRIC 14 'The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'. This relates to the Disposal Group and has been transferred to liabilities associated with assets held for sale (see note 46).

Changes in the effect of the asset ceiling during the year were:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Irrecoverable asset at start of the year	20.6	16.8	–	–
Interest on irrecoverable surplus	0.5	0.5	–	–
Actuarial (losses)/gains	(7.0)	3.3	–	–
Transfer to liabilities associated with assets held for sale	(14.1)	–	–	–

The schemes' assets relating to the Continuing Group were:

	2020			2019		
	Quoted prices in active market £m	Prices not quoted in active market £m	Fund %	Quoted prices in active market £m	Prices not quoted in active market £m	Fund %
Equities	109.9	–	23	234.5	–	25
Government bonds	78.1	–	10	134.6	–	14
Other bonds	174.2	104.0	35	247.1	–	26
Diversified growth	110.0	–	18	154.7	13.1	18
Property	48.5	6.8	7	68.1	3.4	8
Insurance linked security	49.2	–	6	55.2	–	6
Other (including cash funds)	11.2	–	1	23.3	–	3
	581.1	110.8	100	917.5	16.5	100

Other assets at 31 March 2020 represented principally cash contributions received from the Group towards the year end which were invested during the subsequent financial year.

30. Retirement benefit obligations continued

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

	2020			2019		
	Quoted prices in active market £m	Prices not quoted in active market £m	Fund %	Quoted prices in active market £m	Prices not quoted in active market £m	Fund %
Equities	7.6	–	16	10.4	–	19
Government bonds	5.4	–	11	9.4	–	17
Other bonds	19.3	–	40	16.6	–	30
Diversified growth	7.6	–	16	8.9	–	16
Property	3.8	–	8	4.8	–	9
Insurance linked security	3.4	–	7	3.7	–	7
Other	0.8	–	2	1.3	–	2
	47.9	–	100	55.1	–	100

Through its defined benefit pension plan, the Group is exposed to a number of risks, the most significant of which are detailed below:

Asset volatility	The liabilities are calculated using a discount rate set with reference to corporate bond yields; if assets underperform this yield, this will create a deficit. The schemes hold a significant proportion of growth assets (equities and diversified growth funds) which are expected to outperform corporate bonds in the long term, but can give rise to volatility and risk in the short term. The allocation to growth assets is monitored such that it is suitable with the schemes' long-term objectives.
Changes in bond yields	A decrease in corporate bond yields will increase the schemes' liabilities, although this will be partially offset by an increase in the value of the schemes' bond holdings.
Inflation risk	The majority of the schemes' benefit obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation). The majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit.
Life expectancy	The majority of the schemes' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the liabilities.

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

- Holding of cash funds and bonds which are expected to be less volatile than most other asset classes and reflects market movements in the schemes' liabilities
- A proportion of assets with fund managers having freedom in making investment decisions to maximise returns
- Investment of a proportion of the schemes' assets in alternative asset classes which give the potential for diversification (currently property, insurance linked securities and diversified growth).

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

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

The 2019 triennial actuarial valuation of the principal defined benefit scheme has been agreed with an actuarial valuation deficit increasing of £53 million. The Group has made deficit recovery contributions of £31.9 million during the year (2019 £13.1 million), £18.8 million being in advance of the previously agreed recovery plan. Following the finalisation of the 2019 actuarial valuation, the Group is required to make further deficit recovery contributions, in addition to those amounts paid in the year to 31 March 2020, of £2.8 million and £0.4 million in March 2021 and March 2022 respectively, with these amounts being adjusted for inflation. The Group monitors funding levels on an annual basis and the Continuing Group expects to pay total contributions of around £7 million, including expenses, during the year ended 31 March 2021. The new schedule of contributions is in line with the 2016 triennial actuarial valuation.

31. Deferred tax

Deferred tax is provided in full on temporary differences under the liability method using enacted tax rates.

Movements on deferred tax were:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Liabilities/(assets) at 1 April	305.1	295.6	(1.2)	(1.6)
Opening adjustment on adoption of IFRS 16 Leases	(1.8)	–	–	–
Charged/(credited) to the income statement	33.2	13.3	(0.1)	0.2
(Credited)/charged to equity, including impact of change in tax rate	(4.6)	(4.3)	–	0.2
Change of tax rate charged to the income statement – non-underlying	40.6	–	(0.5)	–
Other non-underlying charges in the income statement	(12.7)	0.5	–	–
Transferred to liabilities associated with assets classified as held for sale	(98.2)	–	–	–
Liabilities/(assets) at 31 March	261.6	305.1	(1.8)	(1.2)

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

The majority of the Group's deferred tax liability is expected to be recovered over more than one year. The majority of the Company's deferred tax asset is expected to be recovered over more than one year. All deferred tax assets and liabilities within the same jurisdiction are offset.

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31. Deferred tax continued

The movements in deferred tax assets and liabilities were:

	Revenue on service concession arrangements				Total £m
	Accelerated tax depreciation £m	Fair value adjustments £m	Derivatives £m	Derivatives £m	
At 1 April 2018	259.9	20.6	43.7	0.7	324.9
Charged/(credited) to the income statement	12.1	(4.1)	4.4	(0.2)	12.2
Non-underlying credit to the income statement	–	–	–	1.0	1.0
Charged to equity/SOCI	–	–	–	(0.6)	(0.6)
At 31 March 2019	272.0	16.5	48.1	0.9	337.5
Opening adjustment on adoption of IFRS 16 Leases	(1.8)	–	–	–	(1.8)
Charged/(credited) to the income statement	24.8	(1.3)	2.1	–	25.6
Non-underlying charge/(credit) to the income statement	33.0	1.9	5.5	(12.5)	27.9
Charged to equity/SOCI	–	–	–	(3.1)	(3.1)
Transfer to deferred tax assets	–	–	–	14.7	14.7
Transferred to liabilities directly associated with assets classified as held for sale	(53.6)	–	(55.7)	–	(109.3)
At 31 March 2020	274.4	17.1	–	–	291.5

Deferred tax assets

	Short-term liabilities including provisions £m	Retirement benefit obligations £m	Derivatives £m	Share-based payments £m	Tax losses £m	Fair value adjustment £m	Other £m	Total £m
	At 1 April 2018	(5.4)	(8.4)	–	(0.8)	(1.7)	(9.9)	(3.1)
Charged/(credited) to the income statement	0.1	0.5	–	0.1	0.5	1.3	(1.4)	1.1
Non-underlying credit to the income statement	–	(0.5)	–	–	–	–	–	(0.5)
Charged to equity/SOCI	–	(3.2)	–	(0.5)	–	–	–	(3.7)
At 31 March 2019	(5.3)	(11.6)	–	(1.2)	(1.2)	(8.6)	(4.5)	(32.4)
Charged/(credited) to the income statement	3.5	3.4	–	(0.3)	(0.1)	0.7	0.4	7.6
Non-underlying (credit)/charge to the income statement	(1.1)	2.8	–	(0.1)	(0.2)	(1.0)	(0.4)	–
Charged to equity/SOCI	–	(0.1)	–	(1.4)	–	–	–	(1.5)
Transfer from deferred tax liabilities	–	–	(14.7)	–	–	–	–	(14.7)
Transferred to liabilities directly associated with assets classified as held for sale	1.1	3.0	–	1.0	1.5	–	4.5	11.1
At 31 March 2020	(1.8)	(2.5)	(14.7)	(2.0)	–	(8.9)	–	(29.9)

Net liability

At 31 March 2019	305.1
At 31 March 2020	261.6

Company

Deferred tax assets

	Retirement benefit obligations £m	Derivatives £m	Share-based payments £m	Other £m	Total £m
	At 1 April 2018	(0.6)	(0.5)	(0.2)	(0.3)
Charged to the income statement	–	–	–	0.2	0.2
Charged to equity	–	0.2	–	–	0.2
At 31 March 2019	(0.6)	(0.3)	(0.2)	(0.1)	(1.2)
(Credited)/charged to the income statement	–	–	(0.2)	0.1	(0.1)
Non-underlying (credit) to the income statement	(0.5)	–	–	–	(0.5)
Charged/(credited) to equity, including impact on change in tax rate	1.0	(0.6)	(0.4)	–	–
At 31 March 2020	(0.1)	(0.9)	(0.8)	–	(1.8)

31. Deferred tax continued

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

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Remeasurement of defined benefit obligations	(0.1)	3.2	1.0	–
Cash flow hedges	(3.1)	0.6	(0.6)	0.2
Deferred tax on other comprehensive (gain)/loss	(3.2)	3.8	0.4	0.2
Share-based payments	(1.4)	0.5	(0.4)	–
	(4.6)	4.3	–	0.2

Capital allowances are available when a business incurs qualifying expenditure on capital items such as infrastructure assets. Capital allowances provide tax relief on these items in place of accounting depreciation which is not tax deductible. Over the period of ownership of an asset, cumulative depreciation and capital allowances will equalise. Capital allowance rates are set by the UK Government and every business receives the same rate of allowance. Capital allowance rates vary from 2% up to 100% in certain instances, with most items qualifying at either 6% or 18% per annum. Given the Group's continuing capital expenditure programme, it is likely that the deferred tax liability will continue in to the longer term.

The different accounting treatment of property, plant and equipment for tax and accounting purposes means that the taxable income of the Group is not the same as the profit reported in the financial statements. The adjustments for this are reflected in the current tax reconciliation.

Short-term temporary differences arise on items such as retirement benefit obligations, derivatives, fair value adjustments and share-based payments because the treatment of such items is different for tax and accounting purposes. These differences reverse over future years following that in which they arise, as is reflected in the deferred tax charge in these financial statements. Specifically, retirement benefit obligations will crystallise over the life of the pension scheme, the fair value items will be released over their useful remaining life which is up to 115 years while share-based payments will crystallise over the remaining period of the share schemes, which is up to five years. Short-term liabilities, including provisions typically crystallise in the following year.

Where interest charges or other costs are capitalised in the accounts, tax relief is either given as the charges are incurred or when the costs are taken to the income statement

32. Provisions

	Environmental and landfill restoration £m	Restructuring £m	Other provisions £m	Total £m
Group				
At 1 April 2019	209.6	1.1	21.1	231.8
Charged to the income statement	2.3	–	(5.0)	(2.7)
Capitalised	5.3	–	0.3	5.6
Utilised	(16.0)	(0.4)	(0.1)	(16.5)
Reclassification	–	(0.1)	0.1	–
Transferred to liabilities associated with assets classified as held for sale	(201.2)	–	(16.4)	(217.6)
At 31 March 2020	–	0.6	–	0.6

The amount charged to the income statement includes £7.9 million (2019 £11.1 million) charged to finance costs as the unwinding of discounts in provisions.

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

	2020 £m	2019 £m
Current	0.6	28.7
Non-current	–	203.1
	0.6	231.8

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. The provisions have been established assuming current waste management technology based upon estimated costs at future prices which have been discounted to present value. The Group has applied a discount rate of 4.220% (2019 4.825%) and an inflation rate of 2.0% (2019 2.5%) to its aftercare provision and a discount rate of 2.9% (2019 3.8%) and an inflation rate of 2.0% (2019 2.5%) to its restoration provision.

The restructuring provision relates principally to severance costs and will be utilised within one year.

Other provisions include underperforming contracts of £4.1 million (2019 £7.1 million), which are provided for at the net present value of the operating losses of the underperforming contracts and are to be utilised over the remaining period of the contract to which they relate. The weighted average contract life of underperforming contracts is three years (2019 five years).

Following the announced sale of the Group's waste management business, Viridor, the environmental, landfill restoration and other provisions have been transferred to liabilities directly associated with assets classified as held for sale, see note 46.

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33. Share capital

Allotted, called-up and fully paid

Group and Company	Number of shares		£m
	Treasury shares	Ordinary shares	
At 1 April 2018 ordinary shares of 40.7p each	8,443	419,743,183	170.8
For consideration of £5.1 million, shares issued under the Company's Sharesave Scheme	–	777,415	0.3
At 31 March 2019 ordinary shares of 40.7p each	8,443	420,520,598	171.1
For consideration of £3.6 million, shares issued under the Company's Sharesave Scheme	–	515,959	0.2
At 31 March 2020 ordinary shares of 40.7p each	8,443	421,036,557	171.3

Shares held as treasury shares may be sold or reissued for any of the Company's share schemes, or cancelled.

Employee share schemes

The Group operates a number of equity-settled share plans for the benefit of employees. Details of each plan are:

i) Sharesave Scheme

An all-employee savings-related plan is operated that enables employees, including Executive Directors, to invest up to a maximum of £500 per month for three or five years. These savings can then be used to buy ordinary shares, at a price set at a 17% discount to the market value at the start of the savings period, at the third or fifth year anniversary of the option being granted. Options expire six months following the exercise date and, except for certain specific circumstances such as redundancy, lapse if the employee leaves the Group before the option exercise period commences.

Outstanding options to subscribe for ordinary shares of 40.7p 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	
			2020	2019
14 July 2014	611p	2017 – 2019	2	142
24 June 2015	683p	2018 – 2020	142	194
29 June 2016	709p	2020 – 2021	76	478
28 June 2017	767p	2020 – 2022	327	462
3 July 2018	635p	2021 – 2023	1,115	1,367
9 July 2019	635p	2022 – 2024	874	–
			2,536	2,643

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

	2020		2019	
	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	2,643	674	2,490	700
Granted	925	620	1,456	635
Forfeited	(295)	678	(437)	717
Exercised	(514)	680	(777)	661
Expired	(223)	681	(89)	661
At 31 March	2,536	652	2,643	674

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 820p (2019 750p). The options outstanding at 31 March 2020 had a weighted average exercise price of 652p (2019 674p) and a weighted average remaining contractual life of 1.9 years (2019 2.0 years).

The number of exercisable Sharesave options at 31 March 2020 was 4,000 (2019 1,000) and the weighted average exercise price of exercisable Sharesave options was 649p (2019 683p).

The aggregate fair value of Sharesave options granted during the year was £0.9 million (2019 £0.8 million), determined using the Black-Scholes valuation model.

The significant inputs into the valuation model at the date of issue of the options were:

	2020	2019
Weighted average share price	765	801
Weighted average exercise price	620	635
Expected volatility	20.0%	20.0%
Expected life	3.3 years	3.3 years
Risk-free rate	0.75%	0.5%
Expected dividend yield	5.7%	5.2%

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

33. Share capital continued

ii) Performance and Co-investment Plan

Executive Directors and senior management receive a conditional award of ordinary shares in the Company and are also required to hold a substantial personal shareholding in the Company. The eventual number of shares, if any, which vest is dependent upon the achievement of conditions of the plan over the restricted period, being not less than three years. From 2017/18, no further awards are made under this Plan as it has been superseded by a long-term incentive plan (see iii below).

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

	2020		2019	
	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	256	920	571	865
Vested	(86)	920	–	–
Lapsed	(170)	920	(315)	820
At 31 March	–	–	256	920

There were no outstanding awards at 31 March 2020. The awards outstanding at 31 March 2019 had a weighted exercise price of 920p and a weighted average remaining contractual life of 0.3 years.

iii) Long-term incentive plan (LTIP)

Executive Directors and senior management receive an annual grant of conditional shares. Share awards vest subject to the achievement of specific performance conditions measured over a performance period of not less than three years.

The number and price of shares in the LTIP are:

	2020		2019	
	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	962	796	510	803
Granted	509	753	526	790
Vested	–	–	–	–
Lapsed	(125)	787	(74)	798
At 31 March	1,346	781	962	796

The awards outstanding at 31 March 2020 had a weighted exercise price of 781p (2019 796p) and a weighted average remaining contractual life of 1.4 years (2019 1.9 years).

The aggregate fair value of awards granted during the year was £1.5 million (2019 £1.7 million), determined from market value. No option pricing methodology is applied since the vesting of the shares depend on non-market performance vesting conditions.

iv) Annual Incentive Bonus Plan – deferred shares

Awards under the plan to Executive Directors and senior management involve the release of ordinary shares in the Company to participants. There is no performance condition since vesting is conditional upon continuous service with the Group for a period of three years from the award. The number and weighted average price of shares in the Annual Incentive Bonus Plan are:

	2020		2019	
	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	450	825	405	843
Granted	215	755	191	761
Vested	(113)	950	(117)	791
Lapsed	(28)	786	(29)	790
At 31 March	524	772	450	825

The awards outstanding at 31 March 2020 had a weighted average exercise price of 772p (2019 825p) and a weighted average remaining contractual life of 1.5 years (2019 1.5 years). The Company's share price at the date of the awards ranged from 761p to 950p.

The aggregate fair value of awards granted during the year was £1.6 million (2019 £1.1 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.

Notes to the financial statements

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34. Share premium account

	£m
Group and Company	
At 1 April 2018	218.8
Shares issued under the Sharesave Scheme	4.8
At 31 March 2019	223.6
Shares issued under the Sharesave Scheme	3.4
At 31 March 2020	227.0

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 2018	144.2
At 31 March 2019	144.2
At 31 March 2020	144.2

36. Retained earnings and other reserves

	Own shares £m	Hedging reserve £m	Retained earnings £m	Total £m
Group				
At 1 April 2018	(3.5)	(11.1)	821.7	807.1
Profit for the year	–	–	214.3	214.3
Other comprehensive loss for the year	–	(5.8)	(13.5)	(19.3)
Dividends paid relating to 2018	–	–	(162.0)	(162.0)
Credit to equity in respect of share-based payments (net of tax)	–	–	4.4	4.4
Charge in respect of share options vesting	1.0	–	(1.0)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(1.5)	–	–	(1.5)
At 31 March 2019	(4.0)	(16.9)	863.9	843.0
IFRS 16 Leases opening adjustment	–	–	(8.0)	(8.0)
At 1 April 2019 (adjusted for IFRS 16)	(4.0)	(16.9)	855.9	835.0
Profit for the year	–	–	200.4	200.4
Other comprehensive income for the year	–	(11.2)	18.0	6.8
Dividends paid relating to 2019	–	–	(172.6)	(172.6)
Credit to equity in respect of share-based payments (net of tax)	–	–	4.8	4.8
Charge in respect of share options vesting	1.1	–	(1.1)	–
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	(1.6)	–	–	(1.6)
At 31 March 2020	(4.5)	(28.1)	905.4	872.8

The own shares reserve represents the cost of ordinary shares in Pennon Group plc issued to or purchased in the market and held by the Pennon Group plc Employee Benefit Trust to satisfy awards under the Group's Annual Incentive Bonus Plan.

36. Retained earnings and other reserves continued

The market value of the 589,000 ordinary shares (2019 520,000 ordinary shares) held by the Trust at 31 March 2020 was £6.4 million (2019 £3.8 million).

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 2018	(2.0)	1,113.1	1,111.1
Profit for the year	–	194.8	194.8
Other comprehensive income for the year	0.2	–	0.2
Dividends paid relating to 2018	–	(162.0)	(162.0)
Credit to equity in respect of share-based payments (net of tax)	–	1.5	1.5
Charge in respect of share options vesting	–	(0.9)	(0.9)
At 31 March 2019	(1.8)	1,146.5	1,144.7
Profit for the year	–	330.6	330.6
Other comprehensive (loss)/income for the year	(2.1)	2.6	0.5
Dividends paid relating to 2019	–	(172.6)	(172.6)
Credit to equity in respect of share-based payments (net of tax)	–	2.0	2.0
Charge in respect of share options vesting	–	(1.1)	(1.1)
At 31 March 2020	(3.9)	1,308.0	1,304.1

In making decisions about the level of dividends to be proposed the Directors take steps to check that retained earnings reflect realised profits and are therefore distributable within the requirements of the Companies Act 2006.

37. Perpetual capital securities

	£m
Group and Company	
At 1 April 2018	296.7
Distributions to perpetual capital security holders	(8.6)
Profit for the year attributable to perpetual capital security holders	8.6
At 31 March 2019	296.7
Distributions due to perpetual capital security holders	(8.6)
Current tax relief on distributions to perpetual capital security holders	1.6
Profit for the year attributable to perpetual capital security holders	7.0
At 31 March 2020	296.7

On 22 September 2017 the Company issued £300 million 2.875% perpetual capital securities. Costs directly associated with the issue of £3.3 million were set off against the value of the issuance. They have no fixed redemption date but the Company can at its sole discretion redeem all, but not part, of these securities at their principal amount on 22 May 2020 or any subsequent periodic return payment date after this.

The Company 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.

As the Company paid a dividend in the 12 months prior to the periodic return date of 22 May 2020, a periodic return of £8.6 million (2019 £8.6 million) has been recognised as a financial liability at the year end.

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	
	2020 £m	2019 £m	2020 £m	2019 £m
Profit for the year	206.3	222.6	337.7	203.4
Adjustments for:				
Share-based payments	3.4	3.6	1.7	1.5
Profit on disposal of property, plant and equipment	(2.5)	(3.9)	–	–
Depreciation charge	197.2	190.0	–	–
Amortisation of intangible assets	4.7	5.2	–	–
Non-underlying increase in customer debt provisions	9.0	–	–	–
Non-underlying past service pension credit	(4.9)	–	–	–
Non-underlying remeasurement of fair value movement in derivatives	(18.0)	(5.8)	–	–
Share of post-tax profit from joint ventures	(14.8)	(12.4)	–	–
Finance income	(26.6)	(23.5)	(45.4)	(45.9)
Finance costs (before non-underlying items)	115.3	106.7	38.2	35.5
Dividends receivable	–	–	(335.6)	(196.7)
Taxation charge	95.2	37.7	4.2	3.7
Changes in working capital:				
Increase in inventories	(6.0)	(4.2)	–	–
(Increase)/decrease in trade and other receivables	32.6	(46.4)	(182.9)	(178.8)
Decrease/(Increase) in service concession arrangements receivable	(17.4)	6.8	–	–
(Decrease)/Increase in trade and other payables	(19.2)	(47.7)	2.5	(45.6)
Decrease in retirement benefit obligations from contributions	(30.8)	(7.3)	(0.7)	(0.1)
Decrease in provisions	(7.2)	(21.6)	–	–
Cash generated/(outflow) from operations	516.3	399.8	(180.3)	(223.0)

Reconciliation of total interest paid:

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Interest paid in operating activities	97.7	83.9	37.4	36.8
Interest paid in investing activities	10.6	15.2	–	–
Total interest paid	108.3	99.1	37.4	36.8

The above includes the entire Group, including cash flows relating to the discontinued operations business. Disaggregated information relating to the discontinued business is provided in note 46.

During the year, the Group completed a number of sale and leaseback transactions in respect of its infrastructure assets as part of its ongoing financing arrangements. Cash proceeds of £115.0 million were received and a gain of £nil was recognised. These assets are primarily being leased back over an initial term of 10-year lease term at market rentals.

39. Net borrowings

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Cash and cash deposits	665.9	569.6	367.9	284.8
Borrowings – current				
Bank and other loans	(7.6)	(59.8)	–	(51.8)
Other current borrowings	(33.1)	(27.0)	(6.1)	–
Lease obligations (IAS 17 finance)	(18.2)	(63.6)	–	–
Lease obligations (IAS 17 operating)	(1.0)	–	–	–
Amounts owed to subsidiary undertakings	–	–	(284.4)	(283.9)
Total current borrowings	(59.9)	(150.4)	(290.5)	(335.7)
Borrowings – non-current				
Bank and other loans	(1,894.8)	(1,628.0)	(1,032.0)	(880.2)
Other non-current borrowings	(340.8)	(373.9)	(103.4)	(109.5)
Lease obligations (IAS 17 finance)	(1,384.2)	(1,496.8)	–	–
Lease obligations (IAS 17 operating)	(35.1)	–	–	–
Total non-current borrowings	(3,654.9)	(3,498.7)	(1,135.4)	(989.7)
Total net borrowings in Continuing Group	(3,048.9)	(3,079.5)	(1,058.0)	(1,040.6)
Net borrowings in Disposal Group	(215.1)	–	–	–
Net borrowings in total Group	(3,264.0)	(3,079.5)	(1,058.0)	(1,040.6)

The movements in net borrowings during the periods presented were as follows:

Group	Net borrowings at 1 April 2018 £m	Cash flows – other £m	Foreign exchange adjustments £m	Other non-cash movements £m	Net borrowings at 31 March 2019 £m
Cash and cash deposits	585.3	(15.7)	–	–	569.6
Bank and other loans due within one year	(149.6)	149.6	–	(59.8)	(59.8)
Other current borrowings	(32.0)	32.0	–	(27.0)	(27.0)
Finance leases due within one year	(28.2)	28.2	–	(63.6)	(63.6)
Bank and other loans due after one year	(1,408.8)	(275.0)	1.6	54.2	(1,628.0)
Other non-current borrowings	(291.4)	(109.5)	–	27.0	(373.9)
Finance leases due after one year	(1,476.8)	(75.3)	–	55.3	(1,496.8)
	(2,801.5)	(265.7)	1.6	(13.9)	(3,079.5)

	Net borrowings at 1 April 2019 £m	IFRS 16 transition adjustment £m	Cash flows – other £m	Transfer between non-current and current £m	Other non-cash movements £m	Transfer to Disposal Group £m	Net borrowings at 31 March 2020 £m
Cash and cash deposits	569.6	–	129.6	–	–	(33.3)	665.9
Bank and other loans due within one year	(59.8)	–	57.6	(8.0)	2.6	–	(7.6)
Other current borrowings	(27.0)	–	27.0	(33.1)	–	–	(33.1)
Current lease obligations (IAS 17 finance)	(63.6)	–	63.6	(23.4)	(3.8)	9.0	(18.2)
Current lease obligations (IAS 17 operating)	–	(8.6)	13.0	(10.6)	(4.8)	10.0	(1.0)
Bank and other loans due after one year	(1,628.0)	–	(268.0)	8.0	(6.8)	–	(1,894.8)
Other non-current borrowings	(373.9)	–	–	33.1	–	–	(340.8)
Non-current lease obligations (IAS 17 finance)	(1,496.8)	–	(48.8)	23.4	–	138.0	(1,384.2)
Non-current lease obligations (IAS 17 operating)	–	(137.1)	–	10.6	–	91.4	(35.1)
	(3,079.5)	(145.7)	(26.0)	–	(12.8)	215.1	(3,048.9)
Net borrowings in Disposal Group							(215.1)
Net borrowing in total Group							(3,264.0)

Other non-cash movements for the Group include the increase in the value of financial liabilities at fair value through profit in the year of £0.3 million and the increase in borrowings from interest which is rolled into the amount repayable.

Company	Net borrowings at 1 April 2018 £m	Cash flows – other £m	Other non-cash movements £m	Net borrowings at 31 March 2019 £m
Cash and cash deposits	303.3	(18.5)	–	284.8
Bank and other loans due within one year	(149.6)	149.6	(51.8)	(51.8)
Amounts due to subsidiary undertakings	(283.6)	(0.3)	–	(283.9)
Bank and other loans due after one year	(711.7)	(225.0)	56.5	(880.2)
Other non-current borrowings	–	(109.5)	–	(109.5)
	(841.6)	(203.7)	4.7	(1,040.6)

Notes to the financial statements

continued

39. Net borrowings continued

	Net borrowings at 1 April 2019 £m	Cash flows – other £m	Other non-cash movements £m	Net borrowings at 31 March 2020 £m
Cash and cash deposits	284.8	83.1	–	367.9
Bank and other loans due within one year	(51.8)	49.6	2.2	–
Other current borrowings	–	–	(6.1)	(6.1)
Amounts due to subsidiary undertakings	(283.9)	(0.5)	–	(284.4)
Bank and other loans due after one year	(880.2)	(150.0)	(1.8)	(1,032.0)
Other non-current borrowings	(109.5)	–	6.1	(103.4)
	(1,040.6)	(17.8)	0.4	(1,058.0)

The increase in the value of financial liabilities at fair value through profit in the year of £0.3 million for the Group and £0.3 million for the Company is attributable to other non-cash movements.

40. Subsidiary and joint venture undertakings at 31 March 2020

Principal subsidiary companies	Registered office address	Country of incorporation, registration and principal operations
Water		
South West Water Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
South West Water Finance Plc	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Source Contact Management Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Waste management		
Viridor Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Exeter Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (West Sussex) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Management Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor EnviroScot Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor Resource Management Limited	First Floor Offices, Riverside House, Sir Thomas Longley Road, Medway City, Rochester, ME2 4FN	England
Viridor Waste Kent Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Oxfordshire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor EFW (Runcorn) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Landfill Restoration) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Somerset) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Thames) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Collections) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Electrical) 1 Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	England
Viridor Waste (Electrical) 2 Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Greater Manchester) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Polymer Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Trident Park Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Glasgow) Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor (Lancashire) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Peterborough Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor South London Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Clyde Valley Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Non-household retail		
Pennon Water Services Limited*(1)	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Other		
Peninsula Insurance Limited*(2)	Level 5, Mill Court, La Charroterie, St Peter Port, GY1 1EJ	Guernsey

(1) 80% of share capital owned by Pennon Group plc. All shares in issue are ordinary shares.

(2) Captive insurance company established with the specific objective of financing risks emanating from within the Group.

40. Subsidiary and joint venture undertakings at 31 March 2020 continued

Other trading companies	Registered office address	Country of incorporation
Dragon Waste Limited (81%)	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Leasing Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Properties (Exeter) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Defined Contribution Pension Trustee Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Pension Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Trustee Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Raikes Lane Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Source for Business Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
SSWB Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England

Other dormant companies	Registered office address	Country of incorporation
A.A. Best & Sons Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Acetip	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Albion Water (Shotton) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Alderney Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Analaq Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Aquacare (BWH) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Astley Minerals Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Avon Valley Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Basecall Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Bournemouth Water Investments Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Bournemouth Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
BWH Enterprises Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Cambridge Water Business Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Centre for Environmental Research Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
City Reclamation Services Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Corby Skip Hire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
DMP (Holdings) Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
ELE Datasystems	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Exe Continental	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Greater Manchester Sites Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Greenhill Environmental Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Handside Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Haul Waste Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Hodgejoy Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Industrial Waste Disposals (Sheffield) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Lavelle & Sons Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Mac-Glass Recycling Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Oakley Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Oakley Skip Hire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Parkwood Environmental Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Parkwood Group Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Parkwood Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pearsons Group Holdings Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Peninsula Water Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Power Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Share Plans (Guernsey) Limited*	Albert House, South Esplanade, St Peter Port, GY1 1AW	Guernsey
Pennon Share Scheme Trustees Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon South West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pennon Waste Management Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
pHOX Systems Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pilsworth Forest (1996) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Pilsworth Forest Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Roseland Plant Co. Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Rydon Properties Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Seal Security Systems Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Sheffield Waste Disposal Company Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Shore Recycling (Ozone) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
South Staffordshire Water Business Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
SWW Pension Trustees Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Thames Incineration and Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HT	England
Thames Incineration Services Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Thames Tankering Services Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Thames Waste Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England

Notes to the financial statements

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40. Subsidiary and joint venture undertakings at 31 March 2020 continued

Other dormant companies	Registered office address	Country of incorporation
The Metropolitan Water Company Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Tokenmarch Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Cheshire) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Community Recycling MK) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Community Recycling MKH) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Erith) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Martock) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor (Winsford) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Contracting Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Electrical Recycling (Holdings) Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor Electrical Recycling Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor Enterprises Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Glass Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor London Recycling Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor New England (EfW) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Resource (Peterborough) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Resource Transport Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor South Lanarkshire Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Viridor South West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Adapt) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Allwaste Disposal) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Atherton) Holdings Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Atherton) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Bristol Holdings) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Bristol) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Bury) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Corby) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Earls Barton) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (East Anglia) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Medway Holdings) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Medway) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Sheffield) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Thetford) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste (Wastenot Recycling) Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste 2 Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Disposal Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Suffolk Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Hampshire Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Viridor Waste Wootton Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
VWM (Scotland) Limited	1 Exchange Crescent, Conference Square, Edinburgh, EH3 8UL	Scotland
Waste Treatment Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
Water West Limited*	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England
West Hampshire Water Limited	Peninsula House, Rydon Lane, Exeter, EX2 7HR	England

* Indicates the shares are held directly by Pennon Group plc, the Company.

The subsidiary undertakings are wholly owned unless stated otherwise and all shares in issue are ordinary shares. All companies above are consolidated in the Group financial statements.

40. Subsidiary and joint venture undertakings at 31 March 2020 continued

Joint ventures

All joint ventures and the subsidiary undertakings of Lakeside Energy from Waste Holdings Limited, INEOS Runcorn (TPS) Holdings Limited and Shelford Composting Limited are incorporated and registered in England which is also their country of operation. The registered office of Lakeside Energy from Waste Holdings Limited and Lakeside Energy from Waste Limited is Thames House, Oxford Road, Wallingford OX10 6LX. The registered office of Shelford Composting Limited is 900 Pavilion Drive, Northampton NN4 7RG. The registered office of INEOS Runcorn (TPS) Holdings Limited and INEOS Runcorn (TPS) Limited is PO Box 9, Runcorn Site Headquarters, South Parade, Runcorn, Cheshire WA7 4JE.

	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			
Shelford Composting Limited	50 A ordinary shares	–	
	50 B ordinary shares	100%	Waste management
INEOS Runcorn (TPS) Holdings Limited	1,000 A ordinary shares	40%	
	186,750 B1 ordinary shares	100%	
	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 75%, as returns from the investment are based on holdings of B1 and B2 ordinary shares.

41. Operating lease commitments

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
The future aggregate minimum lease payments under non-cancellable operating leases are:				
Within 1 year	–	12.5	–	–
Over 1 year and less than 5 years	–	37.7	–	–
Over 5 years	–	145.5	–	–
	–	195.7	–	–

Following the adoption of IFRS 16 on 1 April 2019 operating lease commitments are included in borrowings as lease liabilities.

42. Contingencies

Contingent liabilities

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	–	–	460.9	561.5
Performance bonds	197.1	201.7	197.1	201.7
	197.1	201.7	658.0	763.2

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. All of the performance bonds relate to the activities of the Disposal Group.

In connection with the application of the audit exemption under Section 479A of the Companies Act 2006 the Company has guaranteed all the outstanding liabilities as at 31 March 2020 of Viridor Waste 2 Limited since this company qualifies for the exemption.

Other contractual and litigation uncertainties

The Group establishes provisions in connection with contracts and litigation where it has a present legal or constructive obligation as a result of past events and where it is more likely than not an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Matters where it is uncertain that these conditions are met include potential prosecutions by the Health and Safety Executive.

Notes to the financial statements

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43. Capital commitments

	Group		Company	
	2020 £m	2019 £m	2020 £m	2019 £m
Contracted but not provided relating to the Continuing Group	72.0	68.3	–	–

Excluded from the balances at 31 March 2020 above is £98.6 million relating to discontinued operations (see note 46 for further details).

44. Related party transactions

During the year Group companies entered into the following transactions with joint ventures who are not members of the Group. The year end balances as at 31 March 2020 with joint ventures are included within assets held for sale (see note 46 for further details).

	2020 £m	2019 £m
Sales of goods and services		
INEOS Runcorn (TPS) Limited	18.2	16.6
Purchase of goods and services		
Lakeside Energy from Waste Limited	12.8	12.4
INEOS Runcorn (TPS) Limited	8.3	7.1
Dividends received		
Lakeside Energy from Waste Holdings Limited	6.0	5.5

Year-end balances

	2020 £m	2019 £m
Receivables due from related parties		
Lakeside Energy from Waste Limited (loan balance)	7.1	7.7
INEOS Runcorn (TPS) Limited (loan balance)	59.5	65.0
	66.6	72.7
Lakeside Energy from Waste Limited (trading balance)	1.0	1.0
INEOS Runcorn (TPS) Limited (trading balance)	1.2	1.8
	2.2	2.8
Payables due to related parties		
Lakeside Energy from Waste Limited (trading balance)	1.1	0.9
INEOS Runcorn (TPS) Limited (trading balance)	1.7	3.2
	2.8	4.1

The £66.6 million (2019 £72.7 million) receivable relates to loans to related parties due for repayment in instalments between 2018 and 2033. Interest is charged at an average of 13.0% (2019 13.0%).

Company

The following transactions with subsidiary undertakings occurred in the year:

	2020 £m	2019 £m
Sales of goods and services (management fees)	17.9	19.7
Purchase of goods and services (support services)	0.6	2.0
Interest receivable	43.4	43.3
Interest payable	0.1	0.1
Dividends received	335.6	196.7

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

44. Related party transactions continued

Year-end balances

	2020 £m	2019 £m
Receivables due from subsidiary undertakings		
Loans	1,225.6	1,044.6
Trading balances	16.0	19.9

Interest on £591.8 million of the loans has been charged at fixed rates during the year with an average effective rate of 4% (2019 £499.8 million charged at 5%), and on £591.8 million at an average effective rate of three-month LIBOR plus 2.6% (2019 £499.8 million charged at 12-month LIBOR + 2.2%). Interest on £16.0 million (2019 £18.1 million) has been charged at a fixed rate of 6.0%. These loans are due for repayment in instalments over the period 2021 to 2045.

Interest on £13.0 million (2019 £13.5 million) of the loans has been charged at a fixed rate of 5.0%. Interest on £13.0 million (2019 £13.5 million) of the loans has been charged at 12-month LIBOR + 3.0%. These loans are due for repayment in instalments over a five-year period following receipt of a request to repay.

No material expected credit loss provision has been recognised in respect of loans to subsidiaries (2019 £nil).

	2020 £m	2019 £m
Payables due to subsidiary undertakings		
Loans	284.4	283.9
Trading balances	9.1	14.3

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

45. Change in accounting policy on leases

Adjustments recognised on the adoption of IFRS 16

This note explains the impact of the adoption of IFRS 16 'Leases' on the Group's financial statements, and it discloses the new accounting policies that have been adopted from 1 April 2019, where they are different from those applied in earlier periods.

On adoption of IFRS 16, the Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of IAS 17 'leases'. These liabilities were measured at the present value of the remaining leases payments, discounted using the Group's weighted average incremental borrowing rate (IBR).

Following adoption of IFRS 16, the Group no longer distinguishes between an on the balance sheet finance lease and an off the balance sheet operating lease. For leases previously classified as finance leases, the Group recognised the carrying amount of leased assets and lease liabilities immediately prior to transition as the carrying amount of the right-of-use asset and lease liability at the date of initial application. The measurement principles of IFRS 16 only apply after this date.

As permitted under IFRS 16, the Group will present right-of-use assets and lease liabilities within property, plant and equipment and borrowings respectively. This approach is consistent with the Group's previous presentation of finance leases under IAS 17.

At 31 March 2019, the Group had non-cancellable operating lease commitments of £195.7 million. These predominantly relate to leases of properties occupied by the Group in the course of carrying out its businesses. On transition on 1 April 2019, the Group recognised the following items in the balance sheet:

- Right-of-use assets – increase by £132.2 million
- Prepayments – decrease by £0.5 million
- Lease liabilities – increase by £145.7 million
- Accruals – decrease by £4.2 million
- Deferred tax liabilities – decrease by £1.8 million
- Retained earnings – decrease by £8.0 million.

The discount rate used in the calculation of the lease liability involves estimation. The discount rate is calculated on a lease by lease basis. For vehicle leases, which account for less than 1% of the present value of future lease payments, the discount rate is determined by the implicit rate within the lease. For all other leases, where implicit rates are not available, discount rates are calculated using the Group's estimated IBR for each lease. The IBR is determined with reference to applicable reference rate borrowing curves (e.g. LIBOR or its successor), credit margins for the different business segments and lease terms. At the commencement of new leases discount rates are updated to ensure the Group applies the IBR that reflects current market conditions. At 1 April 2019, the date of transition to IFRS 16, the range of rates used was between 2.43% and 4.5% and the weighted average IBR across all leases was 3.6%. If the weighted average rate used was increased by 10bps, this would result in a c.0.9% reduction in the present value of lease liabilities recognised at 1 April 2019.

Notes to the financial statements

continued

45. Change in accounting policy on leases continued

A reconciliation of the lease liability recognised at 1 April 2019 to operating lease commitments at 31 March 2019 is shown below:

	£m
IAS 17 operating lease commitments	195.7
Less: contracts to which the short-term leases exemption has been applied	(0.1)
Less: contracts to which the low-value leases exemption has been applied	(1.6)
Add: adjustment due to different assessment of lease term	0.5
Less: impact of discounting at weighted average discount rate of 3.6%	(48.8)
Operating lease liabilities recognised at 31 March 2019	145.7
Add: finance lease liabilities recognised at 31 March 2019	1,560.4
IFRS 16 lease liability as at 1 April 2019	1,706.1
Of which:	
Current lease liabilities	19.4
Non-current lease liabilities	1,686.7
	1,706.1

Associated right-of-use assets for selected land and building leases were measured on a retrospective basis as if IFRS 16 had always applied from lease inception. All remaining right-of-use assets were measured at the amount equal to the lease liability, adjusted by prepaid or accrued lease payments under IFRS 16 transition provisions relating to leases recognised on the balance sheet at 31 March 2019.

A reconciliation between the opening lease liabilities and right-of-use assets at 1 April 2019 is shown below:

	£m
Lease liabilities following first application of IFRS 16	145.7
Less: adjustment for onerous lease accruals	(1.5)
Less: adjustment for other accruals	(2.9)
Add: adjustment for prepaid lease rentals	0.5
Less: adjustment due to application of IFRS 16 at lease inception	(9.6)
Right-of-use assets on first application of IFRS 16	132.2

In applying IFRS 16 for the first time, the Group has used the following practical expedients and made the following elections permitted by the standard:

- The use of single discount rates to portfolios of leases with similar characteristics
- Reliance on previous onerous lease assessments
- Accounting for operating leases with terms less than 12 months as at 1 April 2019 as short-term leases
- The application of hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease
- Applying the modified retrospective approach: the cumulative effect of initially applying IFRS 16 has been calculated as a reduction to retained profits at 1 April 2019 of £8.0 million. Under this election no restatement of comparative figures will be made
- Electing to apply the standard to contracts that were previously identified as leases when applying IAS 17.

Cash outflows in respect of leasing relate to principal repayments of £142.8 million and interest repayments of £37.7 million, in addition to inflows from lease financing arrangements of £115.0 million.

References to disclosures required by IFRS 16 but not included within this note are outlined below:

- Right-of-use asset depreciations, additions and net book value (see page 161)
- Interest on lease liabilities (see page 153)
- Short-term and low value lease expense (see page 153)
- Maturity analysis of lease liabilities (see page 169).

Based on the additional lease liability and associated assets recognised at 1 April 2019 for the Continuing Group the impact on profit for the year ended 31 March 2020 was a reduction in profit after tax of £0.6 million, resulting from:

- An increase in EBITDA of £1.9 million
- An increase in depreciation of £1.4 million
- An increase in finance costs of £1.2 million; and
- A reduction in corporation tax of £0.1 million.

EBITDA increased as operating lease costs previously charged against EBITDA under IAS 17 has been replaced under IFRS 16 with charges for depreciation and interest which are excluded from EBITDA (albeit included in earnings). Short-term and low value leasing costs continue to be charged against EBITDA.

Net operating cash flows increased under IFRS 16 as the element of cash paid attributable to the repayment of principal is included in financing cash flows. The net increase/decrease in cash and cash equivalents remains unchanged.

46. Discontinued operations and non-current assets held for sale

On 18 March 2020, the Group entered into a formal sale agreement to dispose of Viridor Limited to Planets UK Bidco Limited (Bidco), a newly formed company established by funds advised by Kohlberg Kravis Roberts & Co. L.P. (KKR). In accordance with IFRS 5 'Non-current assets held for sale and discontinued operations', the assets and liabilities related to Viridor were classified as a disposal group held for sale at 31 March 2020. The sale is conditional on approval by the Group's shareholders, merger control clearance from the European Commission and certain other conditions. The first two of these conditions have now been met and the sale is expected to complete in early summer 2020.

The agreed proceeds indicate a £3.7 billion estimated fair value less costs to sell, which exceeds the carrying value of Viridor's net assets, and accordingly no impairment losses have been recognised on reclassification as a disposal group.

The tables below show the results of the discontinued operations which are included in the Group income statement and cash flow statement for the year ended 31 March 2020, together with the classes of assets and liabilities comprising the operations held for sale in the Group balance sheet as at 31 March 2019.

	Notes	Before non-underlying items 2020 £m	Non-underlying items (note 6) 2020 £m	Total 2020 £m	Before non-underlying items 2019 £m	Non-underlying items (note 6) 2019 £m	Total 2019 £m
Discontinued operations							
Revenue	5	753.2	-	753.2	845.6	-	845.6
Operating costs							
Employment costs		(130.4)	4.9	(125.5)	(138.6)	(0.9)	(139.5)
Raw materials and consumables used		(87.2)	-	(87.2)	(94.3)	-	(94.3)
Other operating expenses		(337.5)	(1.1)	(338.6)	(433.8)	(28.7)	(462.5)
Earnings before interest, tax, depreciation and amortisation	5	198.1	3.8	201.9	178.9	(29.6)	149.3
Depreciation and amortisation		(82.1)	-	(82.1)	(78.0)	-	(78.0)
Operating profit		116.0	3.8	119.8	100.9	(29.6)	71.3
Finance income		22.5	-	22.5	20.0	-	20.0
Finance costs		(48.7)	-	(48.7)	(44.8)	-	(44.8)
Net finance costs		(26.2)	-	(26.2)	(24.8)	-	(24.8)
Share of post-tax profit from joint ventures		14.8	-	14.8	12.4	-	12.4
Profit before tax	5	104.6	3.8	108.4	88.5	(29.6)	58.9
Taxation (charge)/credit	9	(13.6)	(11.0)	(24.6)	(10.6)	5.7	(4.9)
Profit for the year		91.0	(7.2)	83.8	77.9	(23.9)	54.0
Attributable to:							
Ordinary shareholders of the parent				83.8			54.0
<hr/>							
					2020 £m		2019 £m
Cash flows from operating activities					149.1		69.2
Cash flows from investing activities					(133.0)		(255.6)
Cash flows from financing activities					(23.1)		(73.1)
Net decrease in cash and cash equivalents from discontinued operations, net of inter-company					(7.0)		(259.5)

Notes to the financial statements

continued

46. Discontinued operations and non-current assets held for sale continued

The net assets relating to the Disposal Group at 31 March 2020 in the Group and Company balance sheet are shown below:

	Group £m	Company £m
Assets of the Disposal Group		
Goodwill	340.8	–
Other intangible assets	86.9	–
Property, plant and equipment	1,584.9	–
Other non-current assets	261.5	–
Investment in subsidiary undertakings	–	1,135.6
Investments in joint ventures	60.1	–
Inventories	29.9	–
Trade and other receivables	277.9	–
Cash and cash deposits	33.3	–
Total assets	2,675.3	1,135.6
Liabilities of the Disposal Group		
Borrowings	(248.4)	–
Trade and other payables	(141.7)	–
Current tax liabilities	(1.0)	–
Provisions	(237.6)	–
Other non-current liabilities	(14.3)	–
Retirement benefit obligations	(15.1)	–
Deferred tax liabilities	(98.2)	–
Total liabilities	(756.3)	–
Net assets	1,919.0	1,135.6

At 31 March 2020 trade and other receivables include a net other receivable of £43.7 million (2019 £43.3 million) relating to gross contractual compensation amounts due totalling £72.0 million (2019 £72.0 million) arising from additional costs incurred in the construction of the Glasgow Recycling and Renewable Energy Centre (GRREC). A full credit risk appraisal has been carried out on this receivable and a provision of £28.3 million (2019 £28.7 million) has been recognised for expected credit losses as detailed in note 4.

The Company has classified its investment in ordinary shares in Viridor Limited as an asset held for sale. On completion of the proposed sale of Viridor, expected in early summer 2020, loans made to Viridor of £1,200 million at 31 March 2020 will be repaid.

Provisions include environmental and landfill provisions relating to landfill sites totalling £201.2 million at 31 March 2020.

Included in provisions are amounts provided in relation to the expected economic outflow of resources required to settle claims associated with ongoing litigation which were transferred from other non-current liabilities in the year. These amounts 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, as the Group believes they are commercially sensitive and doing so would be seriously prejudicial to the Group's position.

47. Events after the reporting period

Repayment of perpetual capital securities

On 6 May 2020, the Company exercised its sole discretionary right to redeem all of the £300 million perpetual capital securities at their principal amount on 22 May 2020, this being the first available date to exercise this right.

Disposal of Viridor

On 18 March 2020 the Group announced the sale of Viridor to KKR subject to shareholder, competition authority approval and other conditions. The first two of these conditions have now been met and the final condition can be waived at Pennon's discretion, giving the Group control of the timetable to complete the transition during early summer 2020.

Impact of COVID-19

The World Health Organization (WHO) announced that COVID-19 was a global pandemic on 11 March 2020 and the UK Government announced its wide ranging lockdown restrictions on 23 March 2020. Given these events took place prior to the Group and Company's financial year end of 31 March 2020, the Directors have taken the impact of these events into account when making its key judgements and estimates at the balance sheet date, as outlined in note 4 to the accounts, up to the date of approving the annual report and accounts.

The Group's operational response to COVID-19 is set out throughout the strategic review section of the annual report on pages 6 to 57. In addition, the risk report on pages 58 to 67 sets out the updated risk assessment in response to the pandemic.

In assessing its going concern and viability the impacts of COVID-19 on these assessments has been considered in full and are set out on pages 119 and page 68 respectively.

Alternative performance measures and glossary

Alternative performance measures (APMs) are financial measures used in this report that are not defined by International Financial Reporting Standards (IFRS). The Directors believe that these APMs assist in providing additional useful information on the underlying trends, performance and position of the Group as well as enhancing the comparability of information between reporting periods. As the Group defines the APMs they might not be directly comparable to other companies' APMs. They are not intended to be a substitute for, or superior to, IFRS measurements.

Underlying earnings

Underlying earnings are presented alongside statutory results as the Directors believe they provide a more useful comparison on business trends and performance. Note 6 in the financial statements provides more detail on non-underlying items, and a reconciliation of underlying earnings for the current year and the prior year is as follows:

£m	Total Group underlying (incl. discontinued operations)	Underlying discontinued operations	Non-underlying items from continuing operations	Statutory results	Earnings per share (p)
EBITDA (see below)	563.4	198.1	(7.9)	357.4	
Operating profit	361.5	116.0	(7.9)	237.6	
Profit before tax	287.6	104.6	10.1	193.1	
Taxation	(52.0)	(13.6)	(32.2)	(70.6)	
Profit after tax from continuing operations				122.5	
Profit after tax from discontinued operations				83.8	
Profit after tax (PAT)				206.3	
PAT attributable to perpetual capital holders				(7.0)	
Non-controlling interests				1.1	
PAT attributable to shareholders				200.4	47.7
Deferred tax before non-underlying items				33.2	7.9
Non-underlying items post tax				29.3	6.9
Non-controlling interests' share of non-underlying items				(1.0)	(0.2)
Adjustment for full year depreciation charge in the Disposal Group				(2.6)	(0.6)
Underlying earnings				259.3	61.7

Underlying earnings reconciliation 2019

£m	Total Group underlying (incl. discontinued operations)	Underlying discontinued operations	Non-underlying items from continuing operations	Statutory results	Earnings per share (p)
EBITDA (see below)	546.2	178.9	3.9	371.2	
Operating profit	351.0	100.9	3.9	254.0	
Profit before tax	280.2	88.5	9.7	201.4	
Taxation	(42.7)	(10.6)	(0.7)	(32.8)	
Profit after tax from continuing operations				168.6	
Profit after tax from discontinued operations				54.0	
Profit after tax (PAT)				222.6	
PAT attributable to perpetual capital holders				(8.6)	
Non-controlling interests				0.3	
PAT attributable to shareholders				214.3	51.1
Deferred tax before non-underlying items				13.3	3.1
Non-underlying items post tax				14.9	3.6
Underlying earnings				242.5	57.8

EBITDA

EBITDA (earnings before interest, tax, depreciation and amortisation) is used to assess and monitor operational underlying performance. An adjusted EBITDA is also presented that includes Viridor's share of EBITDA from its joint ventures and finance income on service concession arrangements. This measure is presented to aggregate earnings from all the Viridor ERFs which are accounted for differently depending upon the contractual relationships, as shown in the reconciliation below.

Alternative performance measures and glossary

continued

Adjusted EBITDA reconciliation

£m	2020			2019		
	Total Group underlying (incl. discontinued operations)	Discontinued operations	Continuing operations	Total Group underlying (incl. discontinued operations)	Discontinued operations	Continuing operations
Statutory EBITDA	559.3	201.9	357.4	520.5	149.3	371.2
Non-underlying items	4.1	(3.8)	7.9	25.7	29.6	(3.9)
Underlying EBITDA	563.4	198.1	365.3	546.2	178.9	367.3
IFRIC 12 interest receivable ⁽¹⁾	15.1	15.1	–	14.6	14.6	–
Joint venture EBITDA ⁽¹⁾	41.3	41.3	–	31.9	31.9	–
Adjusted EBITDA	619.8	254.5	365.3	592.7	225.4	367.3

(1) These adjustments relate to the waste management business, resulting in adjusted waste management EBITDA of £254.5 million (2018/19 £225.4 million).

Total Group effective interest rate

A measure of the mean average interest rate payable on the Group's net debt, which excludes interest costs not directly associated with Group net debt. This measure is presented to assess and monitor the relative cost of financing for the Group.

	2020 £m	2019 £m
Net finance costs after non-underlying items	70.7	77.4
Non-underlying net finance costs	18.0	5.8
Interest receivable on shareholder loans to joint ventures	5.3	5.3
Net interest on retirement benefit obligations	(0.8)	(1.4)
Unwinding of discounts on provisions	(8.2)	(11.1)
Interest receivable on service concession agreements	15.1	14.6
Capitalised interest	11.0	15.2
Net finance costs for effective interest rate calculation	111.1	105.8
Opening net debt	3,079.5	2,801.5
Closing net debt	3,264.0	3,079.5
Average net debt (opening net debt + closing net debt divided by 2)	3,171.8	2,940.5
Effective interest rate	3.5%	3.6%

Total Group interest cover

Underlying net finance costs (excluding pensions net interest cost, discount unwind on provisions and IFRIC 12 interest receivable on service concession arrangements) divided by Group operating profit before non-underlying items.

	2020 £m	2019 £m
Net finance costs after non-underlying items	70.7	77.4
Non-underlying net finance costs	18.0	5.8
Net interest on retirement benefit obligations	(0.8)	(1.4)
Unwinding of discounts in provisions	(8.2)	(11.1)
Interest receivable on service concession arrangements	15.1	14.6
Net finance costs for interest cover calculation	94.8	85.3
Operating profit before non-underlying items	361.5	351.0
Interest cover (times)	3.8	4.1

Total Group dividend cover

Proposed dividends divided by profit for the year before non-underlying items and deferred tax.

	2020 £m	2019 £m
Proposed dividends	184.3	172.7
Profit for the year attributable to ordinary shareholders	200.4	214.3
Deferred tax charge before non-underlying items	33.2	13.3
Non-underlying items after tax in profit for the year	29.3	14.9
Non-controlling interests' share of non-underlying items	(1.0)	–
Adjustment for full year depreciation charge in the Disposal Group	(2.6)	–
Adjusted profit for dividend cover calculation	259.3	242.5
Dividend cover (times)	1.4	1.4

Total Group capital investment

Property, plant and equipment additions plus IFRIC 12 service concession expenditure (ERFs) less landfill restoration asset (spend accounted for through provisions). The measure is presented to assess and monitor the total capital investment by the Group.

	2020 £m	2019 £m
Additions to property, plant and equipment	326.8	387.2
Additions to intangible assets	0.6	–
Landfill restoration asset	(5.3)	(22.8)
IFRIC 12 additions to other intangible assets – service concession agreements	–	24.7
IFRIC 12 additions to non-current assets – service concession agreements	17.1	6.8
IFRIC 12 additions to current trade and other receivables – prepayments and accrued income	–	3.3
Less: IFRIC 12 additions subject to legal contractual process	–	(3.3)
Capital investment	339.2	395.9

Following the adoption of IFRS 16 Property, plant and equipment additions in 2020 include right-of-use assets £6.2 million (2019 £nil million). These assets are directly associated with leases previously classified as operating leases under IAS 17. In 2019, under IAS 17, operating leases and associated assets were not held on the balance sheet.

Total Group capital payments

Payments for property, plant and equipment additions net of proceeds from sale of property, plant and equipment plus IFRIC 12 service concession expenditure (ERFs). The measure is presented to assess and monitor the net cash spend on property, plant and equipment.

	2020 £m	2019 £m
Cash flow statements: purchase of property, plant and equipment	332.8	356.0
Cash flow statements: purchase of intangible assets	0.6	–
Cash flow statements: proceeds from sale of property, plant and equipment	(10.6)	(6.3)
IFRIC 12 additions to other intangible assets – service concession agreements	–	24.7
IFRIC 12 additions to non-current assets – service concession agreements	17.1	6.8
IFRIC 12 additions to current trade and other receivables – prepayments and accrued income	–	3.3
Capital payments	339.9	384.5

Total Group return on capital employed

The total of underlying operating profit, joint venture profit after tax and joint venture interest receivable divided by capital employed (net debt plus total equity invested). An average value for this metric is part of the long-term incentive plan for Directors.

	2020 £m	2019 £m
Underlying operating profit	361.5	351.0
Underlying joint venture profit after tax	14.8	12.4
Joint venture interest receivable	5.3	5.3
Adjusted profit for return on capital employed calculation	381.6	368.7
Values at year end:		
Net debt	3,264.0	3,079.5
Share capital	171.3	171.1
Share premium account	227.0	223.6
Capital redemption reserve	144.2	144.2
Perpetual capital securities	296.7	296.7
Capital employed for return on capital employed calculation	4,103.2	3,915.1
Return on capital employed	9.3%	9.4%

Alternative performance measures and glossary

continued

Total Group operational cash inflows

Cash generated from operations before construction spend on service concession agreements, pension contributions and other tax payments.

	2020 £m	2019 £m
Cash generated from operations per cash flow statements	516.3	399.8
IFRIC 12 additions to other intangible assets – service concession agreements	–	24.7
IFRIC 12 additions to non-current assets – service concession agreements	17.1	6.8
IFRIC 12 additions to current trade and other receivables – prepayments and accrued income	–	3.3
Pension contributions	48.1	32.2
Other tax payments ⁽¹⁾	147.1	137.9
Payment in respect of terminated synthetic derivative, related to a prior period non-underlying charge	–	44.3
Operational cash inflows	728.6	649.0

(1) Other taxes include business rates, employers' national insurance, fuel excise duty, carbon reduction commitment, environmental payments, climate change levy and external landfill tax.

RoRE

This is a key regulatory metric which represents the returns to shareholders expressed as a percentage of regulated equity.

Returns are made up of a base return (set by Ofwat the water business regulator at c.6.0% for 2015-20) plus totex outperformance, financing outperformance and ODI outperformance. Returns are calculated post tax and post sharing (only a proportion of returns are attributed to shareholders and shown within RoRE). The three different types of return calculated and added to the base return are:

- Totex outperformance – totex is defined below and outperformance is the difference between actual reported results for the regulated business compared to the Final Determination (Ofwat published document at the start of a regulatory period), in a constant price base
- Financing outperformance – is based on the difference between a company's actual effective interest rate compared with Ofwat's allowed cost of debt
- ODI outperformance – the net reward or penalty a company earns based on a number of different key performance indicators, again set in the Final Determination.

Regulated equity is a notional proportion of regulated capital value (RCV which is set by Ofwat at the start of every five-year regulatory period, adjusted for actual inflation). For 2015-20, the notional equity proportion is 37.5%.

Further information on this metric can be found in South West Water's Annual Performance Report and regulatory reporting, published in July each year. The most recent can be found at: www.southwestwater.co.uk/about-us/how-are-we-performing.

Totex

Operating costs and capital expenditure of the regulated water and wastewater business (based on the Regulated Accounting Guidelines).

ODI

ODIs are designed to incentivise companies to deliver improvements to service and outcomes based on customers' priorities and preferences. If a company exceeds these targets a reward can be earned through future higher revenues. If a company fails to meet them, they can incur a penalty through lower future allowed revenues.

Glossary

CIC – community interest company, a type of company introduced by the UK Government in 2005 under the Companies (Audit, Investigations and Community Enterprise) Act 2004, designed for social enterprises that want to use their profits and assets for the public good

CMex – customer measure of experience, a mechanism to incentivise water companies to provide an excellent customer experience for residential customers, across both the retail and wholesale parts of the value chain

CPI – consumer price index, a measure of inflation in a representative sample of retail goods and services using a geometric mean and excluding e.g. housing costs

CPIH – consumer price index, a measure of inflation in a representative sample of retail goods and services using a geometric mean, including owner occupiers' housing costs

DNV GL – an independent management consultancy specialising in technical assurance in the utility sector

EBITDA – earnings before interest, tax, depreciation and amortisation

EIB – European Investment Bank

ERF – energy recovery facility

ESG – environmental, social and governance

Fair Tax Mark – an independent certification scheme which recognises organisations that demonstrate they are paying the right amount of corporation tax at the right time. In December 2018, Pennon became the first water services and waste management utility to receive it (see page 50)

GHG – greenhouse gases (see page 116)

GMP – guaranteed minimum pension

GRREC – Glasgow Recycling and Renewable Energy Centre

GVA – gross value added, the measure of the value of goods and services produced in an area, industry or sector of an economy

HomeSafe – our health & safety improvement programme (see page 40)

K7 – the current regulatory price review period during which South West Water's 2020-25 New Deal business plan will be implemented (see page 18)

KPI – key performance indicator, our measures of business performance against the key targets monitored by Board and Pennon Executive (see page 36)

LTIFR – lost time injury frequency rate

MRF – materials recycling facility

ODI – outcome delivery incentives, 15 of which are common across all water companies while others are bespoke to South West Water (see page 43)

Ofwat – The Water Services Regulation Authority, or Ofwat, is the body responsible for economic regulation of the privatised water and sewerage industry in England and Wales

PRF – plastics recycling facility

RoCE – return on capital employed

RoRE – return on regulated equity

RPI – retail price index, a measure of inflation in a representative sample of retail goods and services using an arithmetic mean

SIM – service incentive mechanism, a measure of customer service

STEM – science, technology, engineering and mathematics

Sustainable Financing Framework – the way we link financial impacts with sustainability impacts; the Framework aligns with the Green Bond Principles, the Social Bond Principles and the Green Loan Principles (see page 23)

totex – total expenditure

WaterShare – the programme through which we shared the benefits of outperformance against our 2015-20 business plan targets with water customers

WaterShare+ – the enhanced benefit sharing mechanism introduced for water customers under our 2020-25 New Deal business plan (see page 26)

Five-year financial summary

	Continuing operations		Total Group			
	2020 £m	2020 £m	2019 £m	2018 £m	2017 £m	2016 £m
Income statement						
Revenue before non-underlying items	636.7	1,389.9	1,478.2	1,393.0	1,353.1	1,352.3
Operating profit before non-underlying items	245.5	361.5	351.0	323.9	304.6	261.8
Net finance costs before non-underlying items	(62.5)	(88.7)	(83.2)	(74.5)	(58.8)	(54.1)
Share of profit in joint ventures	–	14.8	12.4	9.4	4.2	3.6
Profit before tax and non-underlying items	183.0	287.6	280.2	258.8	250.0	211.3
Net non-underlying items before tax	10.1	13.9	(19.9)	4.1	(39.5)	(5.0)
Taxation charge	(70.6)	(95.2)	(37.7)	(41.0)	(30.0)	(38.0)
Profit for the year	122.5	206.3	222.6	221.9	180.5	168.3
Attributable to:						
Ordinary shareholders of the parent	116.6	200.4	214.3	200.6	164.3	152.1
Perpetual capital security holders	7.0	7.0	8.6	21.5	16.2	16.2
Non-controlling interests	(1.1)	(1.1)	(0.3)	(0.2)	–	–
Dividends proposed/declared	184.3	184.3	172.7	162.0	149.5	138.5
Earnings per ordinary share (basic):						
From continuing and discontinuing operations						
Earnings per share	27.7p	47.7p	51.1p	48.0p	39.8p	37.0p
Deferred tax before non-underlying items	2.4p	7.9p	3.1p	4.4p	4.5p	9.5p
Non-underlying items (net of tax)	5.3p	6.9p	3.6p	(1.8p)	2.7p	(7.0p)
Non-controlling interests' share of non-underlying items	(0.2p)	(0.2p)	–	–	–	–
Adjustment for full year depreciation charge in the Disposal Group	–	(0.6p)	–	–	–	–
Proportional adjustment on perpetual capital returns	–	–	–	0.3p	–	–
Earnings per share before non-underlying and deferred tax	35.2p	61.7p	57.8p	50.9p	47.0p	39.5p
Declared dividends per share	43.77p	43.77p	41.06p	38.59p	35.96p	33.58p
Capital expenditure						
Acquisitions (including investment in joint ventures)	–	–	54.8	8.4	–	91.0
Property, plant and equipment	326.8	–	387.2	389.0	377.5	284.2
Balance sheet						
Non-current assets	3,226.0	–	5,364.5	5,125.0	4,937.0	4,676.7
Net current assets ⁽¹⁾	2,595.8	–	583.9	412.6	454.4	549.1
Non-current liabilities	(4,109.7)	–	(4,268.6)	(3,898.5)	(3,882.2)	(3,738.2)
Net assets	1,712.1	–	1,679.8	1,639.1	1,509.2	1,487.6
Number of employees (average full time equivalent for year)						
Water	1,623	–	1,616	1,575	1,589	1,706
Waste management	2,986	–	3,426	3,285	3,153	3,230
Non-household retail	143	–	104	81	–	–
Other businesses	101	–	93	73	57	51
	4,853	–	5,239	5,014	4,799	4,987

(1) Net current assets for 2020 includes assets held for sale of £2,675.3 million and liabilities directly associated with assets classified as held for sale of £756.3 million.

Task Force on Climate-related Financial Disclosures (TCFD) 2020 – our approach









Pennon Group's services bring clear societal benefits; we bring resources to life, protecting and enhancing public health, our communities, and the environment.

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

Within our sustainability strategy we have set a clear objective: to demonstrate leadership in minimising emissions that contribute to climate change and develop climate change adaptation strategies. We achieved our 2019/20 target to adopt and implement a Group climate change & carbon management strategy, defining our contribution to a low-carbon economy, including specific carbon management and science-based reduction targets.

As a Group, we have reported our GHG (carbon) emissions since 2013. We also disclose our GHG emissions performance through the annual CDP Climate Change assessment, in which we achieved an improved B rating for 2019.

A summary of our progress against the TCFD recommendations is given below. The Group will continue to work towards the TCFD recommendations and continue to report our progress in future disclosures. To read our consolidated disclosure please see www.pennon-group.co.uk/sustainability

TCFD reference	Pennon reference
Governance	
Board oversight of climate-related risks and opportunities	Sustainability Committee report in the governance section  See pages 20 to 21 and 88 to 89 for further information
Management's role in managing climate-related risks and opportunities	Sustainability Committee report in the governance section  See pages 88 and 89 for further information
Strategy	
What are our climate-related risks, in the short, medium and long term	Refer to CDP Report
What is the impact of climate-related risks and opportunities on our business, strategy and financial planning	Strategic progress  See pages 16 to 19 for further information Operational sections  See pages 42 to 49 for further information
How resilient is our business strategy, to different climate scenarios	See consolidated TCFD disclosure online
Risk management	
What are the processes through which we assess and manage climate-related risk and how are these integrated into our risk management programme	Risk report  See pages 58 to 61 and 65 for further information
Metrics and targets	
How do we assess the climate-related risks and opportunities facing the business	See consolidated TCFD disclosure online. View CDP Report
Our Scope 1, 2 and 3 GHG emissions	 See Directors' report pages 117 and 118 for further information
The targets we use to manage the risk and opportunities	Sustainability at the heart of the business  See pages 20 and 21 for further information Consolidated TCFD report online  Find out more at www.pennon-group.co.uk/sustainability/environmental-leadership

Shareholder information

Financial calendar

Financial year end	31 March
Ex-dividend date for 2020 final dividend	23 July 2020
Record date for 2020 final dividend	24 July 2020
31st Annual General Meeting	31 July 2020
2020 final dividend payable	2 September 2020
2020/21 half-yearly results announcement	24 November 2020
2021 interim dividend payable	April 2021
2020/21 final results announcement	25 May 2021
32nd Annual General Meeting	22 July 2021
2021 final dividend payable	September 2021

Dividend Reinvestment Plan (DRIP) alternative

Ordinary shares quoted ex-dividend	23 July 2020
Record date for final dividend	24 July 2020
Final date for receipt of DRIP applications	10 August 2020
Posting of dividend cheques	1 September 2020
Final dividend payment date	2 September 2020

Shareholder analysis at 31 March 2020

Holding of shares	Number of shareholders	% of total shareholders	% of ordinary shares
1-100	2,391	13.55	0.02
101-1,000	3,665	20.77	0.27
1,001-5,000	7,201	40.81	1.88
5,001-50,000	3,637	20.61	3.32
50,001-100,000	365	2.07	1.73
100,001+	388	2.20	92.78
	17,647		

	Number of accounts	% of total accounts	% of total shares
Individuals	15,510	87.89	5.77
Companies	186	1.06	0.41
Trust companies (pension funds etc.)	6	0.03	0.01
Banks and nominees	1,945	11.02	93.81
	17,647		

Major shareholdings

The net position on 31 March 2020 of investors who have notified interests in the issued share capital of the Company pursuant to the Financial Conduct Authority's Disclosure Guidance and Transparency Rules is as follows:

	Number of voting rights (direct and indirect)	% of voting rights
Lazard Asset Management LLC	41,575,771	9.875

On 24 April 2020, Norges Bank notified the Company that it held 12,857,235 shares (equivalent to 3.054% of voting rights).

No further changes to interests in the Company's issued share capital have been disclosed to the Company between 31 March 2020 and 2 June 2020 (being a date not more than one month prior to the date of the Company's Notice of Annual General Meeting).

Registrar

All enquiries concerning shareholdings including notification of change of address, loss of a share certificate or dividend payments should be made to the Company's registrar, Link Market Services, who can be contacted as follows:

Link Market Services

Pennon Group Share Register
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

Telephone: **0371 664 9234** (calls are charged at standard geographic rate and will vary by provider).

Lines are open 8.30am-5.30pm Monday-Friday, excluding public holidays in England and Wales.

Overseas telephone: **+44 371 664 9234** (calls outside the United Kingdom will be charged at the applicable international rate).

Email: pennon@linkgroup.co.uk

Website: signalshares.com

ShareGift service

Through ShareGift, an independent charity share donation scheme, shareholders who only have a small number of shares with a value that makes it uneconomical to sell them can donate such shares to charity. Donations can be made by completion of a simple share transfer form which is available from the Company's registrar, Link Market Services, or by contacting ShareGift on **020 7930 3737** (www.sharegift.org).

Individual savings accounts

Shareholders may gain tax advantages by holding their shares in the Company in an Individual Savings Account (ISA).

Dividend Reinvestment Plan (DRIP)

Subject to obtaining shareholder approval at the 2020 Annual General Meeting for the payment of a final dividend for the year ended 31 March 2020, full details of the DRIP and how to participate will be published on the Company's website at www.pennon-group.co.uk/dividends/dividend-reinvestment-plan-drip. The full timetable for offering the DRIP is given opposite.

The DRIP provides shareholders with an opportunity to invest the cash dividend they receive on their Pennon Group plc shares to buy further shares in the Company at preferable dealing rates.

Corporate information

Registered office

Peninsula House
Rydon Lane
Exeter
Devon EX2 7HR

Company registration number: 2366640

Company Secretary

Simon A F Pugsley

Corporate brokers

HSBC Bank plc
Morgan Stanley & Co. International plc

Independent auditors

Ernst & Young LLP

Online portfolio service

The online portfolio service provided by Link Market Services gives shareholders access to more information on their investments. Details of the portfolio service are available online at www.signalshares.com.

Electronic communications

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

Shareholders currently receiving a printed copy of the annual report who now wish to sign up to receive all future shareholder communications electronically can do so by registering with Link Market Services' share portal.

Go to www.signalshares.com to register, select 'Account Registration' and then follow the on-screen instructions by inputting your surname, your Investor Code (which can be found on your proxy form) and your postcode, as well as entering an email address and selecting a password.

By registering to receive your shareholder communications electronically, you will also automatically receive your dividend confirmations electronically.

Electronic proxy voting

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.signalshares.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 reports.

Pennon's website

www.pennon-group.co.uk provides news and details of the Company's activities plus links to its subsidiaries' websites.

The Investor Information section contains up-to-date information for shareholders including detailed share price information, financial results, dividend payment dates and amounts, and stock exchange announcements.

There is also a comprehensive shareholder services section which includes information on buying, selling and transferring shares, and how to notify a change in personal circumstances, for example, a change of address.

Shareholder information

continued

Beware of share fraud

The following is taken from the ScamSmart section of the Financial Conduct Authority's website (www.fca.org.uk/scamsmart).

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment.

While high profits are promised, if you buy or sell shares in this way you will probably lose your money.

How to avoid share fraud

1. Keep in mind that firms authorised by the Financial Conduct Authority (FCA) are unlikely to contact you out of the blue with an offer to buy or sell shares.
2. Do not get into a conversation; note the name of the person and firm contacting you and then end the call.
3. Check the Financial Services Register from www.fca.org.uk to see if the person and firm contacting you is authorised by the FCA.
4. Beware of fraudsters claiming to be from an authorised firm, copying its website or giving you false contact details.
5. Use the firm's contact details listed on the Register if you want to call it back.
6. Call the FCA on **0800 111 6768** if the firm does not have contact details on the Register or you are told they are out of date.
7. Search the FCA Warning List of unauthorised firms at www.fca.org.uk/scamsmart. Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme. Seek impartial advice from a financial adviser before you make an investment.
8. Remember: if it sounds too good to be true, it probably is!

5,000 people contact the Financial Conduct Authority about share fraud each year, with victims losing an average of £20,000

Report a scam

If you are approached by fraudsters, please tell the FCA using the share fraud reporting form at www.fca.org.uk/scams where you can find out more about investment scams. You can also call the FCA Consumer Helpline on **0800 111 6768**.

If you have already paid money to share fraudsters you can report this at any time to Action Fraud using their Online Fraud Report Tool at www.actionfraud.police.uk/reporting-fraud-and-cyber-crime or by calling **0300 123 2040**.



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www.merchantcantos.com

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www.pennon-group.co.uk

Registered in England & Wales
Registered Number: 2366640