



**South West
Water**

2020

Annual Report and Accounts



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CHAIRMAN'S STATEMENT

2019/20 saw South West Water once again deliver strong financial performance and operational progress as we approached the commencement of the new K7 (2020-25) regulatory period.

This performance has continued in the face of the COVID-19 crisis, throughout which the Company 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 Company, 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.

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, we began the K7 regulatory period as the only company to have achieved fast-track status for our 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 COMPANY

The Company has an ambitious road map for health & safety, largely focused on our HomeSafe programme. This has yielded a range of encouraging and improving trends. 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 now 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 industry 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 Company-wide action plan. 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 two decades ago.

DELIVERING FOR OUR EMPLOYEES, CUSTOMERS AND COMMUNITIES

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 South West Water's success for the benefit of our stakeholders. Our Section 172 statement can be found on page 118. 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 to directors. We have enhanced our Engagement Forums and seen further improvements in our Company-wide employee survey results.

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.

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 Company.

Great people make great organisations and developing and retaining talent is integral to the Company's future success. Overcoming competition for top talent in the marketplace is a priority for the Company.

We have continued to invest in apprenticeships and are particularly proud of our apprenticeship scheme which started 85 apprentices through this route in 2019/20. This now brings our three-year total to 225.

BOARD AND LEADERSHIP

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 services and deserve our heartfelt thanks. We thank them for their commitment over many years and wish them future success.

OUTLOOK

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.

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 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 business 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:

- Bathing water improvements – 125 of our 151 designated bathing waters classified as excellent (98.7% classified as sufficient or better)
- 100% of 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 (SSSI), with 9 SSSI Water Industry Environment Programme schemes approved by Natural England & 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
- More than 25,500 customers are on a support tariff and more than 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 1,300 subsidised or free water butts distributed
- Supporting Re-Fill Southwest: providing hydration stations at public events, permanent community Re-Fill 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 South West 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 SUSTAINABILITY STRATEGY FOCUS AREAS AND OBJECTIVES

A summary of South West Water's performance against sustainability targets for 2019/20 is outlined below.

HEADLINE TARGET	KPI	PERFORMANCE	PROGRESS
ENVIRONMENT			
<i>RESOURCE EFFICIENCY AND NATURAL CAPITAL STEWARDSHIP</i>			
Measurable natural capital gain and improved resource efficiency across relevant operational areas and projects	3% year on year improvement from a 2019/20 baseline	Methodology approved, assessment underway. Completion summer 2020	2
<i>HEALTHY PLACES AND HABITATS</i>			
Measurable biodiversity gain on our relevant operational sites and projects	5% biodiversity net gain across sites with biodiversity management plans	Sites confirmed and baseline assessments complete	1
<i>ENVIRONMENTAL LEADERSHIP</i>			
Implement Pennon Group's Climate Change and Carbon strategy defining our contribution to a low carbon economy. Embed our compliance culture ensuring positive and measurable impact and regulatory compliance	Zero serious/major or significant environmental incidents	Single Category 2 incident recorded by Environment Agency, despite South West Water challenge	2
SOCIAL			
<i>COMMUNITY INVESTMENT AND BENEFIT</i>			
Measurable community benefit and social capital gain in relevant operational areas and projects	3% year on year improvement from a 2019/20 baseline	Methodology approved, assessment underway. Completion summer 2020	2
<i>HEALTH, SAFETY AND WELLBEING</i>			
Continual improvement in our overall health, safety and well-being achieved through implementation of our HSSA strategy and its core KPIs	LTIFR at 0.5 by end of 2024/25	Target on track	1
<i>SKILLS, DIVERSITY AND DEVELOPMENT</i>			
Continual improvement in employee diversity, skills and engagement	<ul style="list-style-type: none"> increase % of female employees in the Company from 21% in 2019 to 25% by 2022. achieve 65% Trust Index © score by 2021/22 	Improvements on track	1
GOVERNANCE			
<i>QUALITY SERVICES AND SATISFIED CUSTOMERS</i>			
Continual improvement in levels of customer satisfaction and service quality and defined methods to support vulnerable customers	2% year on year increase from a 2019/20 baseline	Methodologies established and baseline complete	1

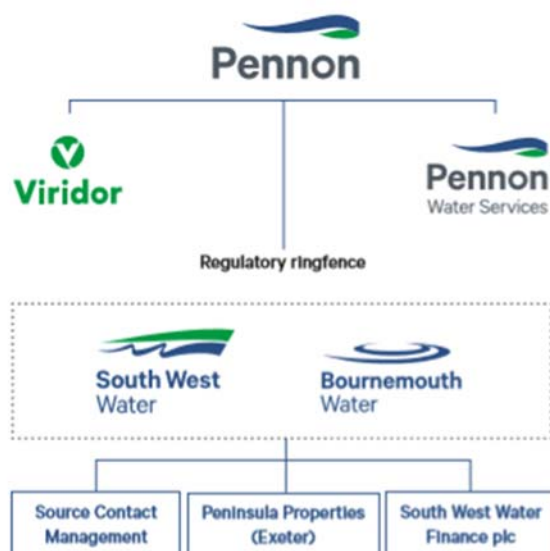
HEADLINE TARGET	KPI	PERFORMANCE	PROGRESS
<i>RESPONSIBLE SUPPLY CHAIN</i>			
Adopt defined sustainability principles within our procurement and contract management processes, building resilience across our supply chain	100% compliance with sustainable procurement policy by end 2021/22	Supply chain rationalisation and segmentation ongoing. Onboarding compliance process continues	1
<i>GOOD GOVERNANCE ENABLING INVESTMENT, INNOVATION AND SUSTAINABLE GROWTH</i>			
Transparent approach to good governance, responsible business and sustainable investment through continual improvement in Environment, Social & Governance (ESG) performance	25% of total finance raised within the Pennon Group Sustainable Financing Framework	72% achieved (£245 million raised through the SFF of a total £340 million)	1

PROGRESS

- 1 - Currently on track and forecast to achieve KPI/target within reporting period
- 2 - Currently not on track but forecast to be achievable 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

SOUTH WEST WATER'S GROUP CONTEXT

South West Water Limited is a subsidiary of Pennon Group plc (which is South West Water's immediate and ultimate parent company), a FTSE 100 company, whose principal significant trading subsidiaries are shown below:



Note: this is a summary structure and excludes smaller, non-externally trading subsidiaries. South West Water's subsidiaries are described in note 17 (page 151).

SOUTH WEST WATER

South West Water provides regulated water and wastewater services across Cornwall, Devon and parts of Dorset and Somerset, water only services in areas of Dorset, Hampshire and Wiltshire (the Bournemouth Water area) and a small amount of non-appointed services. It is responsible for delivering the 2015-20 and 2020-25 business plans in both the original South West Water area of operation and the Bournemouth Water area of operation. South West Water provides retail services to residential (household) customers.

VIRIDOR

Viridor provides waste management services to UK residential and commercial customers including recycling, composting and energy recovery facilities. It was announced that Pennon Group has entered into an agreement to sell Viridor to an external company. Subject to approvals, this sale is expected to be completed during Summer 2020.

PENNON WATER SERVICES

Pennon Water Services provides retail services to non-household customers. Whilst part of the wider Pennon Group, South West Water has in place robust policies and practices to ensure full competition compliance with the market codes for the non-household retail market.

SOUTH WEST WATER'S SUBSIDIARIES

Source Contact Management manages South West Water's billing, collections and customer contact activities.

Peninsula Properties (Exeter) advises South West Water on property development opportunities.

South West Water Finance acts as a financing company, raising borrowings for South West Water.

OUR STAKEHOLDERS

South West Water operates in a high profile industry with a wide stakeholder group. We are committed to listening, engaging and reflecting all 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 staff, customers and regulators builds understanding and appreciation of our business

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

Our board – takes into account stakeholders' interests when making decisions.

Our customers

We supply water to a population of 2.2m and wastewater services to a population of 1.8m.

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, 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 Business Plan for 2020-25, 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 engage with key 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 of the Pennon Group annual report.

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

South West Water's customer satisfaction:

90%

Customer contacts resolved first time:

95.6%

Average based on:
96.2% water
93.6% wastewater

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.

We continually engage and communicate with our people on their health, safety and well-being, 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 hold regular Big Chat calls with employees, providing them with the opportunity to hear directly from the Executive and ask any questions they wish.

Find out more on page 17.

Our engagement score is:

68%

Our communities

Our business operates in the heart of local communities, so we work closely with these stakeholders through regular liaison meetings and community events. Our charity donation and sponsorship schemes support hundreds of good causes in communities where we operate.

We engage regularly with our communities on local projects and initiatives. 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! We hold 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, the Royal Yacht Association and others.

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

Find out more on page 25.

c.2.0 million
visitors to South West
Water's reservoirs

Our environment

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

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 page 24.

98.7%
of bathing waters
classified as 'sufficient' or
better

In line with 2018/19
(98.7%); our long-term
target is 100%

Our suppliers

Our supply chain partners play a vital role in supporting 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.

We have formal contracts and framework agreements with all supply chain partners that meet the appropriate balance between commercial, quality and sustainability focussed delivery. Our e-procurement platforms support a structured, fair and transparent approach to supplier engagement and we work collaboratively to support skills development and investment through the supply chain.

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

Find out more on page 28 of the Pennon Annual Report.

54%
of our suppliers paid within
30 days

Our regulators

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

We engage regularly with all our regulators on 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.

PR19
Fast-track of PR19
business plan

Our policy makers

Engaging with National and Local Government, MPs and Peers, Health & Safety Executive, HM Revenue & Customs and Defra, we have a good ongoing dialogue with policy makers and regularly engage with stakeholders who influence and shape our social contract.

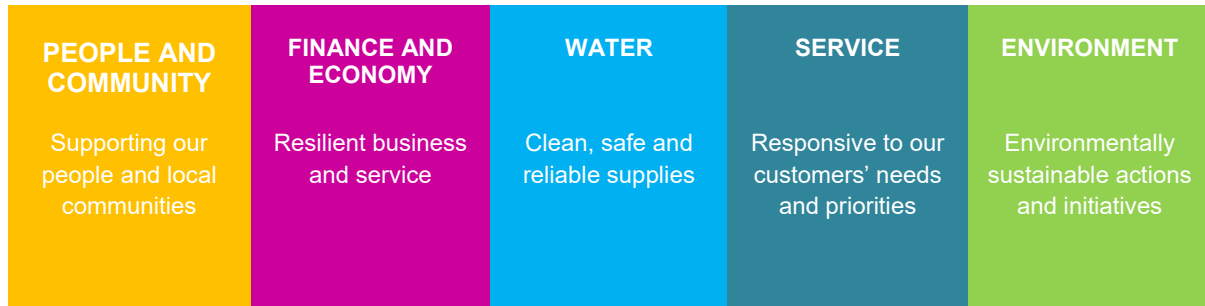
We regularly discuss our strategy, performance and risks and opportunities with policy makers and key opinion formers. We engage through a regular meeting programme, briefings, round tables, consultation responses and through trade bodies including Water UK and British Water.

Find out more on page 29 of the Pennon Annual Report.

SOUTH WEST WATER'S BUSINESS MODEL

OUR STRATEGIC FOCUS AREAS

In line with our vision of 'Bringing Resources to Life' we focus on five strategic focus areas:



OUR BUSINESS MODEL

Underpinned by strong governance, our business model is designed to ensure we:

- deliver value for money services while keeping bills affordable to customers
- achieve or exceed the high quality standards set by our regulators
- safeguard our existing investments (e.g. networks, treatment works, operational assets and systems)
- minimise the impact of our activities on the environment
- ensure fair returns for our investors
- are able to meet future challenges such as climate change, resilience, population growth and new legislation.



FOR THE BENEFIT OF OUR STAKEHOLDERS

OUR CORE BUSINESS

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

Customers – Our high quality services support households and businesses in the regions we serve

Shareholders and investors – Our strong business model ensures shareholders and investors get a fair return

Regulators and stakeholders – Our engagement with regulators and key stakeholders ensures transparency of our business approach

Employees – Our employees are highly valued and are integral to our success. Their health & safety is paramount

Suppliers and contractors – The relationships we have with our suppliers and contractors are fair and deliver many regional economic benefits.

WHAT WE DO

1. We abstract water from the environment

- maintenance of dams including upgrading spillways
- maintenance and upgrades of pumps and other assets (e.g. pipework)
- generation of renewable energy using hydropower, solar panels and wind power.

2. We clean it and make it safe to drink

- maintenance of existing treatment works
- improvements to the drinking water treatment processes
- investment in Granular Activated Carbon (GAC) and other technological advancements to improve efficiency and quality.

3. We distribute it to our customers

- ensuring that clean treated water reaches our customers at the same level of quality as when it leaves our treatment works
- ensuring reliability of supplies
- preventing leakage and bursts.

4. Our customers rely on the services we provide

- ensuring customers get excellent service when they contact us
- ensuring billing and payment systems work smoothly
- making the most of technologies and digital communications (e.g. website and social media).

5. We collect wastewater

- maintenance and upgrades of sewerage infrastructure (network and other assets)
- investment to reduce flood risk and associated pollution incident risks.

6. We treat it and return it to the environment

- maintenance and improvement of wastewater treatment assets as well as wastewater pumping stations
- wastewater treatment improvements to protect bathing and shellfish water quality
- bio-resource recycling
- energy generation from treatment processes through Combined Heat and Power (CHP) and solar panels.

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



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.

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 well-being.

Effective governance

A strong governance framework provides oversight and support to the Company 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 assets.

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.

Efficient financing

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

Well-managed risk

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

OUR PEOPLE

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

BECOMING A GREAT PLACE TO WORK

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

This was the third year we asked our employees how it feels to work for South West Water using Great Places to Work Best Workplace Survey™, consistent with other companies across the Pennon Group. We were pleased to see our highest ever response rate of 80%. South West Water had a Trust Index © score of 62% in 2019. Whilst this is a slight fall from the 2018 score of 63% it remains significantly higher than the national average for large employers of 53%. Our Engagement score increased by 1% to 68% and remains well ahead of the national average for large employers of 56%. These results show we are well on the journey in embedding the Company's HR strategy and demonstrates that we are continuing to make progress in living our values and in 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 well-being 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 Company's highest scoring categories for 2019 included diversity at 83% favourable, line management at 77% favourable and empowerment and accountability at 73% favourable.

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 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 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 Company 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.

The Group-wide 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 the 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 being made against our business plans and strategy, how we are managing through COVID-19 and sharing of the engagement results and progress on actions.

DIVERSITY AND EQUAL OPPORTUNITIES

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 South West Water, the workforce comprises almost 1,500 employees with a gender split of 78% male and 22% female, unchanged from the prior year.

Female membership %		
	2019/20	2018/19
The Board	25	22
Executive Management Team	43	43
Senior Management	11	14
Company	22	22

Note: Senior Management includes members of the Executive Management.

We have reviewed the Company's recruitment practices and are now able to monitor diversity in all job applications. The Company now uses a software gender decoder tool which allows us to check all of 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 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 to ensure that their industry voices are heard.

According to the latest Energy & Utility Skills demographics, 5% of the sector identified as BAME. South West Water stands at 0.3%. 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. Our gender pay data for 2019/20 reports a gender pay gap of 5.0%, which is lower than the national average.

According to Energy & Utility Skills, across the water industry workforce, 20% are identified as female which places South West Water, at 22%, slightly ahead of the sector.

The Board promotes equality of opportunity and diversity across all areas, including gender and ethnicity. The Company has more to do in this area which remains a key focus – see both the Nomination Committee report on page 83 and the Directors' Report on page 116 for further details.

TRAINING AND DEVELOPMENT

We have a strong commitment to investing in the development of our staff and want to build and recognise talent across the Company. 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 utilise our apprenticeship levy and since 2017, we have started 327 new apprentices across the Company. This has increased by 85 during the past year.

To complement our investment in leadership development, we have partnered with Exeter University to develop and offer five of our aspiring future leaders the opportunity to study for an MBA alongside their current role.

Our Company turnover rate in 2019/20 was 10.2%.

RESPONSIBLE EMPLOYER

We continued to live our values and demonstrate we are a responsible employer during the year. South West Water, as part of the Pennon Group, 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. As part of the Pennon Group, 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 Justine Greening. 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.

HEALTH & SAFETY

The Company's flagship health & safety programme, HomeSafe, was the focus of much attention and roll-out in 2019/20. As well as face-to-face training delivery, a further three HomeSafe e-learning packages were deployed across the Company, the most recent of which was targeted at mental well-being. 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 health & safety assurance, mental well-being pilots, a 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 and formal incident review panel. This is designed to establish accountability, causation, action and ultimately drive learning across our operations.

South West Water made significant progress towards certification to ISO45001:2018 which is expected by the end of 2020. These improvements, coupled with enhancements to health & safety new starter induction, new Company 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 rate¹ (LTIFR) by 2025.

LTIFR remains the Company's primary measure of injury performance and is subject to year-on-year target setting. In 2019/20, the Company achieved an LTIFR of 1.27, a reduction of 15% compared to the prior year. To achieve a broader balance of health & safety metrics across the Company, 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 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

South West Water continues to measure progress carefully and the Sustainability Committee monitors the five key performance indicators set in March 2019. These include the core health & safety 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.

OUR OPERATIONS

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.

KEY FACTS

- 2.2m total population served
- 1.0m customers served
- 23 raw water reservoirs
- 34 drinking water treatment works
- 18,370 km of drinking water mains network
- 650 wastewater treatment works
- 17,515 km wastewater mains network
- 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, 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% during 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, more than 35,000 customers have received support from one of our support schemes including WaterCare+ which assists those with affordability or debt issues and more than 25,000 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.

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.

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 AND SAFETY

Our success as a Company relies on the health, safety and well-being 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 is given greater visibility across our operations and engagement with the training programme has been high.

In 2019/20, there were 11 RIDDOR (Reporting of Injuries, Diseases and Dangerous Occurrences Regulations) 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 in 2018/19 to 0.50 by 2025. This would place South West Water in the top quartile of the industry.

Following the implementation of 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 grass land 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 fifteen 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
- 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, we once again delivered a strong financial performance with a cumulative Watershare return on regulated equity (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 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 crisis we took proactive steps to ensure close lines of communication were kept open 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.

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 (SWLT). 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.

REPORT OF THE FINANCE DIRECTOR – FINANCIAL REVIEW

OVERVIEW

South West Water demonstrated continued outperformance in 2019/20 reflecting strong cost control and a continued focus on efficiency.

The Company, including the merged Bournemouth Water, continues to deliver and outperform the sector leading business plan targets for K6 and achieved a Return on Regulated Equity (RoRE) of 12.1% for the year (11.8% cumulatively for the K6 period). This has been achieved through outperformance spread across total expenditure (totex), financing with the lowest effective interest rates in the industry and continued delivery of net ODI rewards. These benefits are being shared with customers through our unique 'Watershare' mechanism. £139 million has been identified for sharing with customers to date.

During 2019/20, we continued to deliver cost efficiencies and delivered our target of c.£300 million of savings over K6.

South West Water also continues to deliver on its targeted capital expenditure programme with the innovative new water treatment works 'Mayflower' for Plymouth now in its commissioning phase and due to enter operations in June 2020. Additional capital expenditure aimed at reducing leakage has been delivered during 2019/20 and we met our ODI target for leakage reduction.

South West Water received its Final Determination from Ofwat in December 2019. Our preparations for K7 are underway and we are well-placed to meet the challenges of the new regulatory period.

During the year our interest rate on average net debt remained low at 3.3% and at 31 March 2020 South West Water continued to have a strong funding position with £293 million of cash and committed facilities.

STATUTORY FINANCIAL PERFORMANCE

South West Water's statutory results show a decline in profit before tax to £171.1 million (2018/19: £178.6 million). In 2019/20 there is a non-underlying charge of £0.2 million relating to past service costs on the defined benefit pension scheme and a £2.8m charge relating to a COVID-19 bad debt provision (see note 6). In 2018/19, there was a non-underlying charge of £1.9 million relating to the equalisation of benefits relating to Guaranteed Minimum Pensions.

REVENUE

Total revenue has decreased by 1.9% to £571.6 million primarily reflecting a 3.7% year on year demand reduction from the hot dry Summer of 2018/19 to the wetter weather of this year. The revenue outturn will generate a WRFIM penalty of £0.2m but this is below the regulatory tolerance levels.

84% of our household customers in the South West area are now benefitting from a metered supply, with 5,065 customers opting for a meter in 2019/20 (2018/19: 5,727). 73% of households in the Bournemouth Water region are metered with 1,197 switching in the year (2018/19: 1,552).

EBITDA

Underlying earnings before interest, tax, depreciation and amortisation (EBITDA) were 0.8% lower than 2018/19 at £363.9 million (2018/19: £367.0 million). Underlying operating profit decreased by 2.3% to £245.2 million (2018/19: £251.0 million) and underlying profit before tax decreased by 3.5% to £174.1 million (2018/19: £180.5 million).

As described above, reduced customer demand has led to a decline in revenue. Operating costs decreased, with no repeat of the additional costs incurred due to the extreme weather of 2018/19. The underlying cost base continued to achieve targeted efficiencies as well as benefit from the merger of Bournemouth Water and operating costs declined by 3.6% compared to prior year. In addition, South West Water's bad debt performance remains strong with a charge of 0.5% of revenue (2018/19: 0.4%), reduced from 1.7% at March 2015. This continues to be driven by efficient collections as we work with our customers to manage their debt and strive to support those customers in vulnerable situations with affordability challenges.

We continue to look to efficiently manage and optimise value from our estates portfolio, recognising a profit on sale of assets in the year of £0.4 million (2018/19: £1.7 million).

NET FINANCE COSTS

Underlying net finance costs of £71.1 million were £0.6 million higher than last year (2018/19: £70.5 million). This primarily reflects a higher average level of debt during the year offset by lower RPI on index linked debt, a lower Libor rate and one-off benefit from lease terminations.

We have secured funding at a cost that is efficient and effective. RPI funding represents approximately 25% of borrowing; at 3.3% the Company interest rate on average net debt for 2019/20 remains sector leading (2018/19: 3.5%).

PROFIT BEFORE TAX

South West Water's underlying profit before tax was £174.1 million, a decrease of 3.5% compared with the prior year (2018/19: £180.5 million). On a statutory basis, profit before tax was £171.1 million (2018/19: £178.6 million) reflecting a non-underlying bad debt charge of £2.8 million relating to potential bad debts resulting from COVID-19 and a net non-underlying charge before tax of £0.2 million relating to past service costs for our defined benefit pension scheme. In 2018/19, there was a £1.9 million non-underlying charge before tax reflecting the equalisation of benefits under Guaranteed Minimum Pensions (see note 6).

TAXATION

The company's mainstream UK corporation current tax charge for the year (including prior year adjustments) was £24.9 million (2018/19: £28.2 million), reflective of an effective tax rate of 14.6% (2018/19: 15.8%). The lower effective rate of taxation reflects the level of capital allowances claims on its increased capital expenditure. The company had a current tax asset of £3.4 million at 31 March 2020. Tax is ordinarily payable in four quarterly instalments, however this year, new rules which came into force accelerated the payments for the current year and for future tax years, such that all tax due in respect of the year is payable in months 3, 6, 9 and 12 of that year. As a result we paid six instalments to HMRC this year, two in respect of the previous financial year and four for the current year. We paid £34.2 million in tax in 2019/20 relating to 2018/19 and 2019/20. A further £9.4 million was paid to fellow Group entities in respect of Group relief.

Underlying deferred tax for the year (including prior year adjustments) was a charge of £9.8 million (2018/19: £1.3 million). This year there is a non-underlying deferred tax charge of £28.3 million (2018/19: £0.3 million credit). The underlying charge in 2019/20 primarily reflects capital allowances in excess of depreciation charge whilst the non-underlying charge of £28.9 million relates to the change in rate of corporation tax which is remaining at 19% having previously been set to reduce to 17% from 1 April 2020, together with a credit of £0.6 million in relation to the non-underlying charge in the year.

Overall the total tax charge for the year was £63.0 million (2018/9: £29.2 million).

DIVIDENDS AND RETAINED EARNINGS

The statutory net profit attributable to ordinary shareholders of £108.1 million has been transferred to reserves.

The Company has established a dividend policy which includes the following components:

- a sustainable level of base dividend growth, determined by a number of factors including the shareholder's investment and the cost of capital
- a further level of growth funded by efficiency outperformance
- comparison with the assumptions made by Ofwat in setting prices for the regulatory period.

Dividend payments are designed to ensure that key financial ratios are not prejudiced, whilst also taking into account balance sheet considerations.

Payments are designed to ensure that the ability of the Appointee to finance its Appointed Business is not impaired. Dividends of £249.7 million were paid to the parent undertaking (2018/19: £123.1 million), representing a base dividend of £60.5 million, £59.3 million of outperformance dividend based on cumulative outperformance for 2018/19, £0.1 million reduction relating to a prior year true up and £130.0 million of special dividend. The dividend was calculated with reference to the projections in the Ofwat 2014 Final Determination and the assumptions for 2019/20 included within the 2015-20 Business Plan.

CAPITAL INVESTMENT

Capital investment was £161.0 million in 2019/20 compared to £154.0 million in 2018/19. 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.

CASH FLOW

South West Water's operational cash inflows in 2019/20 at £217.2 million were £64.3 million lower than last year (2018/19: £281.5 million). These funds have been used to finance the Company's capital structure in an efficient way as well as investing in future growth through our substantial continuing capital investment programme.

Corporation tax payments were £43.6 million. Total tax payments reflecting all taxes borne by the Company in 2019/20 are described in more detail in the section on 'Tax Contribution (borne/collected)' on page 32.

LIQUIDITY AND DEBT PROFILE

South West Water has a strong liquidity and funding position with £293.2 million of cash and committed facilities at 31 March 2020. This consists of cash and deposits of £58.2 million (excluding £225.9 million of restricted funds representing deposits with lessors against lease obligations) and undrawn facilities of £235 million. At 31 March 2020 the Company's borrowings totalled £2,591.3 million. After the £284.1 million held in cash, this gives a net debt figure of £2,307.2 million, an increase of £244.6 million during the year (2018/19: £2,062.6 million).

South West Water has a diversified funding mix of 52% fixed, 23% floating and 25% index-linked borrowings. The Company's debt has a maturity of up to 40 years with a weighted average maturity of 20.4 years matching the asset base. Some of the Company's debt is floating rate, with derivatives being used to fix the rate on that debt. The Company has fixed, or put swaps in place to fix, the interest rate on a substantial portion of the existing debt,

in line with the policy to have at least 60% of funding fixed before the start of a regulatory period. The current level is below our policy of maintaining at least 60% of interest-bearing liabilities at fixed rates. Whilst SWW has entered into a number interest rate swaps over the past 12 months on a path to meet its policy, the ongoing market volatility due to COVID-19 has resulted in a pause to this phased approach. Since the 31 March 2020 this phased approach has recommenced benefiting from the current low levels of interest rates.

£576.3 million of South West Water's debt is index-linked at an overall real rate of under 1.8%. As a result of the aforementioned initiatives, South West Water's cost of finance is among the lowest in the industry. Around two thirds of the net debt is from finance leases, providing a long maturity profile to its debt. Interest payable on them benefits from the fixed credit margins, which were secured at the inception of each lease. A quarter of the net funding for the water business is RPI linked, a level below Ofwat's notional level of 33% leaving headroom for RPI to CPIH transition.

At 31 March 2020 the fair value of the Company's non-current borrowings (excluding leases) was £199.5 million more than its book value (2019: £176.9 million more than book value) as detailed in note 23 to the financial statements. This reflects the continued benefit of securing interest rates below the current market rate, offset by volatility in inflation markets.

CAPITAL STRUCTURE – OVERALL POSITION

The Company's net debt has increased by £244.6 million to £2,307.2 million. Cash inflow from operations was a strong £217.2 million. Cash outflows relating to the capital programme totalled £172.2 million, an increase from the prior year due additional capital expenditure in preparation for the next regulatory period. The gearing ratio at 31 March 2020, being the ratio of net debt to (equity plus net debt) was 82.4% (31 March 2019: 75.5%).

The combined South West Water and Bournemouth Water debt to RCV ratio is 64.6% (31 March 2019: 58.9%), which is broadly aligned with Ofwat's K6 target for efficient gearing of 62.5%.

	2015	2016	2017	2018	2019	2020
Regulatory capital value as at 31 March (£m)	2,928	3,150	3,291	3,431	3,505	3,573

The increase in RCV reflects planned capital investment during the year and Retail Prices Index (RPI) at March 2020 which was 2.6%.

South West Water utilises the role of the Pennon Group's treasury function to ensure it has the funding to meet foreseeable needs, to maintain reasonable headroom for future contingencies and to manage interest rate risk. It operates only within policies approved by the Board and undertakes no speculative trading activity.

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

The Pennon Group has considerable financial resources. The Directors therefore believe that it is well placed to manage its business risks.

INTERNAL BORROWING

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

TAXATION STRATEGY

South Water has adopted the Pennon Group plc tax strategy. This means that we will:

- At all times consider the Company's corporate and social responsibilities in relation to its tax affairs
- Operate appropriate tax risk governance processes to ensure that the policies are applied
- 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 business decisions
- Not enter into artificial tax arrangements or take an aggressive stance in the interpretation of tax legislation
- Not undertake transactions which are outside the Company's low risk appetite for tax or not in line with the Pennon 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.

The Company's approach to tax planning, risk management and governance is in line with the Finance Act 2016 requirements; the Company does not expect its tax strategy to change significantly year on year, however it is reviewed and updated annually. Further details are given in the Group's Tax Strategy document which is available on the Pennon Group website.

TAXATION CONTRIBUTION (BORNE/COLLECTED)

The company's total tax contribution extends significantly beyond the UK corporation tax payments.

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

- Value Added Tax (VAT) of £35.1 million recovered (2018/19: £23.3 million) by South West Water from HMRC. VAT has no material impact upon the profit before tax
- Business rates of £29.1 million (2018/19: £28.9 million) paid to local authorities. This is a direct cost to the Company and reduces profit before tax
- Employment taxes of £21.9 million (2018/19: £20.7 million) including employees' Pay As You Earn (PAYE) and total National Insurance Contributions (NICs). This is a direct cost to the Company and reduces profit before tax
- Fuel Excise Duty of £0.9 million (2018/19: £0.7 million) related to transport costs. This reduces profit before tax
- Payments to Environment Agency and other regulatory bodies total £11.4 million (2018/19: £11.0 million). This reduces profit before tax
- Carbon Reduction Commitment (CRC) payment for the Company of £0.2 million (2018/19: £0.9 million). This reduces profit before tax.

The corporation tax rate for 2019/20 used to calculate the current year's tax is 19%. This was previously due to reduce to 17% for the year ending 31 March 2021, however this was cancelled by the Chancellor in his budget on 11 March 2020 and will now remain at 19%. That change was substantively enacted on 17 March 2020.

To support the fact that we pay our 'fair' share, in 2019/20, Pennon Group again applied to the Fair Tax Mark organisation to seek their independent award. We are delighted to be part of the first water and waste group to be awarded the Mark. The Fair Tax Mark is the UK's accreditation scheme for businesses paying their fair share of corporation tax and reporting on their tax practices transparently.

PENSIONS

The Company is a member of the Pennon Group's defined benefit pension schemes for certain employees of South West Water. The defined benefit schemes were closed to new entrants on or before 1 April 2008.

At 31 March 2020 the Company's share of the pension schemes showed an aggregate surplus (before deferred tax) of £7.1 million (2018/19: £21.9 million deficit). A deficit recovery payment of £28.5 million was made during the year. This has been partially offset by remeasurements in financial assumptions during the year.

INSURANCE

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

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

- self-insurance – pay a moderate excess on most claims
- cover by the Pennon 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.

RISK REPORT

RISK MANAGEMENT AND INTERNAL CONTROL FRAMEWORK

South West Water's core business activities inherently expose the Company to a variety of risks which could materially impact our ability to achieve our strategic priorities. The Board are committed to the effective management of risks to ensure the long-term success of the Company.

South West Water, as part of the Pennon Group operates a mature, integrated risk management framework (see diagram below) which is embedded into our culture and ways of working at all levels of the business. This framework forms a key part of our governance structures to ensure that there is robust review, challenge and assurance over the management of our key risks and opportunities.

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 Company is exposed to and their potential impact on the achievement of our strategic priorities.

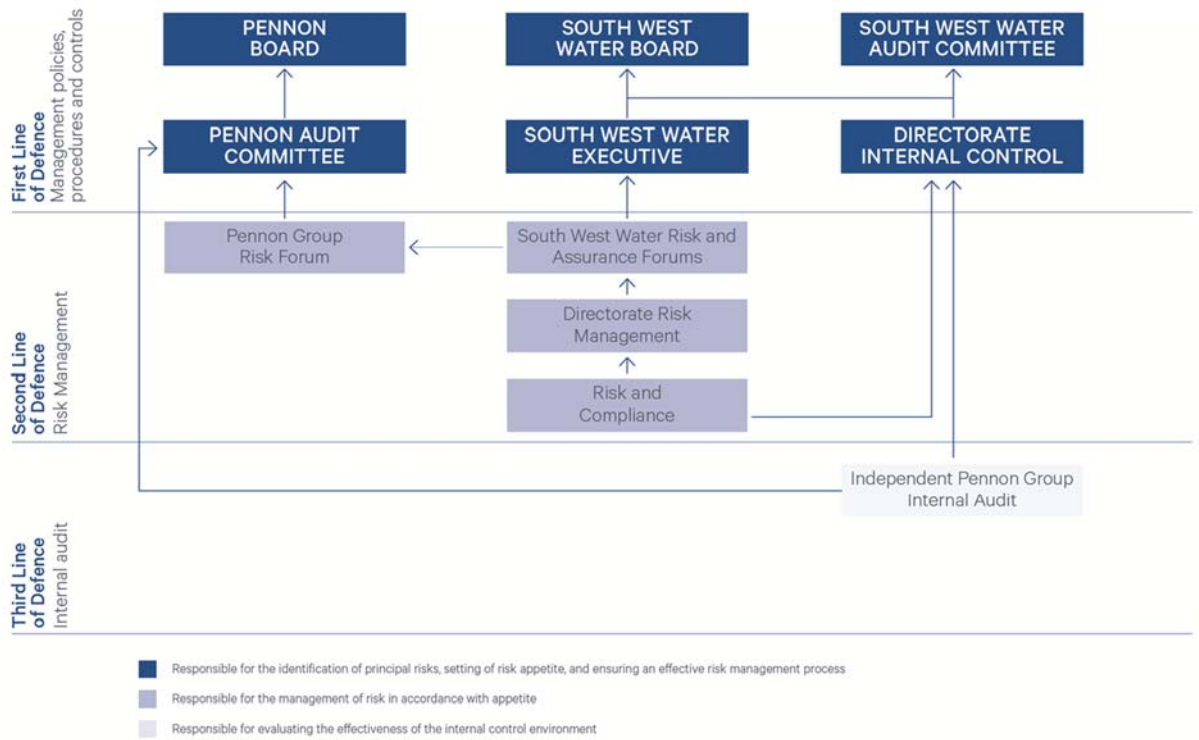
A consistent methodology is applied in the identification, assessment and management of the Company's risks, which considers both the likelihood of the risk occurring over a long-term period and formally from a Company perspective, a five-year period as well as the potential impact assessed across a range of categories including financial, safety, environmental and customer service. All principal and business level risks are captured within risk registers and are subject to regular review and challenge.

The consideration and evaluation of environmental, social and governance (ESG) risks are integrated into the Company's risk management framework, with the delivery of actions and performance monitored through the ESG framework. Further detail on the ESG framework is available in the Pennon Annual Report.

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 Company's strategic priorities. Horizon scanning of emerging risks and opportunities is embedded within the regular risk and opportunity review process. Once an emerging risk is deemed to have crystallised, it is assessed applying the Company's methodology and appropriate mitigating actions are established.

The Company 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 South West Water Executive and the 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 function.

RISK MANAGEMENT FRAMEWORK



The key elements of South West Water's risk management process include:

		Key Risk Management Responsibilities	Key Assurance Activities
FIRST LINE OF DEFENCE	Board	<ul style="list-style-type: none"> • Sets the Company's strategic objectives • Establishes the Company's risk appetite • Determines the Company's principal risks • Ensures an effective internal control framework 	<ul style="list-style-type: none"> • Quarterly reviews of the Company's principal risks against the determined risk appetite • Quarterly reviews of the Company's emerging risk log
	Audit Committee	<ul style="list-style-type: none"> • Reviews the effectiveness of the risk management framework • Reviews the adequacy of the internal control framework 	<ul style="list-style-type: none"> • Perform quarterly 'deep dive' reviews on principal risks • Review the Group Internal Audit Plan in respect of South West Water • Receive reports on the outcomes of key assurance activities
	Executive Management	<ul style="list-style-type: none"> • Day-to-day management of the principal and operational risks • Establish the relevant risk management processes and procedures • Maintains the internal control framework 	<ul style="list-style-type: none"> • Perform a thorough appraisal of the Company's risk profile quarterly • Monitors the Company'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 principal risks and mitigation strategies • Alignment of the top down and bottom up risk management process • Horizon scanning on emerging risks and opportunities 	<ul style="list-style-type: none"> • Review of principal risks on a quarterly basis • Deep dive reviews of specific risks. Topics include: cyber security, health & safety, GDPR, Brexit preparedness and ODI preparedness, recruitment and retention and resilience and business continuity
	South West Water Risk and Assurance Forum	<ul style="list-style-type: none"> • Horizon scanning providing a forward-looking view on South West Water specific emerging risks and opportunities • Reporting of updated risk statuses in respect of key Company projects • Review of Group-wide shared service risk registers focusing on risks relevant to South West Water 	<ul style="list-style-type: none"> • Cyclical review of principal risks over an annual cycle • Quarterly review of assurance processes and by exception the effectiveness of controls in mitigating risks
	South West Water directorate functions	<ul style="list-style-type: none"> • The identification and assessment of risks • Implementation and execution of appropriate risk mitigation strategies, aligned with the agreed risk appetite • Monitor compliance with internal control framework 	<ul style="list-style-type: none"> • Review of principal risks on a quarterly basis by the Executive Management Team • Second line compliance functions undertake compliance activities including regulatory, legal, health & safety, ISO standards

		Key Risk Management Responsibilities	Key Assurance Activities
			compliance and other key business processes <ul style="list-style-type: none"> Self-certification of compliance with internal control framework
THIRD LINE OF DEFENCE	Group Internal Audit	<ul style="list-style-type: none"> Provide independent, risk-based assurance on the effectiveness of the internal control framework Coordination of independent assurance activities 	<ul style="list-style-type: none"> Regular reporting to Audit Committee and Executive on the effectiveness of internal controls and the outcomes from other third line assurance activity

CONTINUOUS IMPROVEMENTS TO RISK MANAGEMENT AND INTERNAL CONTROL

The Company seeks to continually improve its approach to risk management and internal control. During the year there have been a number of developments which have further enhanced these processes:

- 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 Company's principal risks against its risk appetite
- South West Water Risk forums have been streamlined into a single quarterly forum within the extended Executive Management Meeting to allow greater consideration of the cross cutting issues and challenges
- The second line health & safety assurance programme has adopted a risk-based approach to allow resource to be focused on areas of greatest impact
- A project is underway to enhance resilience arrangements, with a Director of Resilience appointed to deliver commitments detailed within our 2020-25 business plan
- An electronic learning and policy acceptance platform has been implemented to enable more effective communication and dissemination of key policies and standards.

OFWAT'S PRINCIPLES - BOARD LEADERSHIP, TRANSPARENCY AND GOVERNANCE

Ofwat requires that holding companies manage their risks in such a way that the regulated company is protected from risk elsewhere in the Group. Pennon 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.

Further details of Group-wide principal risks and application of the Group's risk management framework across the Group are provided in the Pennon Group plc annual report (pages 58 to 67).

RISK APPETITE

The UK Corporate Governance Code requires companies to determine the risk appetite considered appropriate in achieving the Company's strategic priorities. Striking an appropriate balance between risk and reward is key to the success of the Company'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, whilst 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	<p>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, South West Water.</p> <p>The Company also operates a prudent approach to our financing strategy to ensure our long-term financing commitments are met. The Board acknowledges, however, that South West Water 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 Company seeks to mitigate any potential downside and leverage opportunities that may arise from Government policy and regulatory change.</p>
Market and economic conditions	<p>The Board recognises that our activities are exposed to changes in macroeconomic and external market conditions. The Company 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.</p>
Operating performance	<p>The Board has a low appetite for significant operational failure of our 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.</p>
Business systems and capital investment	<p>Whilst 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 appropriate return on a case by case basis. South West Water seeks to minimise technology and security risk to the lowest possible level without detrimentally impacting on the Company's operations.</p>

PRINCIPAL RISKS AND UNCERTAINTIES

South West Water's business model exposes it to a variety of external and internal risks influenced by the possible impact of macro political, economic and environmental factors.

While the ability of the Company 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 Company performs a range of scenario planning and analysis exercises to understand the risk exposure of one or a number of these events occurring:

BRITAIN'S EXIT FROM THE EUROPEAN UNION

Prior to Britain's exit from the European Union (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. Negotiation on a future trading agreement between Britain and the EU is ongoing and continue to be closely monitored. The impact of any agreement on the Company'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 Organisation (WTO) rules, existing contingency plans will ensure that South West Water 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 keyworker status to our front line 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 implemented appropriate response plans, whilst 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 Executive and Board continue to receive regular updates on South West Water'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 on going restrictions in place during 2020/21 which could provide continued challenges to the delivery our key operational activities. Medium term response planning has been undertaken to mitigate these risks where possible, which has considered a range of potential scenarios 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 in the following pages have been assessed applying our impact and likelihood methodology, separately identifying both the underlying risk assessment (pre COVID-19) and the risk assessment incorporating the emergence of COVID-19. The commentary for individual principal risks 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 Company. The assessment of the Company'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 50.

OTHER CHANGES TO RISK ASSESSMENTS

Risk A (Changes in Government Policy) is now assessed as amber at a net risk level, having previously been assessed as red. This reflects the reduction in risk of renationalisation following the December 2019 general election.

Details relating to other changes to assessed direction of travel of risks is considered in the detailed tables.

A risk reported in the previous year 'Poor customer service / increased competition leading to loss of customer base' is not reported this year. Customer service risk is included within the assessment of the risk of non-delivery of regulatory outcomes, whilst the competition element is deemed limited in the context of South West Water.




OVERALL ASSESSMENT OF RISKS

The Directors confirm that during 2019/20 they have carried out a robust assessment of risks facing the Company, including assessing the impacts on its business model, future performance, solvency and liquidity.

These principal risks have been considered in preparing the viability statement on page 50.

STRATEGIC IMPACT AND RISK RANKING

Our principal risks link to the strategic focus areas as described on page 14, and have been assessed on the following scale:

Key	Risk level		
	Low	Medium	High
The low, medium and high risk level is our estimate of the net risk to the Company after mitigation. It is important to note that risk is difficult to estimate with accuracy and therefore the actual risk may be greater or less than our estimate indicates.			
	GREEN	AMBER	RED
Current assessment of direction of travel of risk level	Increasing 	Stable 	Decreasing 

REPORTING AN OVERVIEW OF THE PRINCIPAL RISK PROFILE

PRE COVID-19



POST COVID-19



Principal risks	Ref	Strategic priorities	Risk description	Pre COVID-19		Post COVID-19	
				Net risk level	Trend	Net risk level	Trend
Law, regulation and finance	A	Finance and economy	Changes in Government policy	GREEN	↔	AMBER	↑
	B	Environment Finance and economy	Regulatory reform	GREEN	↑	AMBER	↑
	C	Environment Finance and economy	Compliance with laws and regulations	GREEN	↑	AMBER	↑
	D	Finance and economy	Maintaining sufficient finance and funding, within our covenants, to meet ongoing commitments	GREEN	↔	GREEN	↔
	E	People and community	Non-compliance or occurrence of avoidable health & safety incident	AMBER	↔	AMBER	↔
	F	People and community Finance and economy	Tax compliance and contribution	GREEN	↔	GREEN	↔
	G	Finance and economy	Failure to pay all pension obligations as they fall due and increased costs to the Company should the defined benefit pension scheme deficit increase	AMBER	↑	AMBER	↑
Market and economic conditions	H	Finance and economy	Non-recovery of customer debt and affordability	GREEN	↑	AMBER	↑
	I	Finance and economy	Macro-economic risks impacting inflation, commodity and power prices	AMBER	↓	AMBER	↑
Operating performance	J	Water Environment	Poor operating performance due to extreme weather or climate change	AMBER	↔	AMBER	↔
	K	Service	Poor customer service and/or increased competition leading to loss of customer base	N/A	N/A	N/A	N/A
	L	Water Service Environment	Business interruption or significant operational failure/incidents	AMBER	↔	AMBER	↑
	M	People and community	Difficulty in recruitment, retention and development of appropriate skills which are required to deliver the Company's strategy	AMBER	↔	AMBER	↑
	N	Water Service Environment People and community Finance and economy	Non-delivery of regulatory outcomes and performance commitments	AMBER	↑	RED	↑
Business systems and capital investments	O	Finance and economy	Failure or increased cost of capital projects/exposure to contract failures	GREEN	↔	GREEN	↑
	P	Water Service	Failure of IT systems, management and protection including cyber risks	AMBER	↑	AMBER	↑

LAW REGULATION AND FINANCE

Strategic impact	Mitigation and commentary	Risk appetite
Principal Risk A: Changes in Government policy		
2020 Net risk and direction:		2019 Net risk and direction:
GREEN, STABLE (Pre COVID-19)		RED, STABLE
AMBER, INCREASING (Post COVID-19)		
<p>Finance and economy</p> <p>Changes in Government policy may impact our ability to deliver the Company's strategic priorities.</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.</p> <p>We continue to engage with all MPs and 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. A further announcement will be made in subsequent years.</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 on the business is minimised.</p>	<p>We recognise that government policy evolves and seek to minimise potential risk whilst maximising opportunities through regular engagement, communication and robust scenario planning.</p>
Principal Risk B: Regulatory Reform		
2020 Net risk and direction:		2019 Net risk and direction:
GREEN, INCREASING (Pre COVID-19)		AMBER, STABLE
AMBER, INCREASING (Post COVID-19)		
<p>Environment</p> <p>Finance and economy</p> <p>Reform of the regulatory framework may result in changes to our priorities and the service we provide to our customers. It may have a significant impact on our performance which can impact 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, which we accepted in February 2020.</p> <p>There remains a continued focus from Ofwat on the governance of companies in the water sector; in particular the introduction of a 'social contract' between water companies and their stakeholders. We have been an active voice in the sector on this topic. This concept was at the heart of South West Water's 2020-25 business plan, entitled 'New Deal'.</p> <p>We maintain ongoing dialogue directly with the regulators and through sector-wide forums and we engage fully with consultations and proposed reforms of the regulatory framework.</p> <p>A number of temporary regulatory changes have been introduced in response to COVID-19; in particular wholesaler support for the retail market. 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 South West Water's activities.</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>

LAW REGULATION AND FINANCE (CONTINUED)

Strategic impact	Mitigation and commentary	Risk appetite
Principal Risk C: Compliance with laws and regulations		
2020 Net risk and direction:		2019 Net risk and direction:
GREEN, INCREASING (Pre COVID-19)		GREEN, STABLE
AMBER, INCREASING (Post COVID-19)		
<p>Environment</p> <p>Finance and economy</p> <p>South West Water is required to comply with a range of environmental laws and regulations.</p> <p>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>South West Water operates within robust and mature regulatory frameworks ensuring compliance with Ofwat, Drinking Water Inspectorate, Environment Agency and other relevant requirements. These frameworks are subject to regular Executive review.</p> <p>Compliance with the regulatory framework has become more complex as a result of a number of temporary changes by our regulators in response to COVID-19. All regulatory changes are subject to detailed review and, where necessary, internal processes and systems are adjusted to ensure compliance.</p> <p>South West Water also maintains a comprehensive internal framework to ensure compliance with corporate laws and regulations. This is reinforced through key policies such as the Code of Conduct, supply chain code of conduct and anti-slavery. Additionally, the Pennon Group's Speak Up whistleblowing process allows any concerns to be raised confidentially and dealt with through appropriate investigation.</p>	<p>South West Water has the highest standards of compliance and has no appetite for legal or regulatory breaches.</p>
Principal Risk D: Maintaining sufficient finance and funding, within our debt covenants, to meet ongoing commitments		
2020 Net risk and direction:		2019 Net risk and direction:
GREEN, STABLE (Pre COVID-19)		GREEN, STABLE
GREEN, STABLE (Post COVID-19)		
<p>Finance and economy</p> <p>Failure to maintain funding requirements could lead to additional finance costs and put our growth agenda at risk.</p> <p>Breach of covenants could result in the requirement to repay certain debt.</p>	<p>South West Water and the entire Pennon Group have mature treasury, funding and cash flow arrangements in place and the impact of political, economic and regulatory risks on the Company's financing commitments and cash flow is regularly reviewed by the Executive and Board.</p> <p>The Company operates with a strong liquidity position and a diversified funding mix. Funding is in place at effective average interest rates below many in the sector, with prefunding and headroom, including revolving credit facilities, available to meet future funding requirements.</p> <p>South West Water is prefunded well into the 2020-25 period and is already identifying further funds into the period. These funds include £245m provided through Pennon's pioneering Sustainable Funding Framework.</p> <p>The strength of our position provides the Company with added resilience in the event of short-term volatility as a result of COVID-19.</p>	<p>We operate a prudent approach to our financing strategy in order to ensure our funding requirements are fully met.</p>

LAW REGULATION AND FINANCE (CONTINUED)

Strategic impact	Mitigation and commentary	Risk appetite
Principal Risk E: Non-compliance or occurrence of an avoidable health & safety incident		
2020 Net risk and direction:		2019 Net risk and direction:
AMBER, STABLE (Pre COVID-19)		AMBER, STABLE
AMBER, STABLE (Post COVID-19)		
<p>People and community</p> <p>A breach of health & safety law could impact upon our people (including contractors) as well as leading to financial penalties, significant legal costs and damage to South West Water's reputation.</p>	<p>The effective management of health & safety risks continues to be a priority for the Board and Executive.</p> <p>During the year the full roll out of HomeSafe was progressed and experienced health & safety professionals are embedded within the business providing advice, guidance and support to operational staff. The Long Term Injury Frequency Rate (LTIFR) of 1.27 is a further improvement on prior year and the Company remains on track to achieve its target of 0.50 by 2025.</p> <p>In response to COVID-19 additional safety measures have been introduced to ensure that key activities within South West Water 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 personal protective equipment (PPE).</p>	<p>The Board has no appetite for health & safety-related incidents and expects the highest standards of compliance within the Company and third parties.</p>
Principal Risk F: Taxation compliance and contribution		
2020 Net risk and direction:		2019 Net risk and direction:
GREEN, STABLE (Pre COVID-19)		GREEN, STABLE
GREEN, STABLE (Post COVID-19)		
<p>People and community</p> <p>Finance and economy</p> <p>Non-compliance may result in financial penalties, legal costs and reputational damage.</p> <p>Furthermore, the perception that South West Water's overall tax contribution is inadequate could have a detrimental impact on the reputation of the Company.</p>	<p>The Pennon Group, including South West Water, 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>South West Water utilises an experienced and professionally qualified Pennon Group in-house Tax team, supported, where necessary, by external specialists.</p> <p>The senior accounting officer is required to review and declare annually the effectiveness of tax related internal controls.</p>	<p>We ensure full compliance with HMRC requirements and will not enter into artificial tax arrangements or take an aggressive stance in the interpretation of tax legislation.</p>
Principal Risk G: Failure to pay all pension obligations as they fall due and increased costs to the Company should the deferred pension scheme deficit increase		
2020 Net risk and direction:		2019 Net risk and direction:
AMBER, INCREASING (Pre COVID-19)		AMBER, INCREASING
AMBER, INCREASING (Post COVID-19)		
<p>Finance and economy</p> <p>The Company could be called upon to increase funding to reduce the deficit, impacting our cost base.</p>	<p>The Company utilises an experienced Pennon Group in-house Pensions team who also engage professional advisors to manage the pension scheme's investment strategy, ensuring the scheme can pay its obligations as they fall due.</p> <p>A revaluation of the defined benefit pension scheme is ongoing, and the Company is in the process of reviewing its pension provisions going forward.</p>	<p>The Company will ensure that all obligations are met in full but seeks to manage this without unnecessary increased costs to the Company.</p>

MARKET AND ECONOMIC CONDITIONS

Strategic impact	Mitigation and commentary	Risk appetite
Principal Risk H: Non-recovery of customer debt and affordability		
2020 Net risk and direction:		2019 Net risk and direction:
GREEN, INCREASING		GREEN, INCREASING
AMBER, INCREASING		
<p>Finance and economy</p> <p>There is a 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 in place for the recovery of domestic customer debt which has delivered improved collection rates and decreased bad debt exposure during the year.</p> <p>The potential impact of COVID-19 could place affordability pressure on our customers.</p> <p>We work proactively with our domestic customers and have a range of affordability schemes and tariffs to support them including Restart, WaterCare and Freshstart. Additional short-term flexibility, requested by our regulators, has already been incorporated within our collection processes.</p>	<p>While seeking to minimise non-recoverable debt, we recognise customer affordability challenges and the inability to disconnect customers results in a residual risk of uncollectable debt remaining.</p>
Principal Risk I: Macro-economic risks impacting commodity and power prices		
2020 Net risk and direction:		2019 Net risk and direction:
AMBER, DECREASING (Pre COVID-19)		AMBER, STABLE
AMBER, INCREASING (Post COVID-19)		
<p>Finance and economy</p> <p>The economic climate as well as commodity and energy prices have a direct impact upon the amount we pay for goods and services.</p>	<p>South West Water has established procurement procedures to source its goods and services through the most appropriate channels, ensuring quality of provision and price.</p> <p>Energy usage is minimised (including reduction of usage during periods of increased cost) 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 prices are relatively stable and South West Water has hedged the majority of wholesale power costs for the first two years of the 2020-25 regulatory period.</p>	<p>We seek to take well-judged and informed decisions whilst ensuring plans are in place to mitigate the potential impact of macro-economic risks.</p>

OPERATING PERFORMANCE

Strategic impact	Mitigation and commentary	Risk appetite
Principal Risk J: Poor operating performance due to extreme weather or climate change		
2020 Net risk and direction:		2019 Net risk and direction:
AMBER, STABLE (Pre COVID-19)		AMBER, STABLE
AMBER, STABLE (Post COVID-19)		
<p>Water</p> <p>Environment</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 Company seeks to mitigate this risk through investment via a planned capital investment programme, emergency resources and contingency planning. As part of the risk management process the Company also performs horizon scanning on the longer term impacts of climate change on its operations.</p> <p>Further improvement in our resilience is a key focus area within the 2020-25 regulatory period. A Director of Resilience has been appointed during the year to lead this workstream.</p>	<p>We seek to reduce both the likelihood and impact of climate change through long-term planning and forecasting to ensure sufficient measures are in place to mitigate the impact of extreme weather and climate change on our operations.</p>
Principal Risk L: Business interruption or significant operational failure / incidents		
2020 Net risk and direction:		2019 Net risk and direction:
AMBER, STABLE (Pre COVID-19)		AMBER, INCREASING
AMBER, INCREASING (Post COVID-19)		
<p>Water</p> <p>Service</p> <p>Environment</p> <p>Operational failure could mean that we are unable to supply clean water to our customers or provide safe wastewater processes.</p> <p>This has a direct impact on the successful delivery of the business plan.</p>	<p>Due to the nature of South West Water's operations, there are risks which arise during the normal course of business, including risk of failure of assets, processes or systems.</p> <p>These could include:</p> <ul style="list-style-type: none"> • water quality deterioration • contamination of water supplies • pollution and flooding events • water resource restrictions. <p>South West Water has mature processes in place for the management of its assets which is done through a programme of sophisticated planned and preventative maintenance and effective management of stores.</p> <p>Existing processes have been extensively reassessed in the light of the potential impact of COVID-19 and appropriate measures and actions have been introduced, working with the wider sector and our key strategic partners, to ensure the continued delivery of our highest priority activities.</p>	<p>We operate a low tolerance for significant operational failure or incidents. We seek to mitigate these risks where possible.</p>

OPERATING PERFORMANCE (CONTINUED)

Principal Risk M: Difficulty in recruitment, retention and development of appropriate skills, which are required to deliver the Company's strategy		
2020 Net risk and direction:		2019 Net risk and direction:
AMBER, STABLE (Pre COVID-19)		AMBER, STABLE
AMBER, INCREASING (Post COVID-19)		
<p>People and community</p> <p>Failure to have a workforce of skilled and motivated individuals will detrimentally impact all of our strategic priorities.</p> <p>We need the right people in the right places to share best practice, deliver on our customers' priorities and generate synergies (including through the Pennon Group's 'shared services' structure) to move the Company forward.</p>	<p>The Pennon Group's HR Strategy continues to be embedded across the organisation in order to continue to attract, retain and develop our employees.</p> <p>South West Water's Employee Engagement Forum provides 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 shows a Trust Index © score of 62% and an Engagement score of 68%. We also achieved our highest ever participation rate of 80% demonstrating employees value this mechanism for feedback.</p> <p>Succession plans remain in place for senior and other key positions. In order to ensure South West Water can compete for the top talent in the marketplace during the year we recruited an additional 85 new apprentices.</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 Company. It is recognised that there may be longer term challenges and action is underway to minimise the impact of these.</p>	<p>Whilst turnover of staff does occur, we ensure the appropriate skills and experience are in place with succession plans providing adequate resilience.</p>
Principal Risk N: Non-delivery of regulatory outcomes and performance commitments		
2020 Net risk and direction:		2019 Net risk and direction:
AMBER, INCREASING		AMBER, INCREASING
RED, INCREASING		
<p>Water Service People and community Environment Finance and economy</p> <p>South West Water's Regulatory Outcomes and performance commitments span all of our strategic focus areas.</p> <p>Non-delivery of these could result in financial penalties being applied as well as reputational damage.</p>	<p>The regulatory framework has been in place since 1 April 2015 and South West Water has delivered cumulative net ODI rewards of £13.3m 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. It is recognised that in order to meet these revised commitments further action is required in specific areas.</p> <p>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>We are committed to achieving all of our performance commitments over the length of each regulatory period.</p> <p>Where performance in an individual year falls below expectation we implement action plans and targeted interventions to ensure performance returns to committed levels.</p>

BUSINESS SYSTEMS AND CAPITAL INVESTMENT

Strategic impact	Mitigation and commentary	Risk appetite
Principal Risk O: Failure or increased cost of capital projects / exposure to contract failures		
2020 Net risk and direction:		2019 Net risk and direction:
GREEN, STABLE (Pre COVID-19)		GREEN, STABLE
GREEN, INCREASING (Post COVID-19)		
<p>Finance and economy</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 environmental performance.</p>	<p>All capital projects are subject to a robust business case process which includes challenge and risk modelling over key assumptions. Projects are delivered using skilled project management resource complemented by senior oversight and leadership.</p> <p>Agreements are in place with strategic partners who will support the delivery of the capital programme during 2020-25.</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>South West Water's investment activities are taken on an informed basis with risks weighed against appropriate returns.</p>
Principal Risk P: Failure of information technology systems, management and protection including cyber risks.		
2020 Net risk and direction:		2019 Net risk and direction:
AMBER, INCREASING (Pre COVID-19)		AMBER, INCREASING
AMBER, INCREASING (Post COVID-19)		
<p>Water</p> <p>Service</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.</p>	<p>South West Water operates a mature and embedded governance framework and holds the ISO27001 certification.</p> <p>There has been a significant increase in the number of staff working remotely as a result of COVID-19 which has placed additional strain on 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 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>We seek to minimise the risk of informational technology failure and cyber security threats to the lowest level without detrimentally impacting on business operations.</p>

VIABILITY STATEMENT

The Board has assessed the Company's financial viability and confirms that it has a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due up to the end of 2030. The assessment has been made with reference to the Company's current position and prospects, including the ongoing COVID-19 pandemic, its longer-term strategy, the Board's risk appetite and the Company's principal risks and how these are managed, as detailed on pages 39 to 49 of the Risk Report. South West Water is a long-term business characterised by a multi-year investment programme, with associated revenue streams.

The Company's strategic business plan, including consideration of the ongoing COVID-19 pandemic, principal risks and Ofwat viability scenarios are the foundation of the scenario testing. This assessment has considered the potential impact of arising risks 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 Company's viability.

In performing this stress testing the following factors have been considered:

- Principal risks have been ascribed a value with reference to risk weighting, factoring in the likelihood of occurrence and financial impact
- Ofwat viability scenarios have been modelled and monetised
- A near-term downside impact of COVID-19 has been modelled.

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
Cyber security
Health & safety
Energy management
General Data Protection Regulation (GDPR)
Brexit readiness
ODI preparedness
Dam Safety
Resilience and business continuity

In stress testing the Company's business plan it was determined that none of the individual principal risks would in isolation, or in aggregate, compromise the Company's viability.

As part of the Board's considerations additional scenarios concerning viability were reviewed. 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 years to the end of 2030
- ODI penalty of 1.5% in each of the years to the end of 2030
- 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 the assessment period to 2030.

In addition, a reverse engineered scenario that could possibly compromise the Company's viability over the assessment period has been modelled. This scenario builds on the factors above and additionally assumes a more severe COVID-19 downside scenario including a lower Retail Price Index (RPI) and an assumption that the Ofwat combined scenario and principal risks impact every year up to 2030.

The Board considered the likelihood of this scenario on the Company's viability over the period to 2030 and noted the potential mitigating actions which could include a reduction in capital and operational spend and dividends, concluding the Company could remain viable.

In making its assessment of the Company's viability, the Director's have taken account of the Company's robust capital solvency position, the Company's latest assessment 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 Company, the Directors note that, as the Company 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 73, the Director's reviewed and discussed the process undertaken by management and also reviewed the results of the stress testing performed.

FORWARD-LOOKING STATEMENTS

This strategic report, consisting of pages 3 to 33, 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 South West Water, wherever they occur in this strategic report, are necessarily based on assumptions reflecting the views of South West Water as appropriate.

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

The strategic report consisting of pages 3 to 33 was approved by the Board on 19 June 2020.

By Order of the Board

A handwritten signature in blue ink that reads "Chris Loughlin". The signature is written in a cursive, flowing style.

C Loughlin
Managing Director
19 June 2020

GOVERNANCE AND REMUNERATION

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CHAIRMAN'S LETTER

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 on our governance policies and our application of the principles of good corporate governance.

Strong governance is central to our successful management of the Company 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 South West Water, I remain committed to ensuring that we continue to operate to the highest standards of corporate governance.

South West Water is a subsidiary of Pennon Group plc, however as a regulated water and wastewater business, South West Water complies with the requirements of Ofwat. It has its own independent Board of Directors and operates as if it is a publicly listed company in its own right.

The South West Water Board, which includes myself as Chairman, two Executive Directors, two Pennon Non-Executive Directors and three South West Water only, Independent Non-Executive Directors convenes on the same day as each Pennon Group Board meeting and considers South West Water strategy, performance and regulatory planning.

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 stakeholders.

It is my view that the Board is highly effective with a good understanding of the Company'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. Further details are provided on page 83.

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 17.

STAKEHOLDER ENGAGEMENT

The Board understands the part South West Water 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 at improving the provision of water and wastewater services for benefit of all our stakeholders.

There are a number of routes through which the Board gain an understanding of employees' views on key decisions, most notably staff forums and the 'Big Chat'. 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 these being rescheduled in 2020/21.

We continue to engage actively with all our stakeholders including our customers, our communities, our people and our suppliers, our regulators and other stakeholders. We are acutely aware that all of 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. Further detail on stakeholder engagement is contained on pages 26 to 29 of the Pennon annual report.

COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE AND OTHER REQUIREMENTS

South West Water aims to comply with the UK Corporate Governance Code (the 'UK Code') as fully as possible, within the context of being a subsidiary of a listed company, Pennon Group plc, which itself fully complies with the UK Code. The UK Code is published on the Financial Reporting Council (FRC) website, www.frc.org.uk. In accordance with the FRC's requirements, we have reported against the new 2018 version of the Code.

Given the Group structure there are a limited number of areas in which South West Water does not comply with specific Code provisions. These areas are described on page 72 alongside any additional mitigations deemed necessary.

In addition, South West Water has complied with Ofwat's revised 'Board leadership, transparency and governance' principles which applied from April 2019. Further details on our compliance with these principles will be provided in our Annual Performance Report and Regulatory Reporting.

My introduction to this corporate governance report and the following sections are made in compliance with the UK Code and cover the work of our Board and its Committees, our internal control systems and procedures including risk management, our corporate governance statements relating to share capital and control, our confirmation of the Company as a going concern and Directors' responsibility statements. Finally, in accordance with reporting requirements, on pages 120 and 121 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.

SOUTH WEST WATER LIMITED BOARD OF DIRECTORS

The South West Water Board of Directors at the end of the 2019/20 financial year comprises the Chairman (a Non-Executive Director), one Senior Independent Director (a Non-Executive Director), two Executive Directors and four further Independent Non-Executive Directors. In addition Susan Davy, Pennon Group Chief Financial Officer, Iain Evans and Claire Ighodaro, both Pennon Non-Executive Directors, attend the South West Water Board meetings. The Board considers the Non-Executive Directors to be independent in accordance with the UK Corporate Governance Code. The Board believes its Directors have an appropriate range of skills and experience to oversee the business of the Company.

Sir John Parker Chairman
<p>Appointment Sir John was appointed to the South West Water Board on 31 July 2015.</p> <p>He became Chairman of South West Water on 1 August 2015 and is also Chairman of Pennon Group plc.</p> <p>He is also Chairman of the Nomination Committee.</p>
<p>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.</p> <p>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.</p>
<p>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.</p>

Chris Loughlin Pennon Group Chief Executive Officer, Managing Director South West Water
<p>Appointment Chris was appointed to the Board on 1 August 2006 as Chief Executive of South West Water. He became the Pennon Group Chief Executive Officer on 1 January 2016.</p> <p>Chris is Chairman of the Pennon Executive and a member of the Sustainability Committee. Chris also serves as Managing Director of South West Water.</p>
<p>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.</p> <p>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.</p> <p>An enthusiastic advocate of local business, Chris was previously the Vice-Chairman of the Cornwall Local Enterprise Partnership.</p>
<p>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.</p>

Louise Rowe Finance Director
Appointment Louise was appointed South West Water Finance Director on 1 February 2015.
Skills and experience Louise has been with South West Water for over nine years, holding a range of managerial roles in the Finance Directorate prior to her appointment as Finance Director. She is a physics graduate and qualified as a chartered accountant with KPMG.
External appointments Louise is a member of the Water UK Finance Directors Forum and up to the 23 May 2020 she was a Non-Executive Director and Chair of the Audit and Assurance Committee of the Cornwall and Isles of Scilly Local Enterprise Partnership.

Lord Matthew Taylor of Goss Moor Senior Independent Director (Non-Executive Director)
Appointment Matthew was appointed to the South West Water Board on 1 March 2010 and appointed as Senior Independent Director on 28 March 2018.
Skills and experience Matthew has advised successive governments on planning policies for sustainable communities for over a decade. He is an experienced Non-Executive Director, and was previously MP for Truro and St Austell for 23 years from 1987, until he stood down at the 2010 general election.
External appointments Matthew runs his own planning consultancy, Taylor & Garner Ltd. He also chairs the Carclaze Garden Village Strategic Partnership Board and is Chair and Non-Executive Director of Bridgehall Real Estate Limited and Kensa Heat Pumps Limited. Matthew is an Honorary Member of the RTPI, Visiting Professor of Planning at Plymouth University and Senior Visiting Fellow at Cambridge University's School of Planning.

Jon Butterworth MBE Non-Executive Director
Appointment Jon was appointed to the Board on 28 September 2017. He is a member of the Sustainability Committee and is also independent scrutineer of health & safety processes across the Group (including within South West Water) to help ensure that these are robust and effective.
Skills and experience Jon has a distinguished track record within the utility industry, having started his career over 40 years ago in British Gas as an apprentice technician and subsequently progressing through a variety of senior leadership roles spanning Construction, Asset Management, Regulation and Operations. As the National Operations Director, Jon was accountable for the National Grid Gas Emergency Service across the UK, before taking on the role of Global Director of Safety, Sustainability & Resilience. Jon is currently Chief Operating Officer of non-regulated business within National Grid plc, providing direction and leadership to a sizeable portfolio of gas and electricity assets across the US and Europe, applying strategic thinking and commerciality to ensure continued growth and profitability. Jon's utility background provides him with an immense depth of knowledge and experience of the importance of maintaining a balance between profit and safety and constructively challenges the Board and management to constantly raise the bar in this area. Jon is passionate about corporate and social responsibility and was awarded an MBE in 2009 for services to Britain's Gas Industry. He was instrumental in the Governments Rehabilitation of Young Offenders programme and has dedicated over 10 years to Special Olympics Great Britain (SOGB).
External appointments Jon is a Fellow of the Institute of Directors and is also Chairman of CORGI, North Sea Link, NEMO Link, BritNed Netherlands, Ex-Ambassador of the HM Young Offenders Programme and a Trustee of the National Gas Museums Trust.

Martin Hagen Non-Executive Director
Appointment Martin was appointed to the Board on 1 September 2010.
Skills and experience Martin was previously Deputy Chairman of the Financial Conduct Authority's Regulatory Decisions Committee, a Board Member and President of the Institute of Chartered Accountants in England and Wales and Senior Partner of Deloitte's West of England practice. He was also an Independent Member of the Audit and Risk Assurance Committee of the Department for Work and Pensions and a Governor and Audit Committee Chair of UWE Bristol.
External appointments Martin is a Board Member and Chair of the Audit Committee of Companies House.

Neil Cooper Non-Executive Director
Appointment Neil was appointed to the Board on 1 April 2016, having joined the Pennon Group plc 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 the Company's approach on a number of significant matters including internal control, governance and financial reporting.
External appointments Neil is an Executive Director of Currencies Direct.

Gill Rider CB Non-Executive Director
Appointment Gill was appointed to the Board on 1 April 2016, having been appointed to the Pennon Group plc board on 1 September 2012. She is Chairman of the Remuneration Committee and a member of the Audit, Nomination and Sustainability Committees.
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 South West Water's approach on executive remuneration, ensuring that it is aligned with and supports the Company'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.

IN ATTENDANCE AT THE BOARD

The following attend the Board alongside the Company's Directors:

Susan Davy Pennon Group Chief Financial Officer
Skills and experience Susan is a member of the Pennon Board. She is a graduate qualified chartered accountant with 20 years' experience in the utility sector. Prior to her current appointment within Pennon Group plc, 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 the Group's strategy and her input has been invaluable to the Board in its deliberations.
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.

Iain Evans CBE Pennon Group Independent Non-Executive Director
Skills and experience Iain was appointed to the Pennon Board on 1 September 2018. He is chairman of the Sustainability Committee. 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 a Non-Executive Director of Welsh Water plc in 1989 and served on the Board for nearly 10 years, including five as Chairman. As chairman of the Sustainability Committee for both Pennon Group and South West Water, Iain is leading the 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.

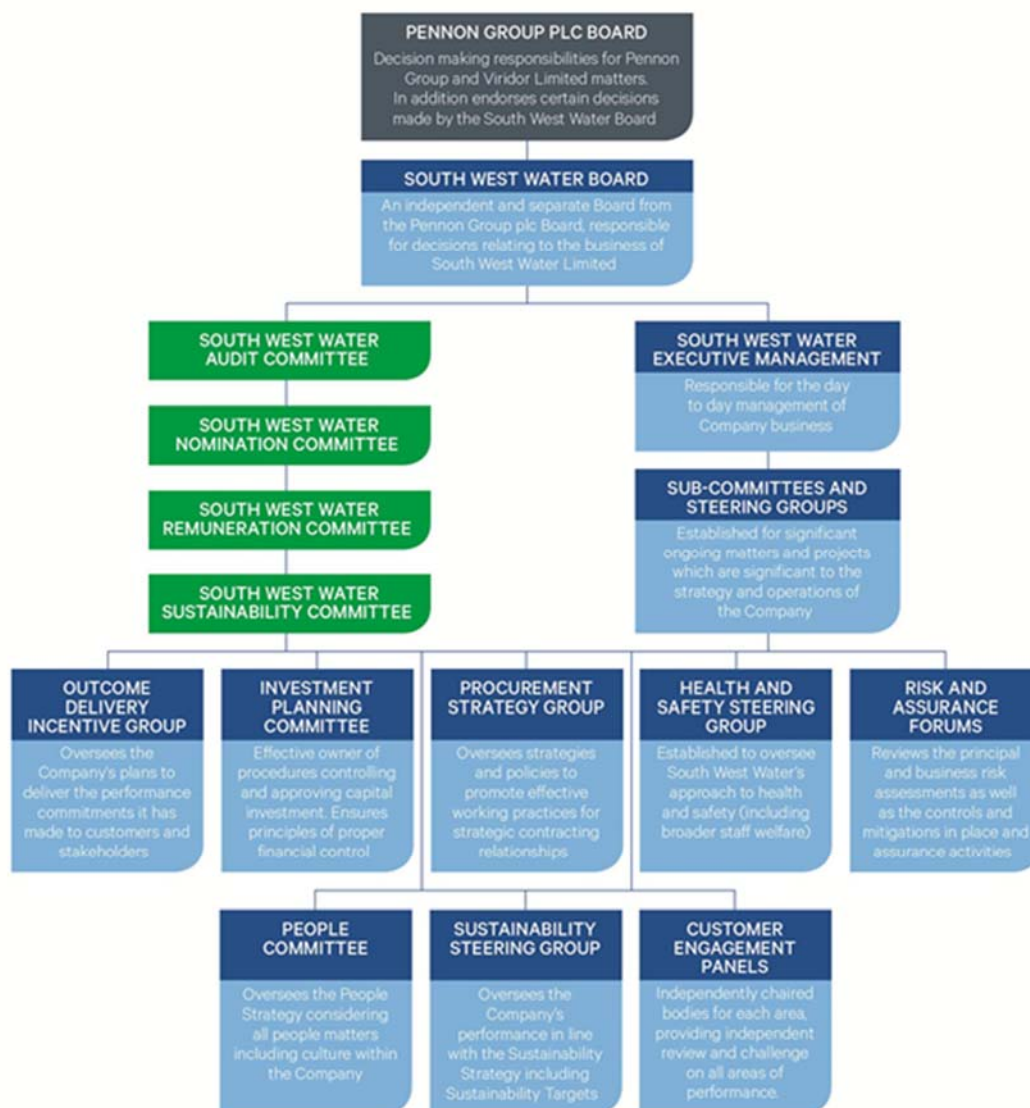
Claire Ighodaro CBE Pennon Group Independent Non-Executive Director
Skills and experience Claire has held a number of senior roles and directorships of UK and International organisations and has extensive board experience of serving on audit and governance committees. In May 2019, she stepped down from 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

GOVERNANCE STRUCTURE

BOARD STRUCTURE SUMMARY

The following diagram summarises the context and structure within which the South West Water Board operates aligned with the revised governance approach of Pennon Group plc:



PENNON GROUP PLC BOARD

The Pennon Group Board concentrates on strategic matters for all parts of the Group. Its responsibilities include overall leadership of the Pennon 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. Without reserving to itself the final decision-making power, the Pennon Group 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 business plan
- annual budgets
- certain decisions relating to financing.

This approach is compatible with Ofwat's principles in respect of Board leadership, transparency and governance.

SOUTH WEST WATER BOARD

As a regulated water and sewerage company which is part of the listed Pennon Group, it is important that South West Water acts as a separate company and that the interests of customers and other stakeholders are protected. South West Water's 'Board, Leadership, Transparency and Governance Code' commits it to acting as if it is a separate Public Listed Company as far as is possible.

The South West Water Board continues to operate as a separate independent Board in accordance with its own schedule of matters reserved to ensure compliance with Ofwat's principles on Board leadership, transparency and governance. As described in more detail on pages 69 to 72, South West Water itself complies with the UK Corporate Governance Code as far as is possible within the context of the Group structure.

The South West Water Board, which includes the Chairman, the Managing Director, two of the Pennon Non-Executive Directors as well as three South West Water only Non-Executive Directors, convenes before each Pennon Board meeting and considers South West Water strategy, performance and regulatory planning.

Further information on the operations of the Board and Committees are included on pages 56 to 87.

THE SOUTH WEST WATER EXECUTIVE MANAGEMENT

Day-to-day management of South West Water's operations and activities is undertaken by South West Water's Executive Management. It comprises Chris Loughlin (Managing Director) and Louise Rowe (Finance Director), who are also members of South West Water's Board and whose experience is described on page 56. There are five further members of the Executive Management, who have responsibilities for key areas of operations of South West Water:

- Matthew Crabtree – Engineering and Supply Chain Director
- Jo Ecroyd – Customer Services Director
- Sally Mills – Regulation Director
- Ed Mitchell – Operations Director (Wastewater Services)
- Iain Vosper – Operations Director (Drinking Water Services)

Group support functions in attendance:

- Head of IT
- Head of HR

In addition to the details provided in this report, further information on the structure and operations of the South West Water Executive Management and the sub-committees which support the decision making of the business is included within the South West Water Annual Performance Report and Regulatory Reporting, published in July 2020 (www.southwestwater.co.uk/report2020).

The South West Water Executive Management also meet formally on a monthly basis with the Pennon Group Chief Financial Officer also in attendance.

APPROACH TO GOVERNANCE

The Board acts as the main governing body for the purpose of oversight for the Company. Our approach to governance is an integral part of our culture, guiding how we do business and create value for our stakeholders.



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 sector, investing 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 control environment under regular review and seek to continually improve our approach.

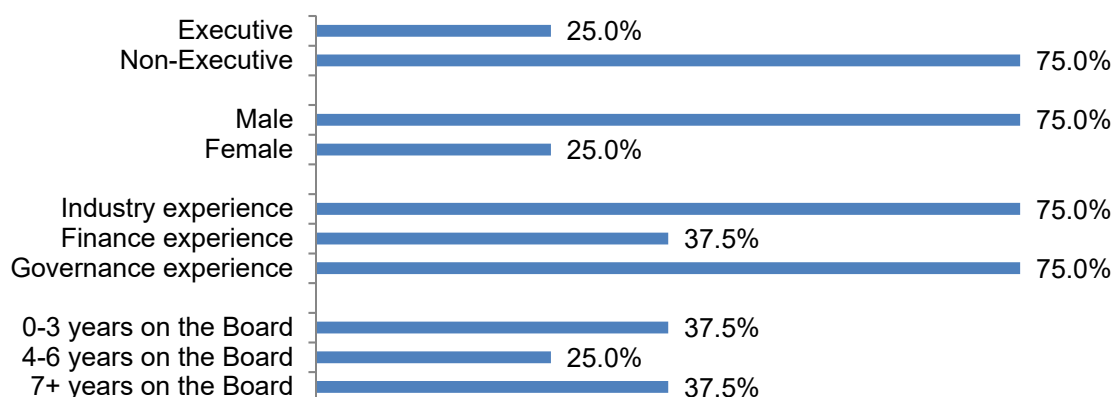
VISION AND VALUES

Our vision – 'Bringing resources to life' – and its supporting values of 'trusted, responsible, collaborative 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 we are trusted and valued by all our stakeholders.

BOARD COMPOSITION, INDEPENDENCE, EXPERIENCE AND TENURE (AS AT 31 MARCH 2020)



All of the Non-Executive Directors were considered by the Board to be independent throughout the year. None of the relationships or circumstances set out in Provision 10 of the UK Corporate Governance Code (the UK Code) applied to the Non-Executive Directors listed on page 114.

Notwithstanding their directorship of Pennon Group plc, Neil Cooper and Gill Rider are considered to be independent in character and judgement given that they were appointed to the South West Water Board in order to facilitate the Group's revised governance framework, rather than to represent the interests of the shareholder.

Sir John Parker was considered to be independent at the time of his appointment in accordance with Provision 9 of the UK Code. At that time, the Board concluded that none of the conditions set out in Provision 10 of the UK Code applied to Sir John; although he was appointed to the position of Pennon Group plc on the same date, he was not placed on the South West Water Board by Pennon in order to represent Pennon's interests but rather to help the flow of information and foster an understanding of the issues facing South West Water at Pennon Board level. The operation of the Group's governance framework is underpinned by the dual South West Water/Pennon appointments held by Sir John and other Non-Executive Directors.

All Directors are subject to re-election each year in accordance with Provision 18 of the UK Code. At year end, the Board had 25% female representation, which is less than its 33% female representation target. Further details of gender diversity within the Company are described on page 18 and page 84.

All of the Non-Executive Directors are considered to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations. Their biographies on pages 56 to 58 and the experience chart on page 64 demonstrate collectively a broad range of business, financial and other relevant experience.

BOARD ROLES

During the year there was a clear separation of responsibilities between the Chairman and the Managing Director, divided between managing the Board and the business, while they maintained a close working relationship.

Neil Cooper is chairman of the SWW Audit Committee and in accordance with the UK Code he has recent and relevant financial experience (as set out in his biography on page 58).

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 Executive Directors Representing the Company and being available to stakeholders Discussing separately with the Non-Executive Directors performance and strategic issues
Managing Director	Chris Loughlin	<ul style="list-style-type: none"> Managing South West Water and providing executive leadership Leading the operation of the Company in accordance with the decisions of the Board Co-ordinating with the Chairman on important and strategic issues of the Company and providing input to the Board's agenda Contributing to succession planning and implementing the organisational structure Managing stakeholder relations
Finance Director	Louise Rowe	<ul style="list-style-type: none"> Supporting the Managing Director in providing executive leadership and developing strategy Reporting to the Board on performance and developments across the business Implementing decisions of the Board Managing specific business responsibilities
Senior Independent Director	Lord Matthew Taylor	<ul style="list-style-type: none"> Assisting the Chairman with stakeholder communications and being available as an additional point of contact for stakeholders Being available to other Non-Executive Directors if they have any concerns that are not satisfactorily resolved by the Chairman
Non-Executive Directors	Jon Butterworth Martin Hagen Neil Cooper Gill Rider	<ul style="list-style-type: none"> Critically reviewing the strategies proposed for the Company Critically examining the operational and financial performance of South West Water 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 MEMBERSHIP AND ATTENDANCE

The Directors and their attendance at the six scheduled meetings of the Board during 2019/20 are as follows:

Board membership		Attendance
Chairman Sir John Parker	Chairman	6/6
Executive Directors Chris Loughlin Louise Rowe	Managing Director Finance Director	6/6 6/6
Senior Independent Director Lord Matthew Taylor	Independent Non-Executive Director	6/6
Non-Executive Directors Jon Butterworth Martin Hagen Neil Cooper Gill Rider	Independent Non-Executive Director Independent Non-Executive Director Independent Non-Executive Director Independent Non-Executive Director	6/6 6/6 6/6 6/6
In attendance Susan Davy Iain Evans Claire Ighodaro	Pennon Group Financial Officer Pennon Group Independent Non-Executive Director Pennon Group Independent Non-Executive Director	6/6 6/6 4/4

All Directors served during the year. Stephen Bird served on the Board until he passed away on 10 May 2019. In addition to the six Board meetings a Group-wide strategy day is held in September of each year.

MANAGING SOUTH WEST WATER

The South West Water Board continues to operate as a separate independent board in accordance with its schedule of matters reserved (see below) to ensure compliance with Ofwat's 2019 Board leadership, transparency and governance principles.

The Pennon Group 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 delegates more detailed consideration of certain matters to the Board Committees, to the Executive Directors and to the Company Secretary. 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
- Company policies, procedures and delegations
- appointments to the Board and its Committees
- approval of the annual reports and financial statements and the Annual Performance Report and Regulatory Reporting.

Without reserving to itself the final decision-making power, the Pennon Group 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 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 other senior executives within the Company and from external advisors to facilitate the decision making of the Board.

In arriving at decisions, the Board always considers the impact they might have on stakeholder groups when considering what is in the best interests of stakeholders as a whole.

The Chairman and Non-Executive Directors take particular care to ensure that the Board considers the interests of customers in all matters discussed by the Board, reflecting a very real understanding of the particular pressures on South West Water customers. In addition to a monthly review of customer contact and complaint analysis, the Board is regularly updated on customer satisfaction surveys.

South West Water has monitored customer satisfaction with service and value for money quarterly for over 20 years, and has also facilitated focus groups to discuss local and regional investment. Findings from all methods of customer consultation are fed back to the Board and incorporated into Company plans.

All Directors are equally accountable for the stewardship of the Company's affairs with the Non-Executive Directors having a particular responsibility for ensuring that strategies proposed for the development of the business are critically reviewed. The Non-Executive Directors also examine the operational and financial performance of the Company and fulfil a key role in corporate accountability through their membership of the governance Committees of the Board.

SOUTH WEST WATER EXECUTIVE MANAGEMENT

The role of the South West Water 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 resources to create and maximise shareholder value whilst protecting the interests of the wider stakeholder group.

Chaired by the Chief Executive Officer, the Pennon Executive meets formally on a monthly basis to review and refine recommendations to be presented to the Board.

Further details concerning the Executive Management and its sub-groups are provided on pages 61 and within the South West Water Annual Performance Report and Regulatory Reporting, published in July 2020 (www.southwestwater.co.uk/report2020).

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 there are good information flows between the Directors, the Board and its Committees.

Newly appointed Directors receive a formal induction which includes, inter alia, an explanation of the Pennon Group structure, regulatory and legal issues impacting the Company, the Pennon Group governance framework and policies, the Pennon Group's approach to risk management and the Company's 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 Pennon Group shares), and the current activities of the Board and its Committees. Newly appointed Directors are also invited to visit different operating facilities and have to meet with staff in order to better understand key processes and systems.

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

BOARD COMMITTEES' TERMS OF REFERENCE

In accordance with policies, a range of key matters are delegated to the Board's Committees as set out on pages 73 to 86 of this governance report.

The terms of reference of each of the Board's Committees are set out on the Company's website www.southwestwater.co.uk 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. This Board consider 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.

RISK MANAGEMENT AND INTERNAL CONTROL

The Board is responsible for maintaining the Company's system of internal control to safeguard shareholders' investment and the Company'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 Company that have been in place throughout 2019/20 and up to the date of the approval of this annual report and accounts.

The Company'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 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 34 to 37 in the strategic report provides for the identification of key risks including ESG risks in relation to the achievement of the business objectives of the Company, 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 and tax compliance. Details of the key risks affecting the Company are set out in the strategic report (pages 39 to 49).

KPIs are in place to enable the Board to measure the Company's ESG performance, including agreed regulatory performance commitments in respect of Outcome Delivery Incentives (ODIs), and a number of these are linked to remuneration incentives (see pages 90 to 113). A full breakdown of performance during the year against these KPIs is provided in South West Water's Annual Performance Report, which is published in July (see www.southwestwater.co.uk/report2020).

As part of the review of the effectiveness of the system of risk management and internal control under the Company 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 Company procedures.

The processes and policies serve to ensure that a culture of effective control and risk management is embedded throughout the Company and that the Company is in a position to react appropriately to new risks as they arise. Details of key risks affecting the Company are set out in the strategic report on pages 39 to 49.

CODE OF CONDUCT AND POLICIES

South West Water has adopted the Pennon Group's Code of Conduct and related policies which set out the commitment to promoting and maintaining the highest level of ethical standards. Areas covered include our impact on the environment and our communities, our workplace and our business conduct.

The policy on anti-bribery and anti-corruption strictly prohibits employees from offering or accepting bribes, facilitation payments and kickbacks. The policy requires that due diligence checks of third parties doing business with the Company, including a corruption risk assessment examining 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 Company, with ongoing face-to-face and online training provided into business units by the dedicated Pennon 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 staff, customers and suppliers around potential wrongdoing.

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 Company'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 Company'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 Company's whistleblowing policy specifically includes and encourages reporting of:

- Bribery or corruption
- Stealing or fraud
- Corruption or dishonest activity

- Anything else contrary to the law

Allegations of misconduct and irregularity are thoroughly investigated and follow-up action in respect of the Group's control environment is taken when appropriate. In the normal course of business, investigations into irregularities may be ongoing as of the date of the approval of the financial statements.

Our Code of Conduct and our policies are available on the Company website.

COMPANY AND GROUP COMPLIANCE WITH THE HIGHEST STANDARDS OF BOARD LEADERSHIP AND GOVERNANCE

South West Water Limited is a wholly-owned subsidiary of Pennon Group plc, a FTSE 100 company with a premium listing on the Official List, trading on the main market for listed securities of the London Stock Exchange.

South West Water and its parent company Pennon Group plc, remain committed to operating to the highest standards of Board leadership and governance including transparency of reporting to investors, customers, regulators and other stakeholders. The full range of South West Water's corporate issues including strategy, performance, delivery, compliance and governance are covered within the governance structure shown above.

South West Water adopted its own Board leadership, transparency and governance Code which sets out how South West Water complies with the Ofwat principles from January 2019.

The South West Water Code states that the Company will comply with the UK Corporate Governance Code (the Code) to the extent that it can be applied to South West Water within the context of the Pennon Group structure. The Company will continue to regularly review its governance structures, ensuring it continues to carry out its business in a transparent way, designed to secure the Company's long-term success and profitability. The Company complied fully with the provisions and spirit of the UK Code during the year, subject to the exceptions as described below. Most of the exceptions relate to the Group structure, where certain responsibilities rest with Pennon Group plc (South West Water's parent company) which is fully compliant with the UK Code.

Details of how we have applied the Principles that form the UK Code are provided throughout this annual report and the table below provides some useful signposting. Further The UK Code is published on the Financial Reporting Council (FRC) website, www.frc.org.uk. Exceptions are detailed below.

INDEPENDENCE OF THE CHAIRMAN

Sir John Parker was considered to be independent at the time of his appointment, in accordance with Provision 9 of the Code. At that time, the Board concluded that none of the criteria set out in Provision 10 of the Code applied to Sir John; although he was appointed to the position of Chairman of Pennon Group plc on the same date, he was not placed on the South West Water Board by Pennon in order to represent Pennon's interests but rather to help the flow of understanding of the issues facing South West Water at Pennon Board level.

In addition, the operation of South West Water and the wider Pennon Group's governance framework is underpinned by the dual South West Water/Pennon Group plc appointments held by Sir John Parker and other Non-Executive Directors.

Notwithstanding Sir John's Chairmanship of Pennon Group plc, the South West Water Board believes he continues to demonstrate independence of character and judgement (of Pennon Group plc and its investors, and of management) when leading the Board in debate on South West Water matters.

INDEPENDENCE OF THE NON-EXECUTIVE DIRECTORS

Neil Cooper and Gill Rider are also Non-Executive Directors of our parent entity, Pennon Group plc. In addition, Lord Matthew Taylor and Martin Hagen have both served in excess of nine years on the Board, having both been appointed in 2010. In light of the above circumstances and the possible factors that could impair the individual directors independence, the Board has undertaken a particularly rigorous review of their performance. In addition, as part of the Board's external board evaluation exercise, a review was undertaken of the performance of each individual director. Following these reviews, the Board can confirm that, based on their participation at meetings and their contribution outside of the boardroom, each of the Non-Executive Directors continue to perform effectively and demonstrate commitment to their roles. It is intended that both Lord Matthew Taylor and Martin Hagen will step down from the Board on conclusion of the Annual General Meeting.

HOW WE PERFORMED AGAINST THE PRINCIPLES OF THE 2018 UK CODE

	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 Contributing to wider society 	<ul style="list-style-type: none"> See Board information (page 114) See business model section (page 14) See sustainability section (page 6)
	<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"> See governance introduction above See Code of Conduct information (page 68)
	<ul style="list-style-type: none"> Resources, internal controls, risk management 	<ul style="list-style-type: none"> See strategic report – investment and capital expenditure (page 30) See Risk report (page 34)
	<ul style="list-style-type: none"> Stakeholder engagement 	<ul style="list-style-type: none"> See pages 11 to 13
	<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"> See People section (page 17) See Code of Conduct information (page 68) See Speak Up information (page 17)
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"> See performance evaluation information (page 83) See Operation of the Board section (page 66)
	<ul style="list-style-type: none"> Board composition – balance of Executive/Non-Executive 	<ul style="list-style-type: none"> See Board composition (page 63) See Nomination Committee report (page 83) See Directors' roles (page 63)
	<ul style="list-style-type: none"> NED time commitment NED roles – to provide constructive challenge, strategic guidance, offer specialist advice and hold management to account 	<ul style="list-style-type: none"> See Board of Directors (page 56) See Director independence (page 69) See Directors' roles (page 63)
	<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"> See Operation of the Board (page 66) See Board support and training (page 66)

	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 	<ul style="list-style-type: none"> See Nomination Committee report (page 83)
	<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 	<ul style="list-style-type: none"> See Board of Directors (page 60) See Board composition, independence and experience (page 63)
	<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 	<ul style="list-style-type: none"> See performance evaluation (page 83) See Nomination Committee report (page 83)
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 	<ul style="list-style-type: none"> See Audit Committee report (page 73)
	<ul style="list-style-type: none"> The Board presents a fair, balanced and understandable assessment of the Company's position and prospects 	<ul style="list-style-type: none"> See Audit Committee report (page 73) See Statement of Directors' Responsibilities (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 	<ul style="list-style-type: none"> See Risk report (page 34)
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 	<ul style="list-style-type: none"> See Directors' Remuneration report (page 102)
	<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 	<ul style="list-style-type: none"> See Remuneration Committee report (page 86)
	<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 	<ul style="list-style-type: none"> See Directors' Remuneration report (page 102)

COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE

Throughout the year, South West Water complied with its own Board leadership, transparency and governance Code. The South West Water Code states that the Company will comply with the current UK Corporate Governance Code (the UK Code) to the extent it can be applied to the Company in the context of the Pennon Group structure.

The Company complied fully with the provisions and spirit of the UK Code during the year, subject to the exceptions as described below. Most of the exceptions relate to the Group structure, where certain responsibilities rest with Pennon Group plc (South West Water's parent company) which is fully compliant with the UK Code.

Provision 25 of the UK Code states that the Audit Committee should make recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor. Provision 25 also states that the Audit Committee should develop and implement policy on the engagement of the external auditor to supply non-audit services. As the auditor is appointed on a Group basis, the appointment, re-appointment and removal of South West Water's external auditor is (and has been throughout the year) a matter for the Pennon Group Audit Committee, as is the auditor's remuneration, terms of engagement and non-audit services.

Provision 26 of the UK Code states that a separate section of the annual report should describe the work of the Committee in discharging its responsibilities, in particular an assessment of the effectiveness of the external audit process. Due to the Group structure, the overall assessment as to whether the external audit function is effective is (and has been throughout the year) the responsibility of the Pennon Group Audit Committee, which carries out its assessment in conjunction with the South West Water Audit Committee.

Provision 38 of the UK Code states that the Remuneration Committee should have delegated responsibility for determining the policy for Executive Director remuneration and setting remuneration for the Chair, Executive Directors and senior management.

Provision 33 of the UK Code states that the Remuneration Committee should have delegated responsibility for setting remuneration for all Executive Directors and the Chairman. However, the remuneration of the Chairman, who is also the Chairman of Pennon Group plc and the Pennon Group Chief Executive Officer, who is also a member of the Pennon Group plc Board is the responsibility of the Pennon Group Remuneration Committee.

During the year Pennon Group plc complied fully with the UK Code. Full reports of the Pennon Group plc Board's Committees are contained within the Pennon Group plc annual report and accounts.

THE AUDIT COMMITTEE

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 Company'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 Company'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 Company. This includes monitoring the Company'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 Company, 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 Company'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, health & safety, cyber risk management, Brexit readiness and the Company's approach to General Data Protection Regulation (GDPR). More detail on our risk management processes, principal risks and their associated mitigation can be found on pages 34 to 49.

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 Company'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 and most recently the ongoing COVID-19 pandemic. 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 50.

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 76. 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 to best support the Company's stakeholders.

SOUTH WEST WATER AUDIT COMMITTEE COMPOSITION AND MEETINGS

Five meetings of the South West Water Audit Committee were held during the year. Membership of the South West Water Audit Committee and their attendance was as follows:

Membership	Role	Attendance
Neil Cooper	Chairman	5/5
Lord Matthew Taylor	Non-Executive Director	5/5
Martin Hagen	Non-Executive Director	5/5
Gill Rider	Non-Executive Director	5/5

Regular attendees to Committee meetings during the year included: the Managing Director of South West Water; the Finance Director; the Chief Financial Officer of Pennon; the Group General Counsel and Company Secretary; 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 Company.

The Board is satisfied that Neil Cooper and Martin Hagen have recent and relevant financial experience and competence in accounting or auditing. Details of each Director's significant current and prior appointments are set out on page 58.

The Chairman and two fellow 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 AUDIT 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 Company.

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 Company and the half-year and full-year results relating to the Company'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 Company.
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External auditor	<ul style="list-style-type: none"> • Considered 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 • Considered the auditor's report on control themes and observations for the year ended 2019, which did not identify any significant deficiencies. <p>Note, in line with the structure of the Group, certain activities such as recommending reappointment of the statutory financial auditor and assessment of effectiveness of the statutory financial auditor are performed by the Pennon Group Audit Committee. The responsibilities of the Pennon Group Audit Committee are described in the Pennon Group annual report (pages 84 to 87).</p>
Risk management	<ul style="list-style-type: none"> • Reviewed the Company'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 Company risk register and considered appropriate areas of focus and prioritisation for the audit work programme for the year • Management of information security across the Company 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"> • Discussed the results of the performance evaluation of the Committee • Reviewed new annual report disclosure requirements, including the audit report • Considered and approved Company 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 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 122 to 128. In addition to the significant matters set out in the table below, the Committee considered a range of other matters.

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 have been:

Area of focus by the Committee: Revenue recognition

How the matter was addressed by the Committee:

Given the nature of the Company's revenue, the areas of judgement continue to be in respect of revenue recognition relating to income from measured water services and estimates of timing of receipt of unmeasured revenue. 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. 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.

Area of focus by the Committee: Bad and doubtful debts

How the matter was addressed by the Committee:

Regular updates on progress against debt collection targets and other contractual payments due are received by the Board. Performance is monitored regularly against both South West Water's historical collection record and the track record of other companies in the sector. The Committee was particularly mindful of the impact of COVID-19 pandemic on the assessment of expected credit losses (ECLs) in determining the bad debt provision, noting the likely impacts of the pandemic on non-household retailers and household customers. 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 ECL's was reasonable.

Area of focus by the Committee: Going concern basis for the preparation of the financial statements and viability statement

How the matter was addressed by the Committee:

A report from the Pennon Group Chief Financial Officer on the financial performance of both the Pennon Group and South West Water, 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 Pennon Group 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. The Committee also reviewed a report from the Finance Director and Pennon Group Chief Financial Officer on the Company's financial viability over an appropriate period, which the Board considers to be up to 2030, in connection with the UK Corporate Governance Code and Ofwat's requirement for a viability statement to be given by the Board. Similarly, this report also considered the viability of the Company considering a downside COVID-19 scenario alongside the manifestation of other adverse events modelled from the Company's principal risks and Ofwat's mandated sensitivities for water companies. 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 Company 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 50.

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 Company'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 page 75. No issues were raised during that review and the Committee concluded that the auditor was effective during the year. 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 Company.

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 43.7% of the audit fee, which is well within the Company's 70% non-audit fee limit.

INTERNAL AUDIT

The internal audit activities of the Company are a key part of the internal control and risk management framework of the Company. There is a long-standing and effective centralised internal audit service at Pennon Group plc which makes a significant contribution to the ability of the Committee to deliver its responsibilities.

In 2018/19 Pennon Group plc established a new directorate of Risk and Assurance, encompassing Group risk reporting and internal audit. The consolidation of these activities fully aligns our internal audit approach with the

Group's ongoing risk monitoring and mitigation. The 2019/20 Group and Company 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 Company.

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 has applied a detailed FBU review framework that takes account of the Company'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 122 to 128.

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

Pennon Group plc undertook a competitive audit tender process in 2014, which included the statutory audit engagement for South West Water. The Group 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 Pennon Group's external audit services, including the statutory audit of South West Water, subject to its annual reviews, likely in the year ending March 2024. This allows for any potential new audit firm to take up the role for the year ending March 2025. The Committee believes this approach is in the best interest of shareholders, as over this period the Pennon Group will benefit from an efficient and effective audit, while receiving fresh challenge from a new senior statutory auditor.

INTEGRATED ASSURANCE FRAMEWORK

Throughout the year South West Water had in place an effective integrated assurance framework which identifies and monitors all types of assurance to enable a full evaluation of the conclusions drawn by all auditors, inspectors and reviewers from both internal and external providers.

The framework utilises a risk-based approach to ensure an appropriate balance of varied providers of assurance dependent on the assessed risk and complexity of assurance requirements.

(i) Group independent internal audit

South West Water utilises the Pennon Group's independent Internal Audit function, to provide effective risk-based coverage over the internal control environment. The Audit Committee's interactions and engagement into internal audit, including input into the annual plan is summarised above.

(ii) Annual assurance (financial and technical audit)

Alongside the statutory external auditor, South West Water also engages a technical auditor to provide assurance over key areas of regulatory performance reporting. This assurance considers our reported performance against key regulatory outputs and measures.

(iii) Quality assurance and ISO Internal Reviews

The South West Water Audit Committee also considers the resources for carrying out internal audits and reviews in key Company specific areas and endorses and acts on findings from these reviews carried out within the Company. There is a programme of internal audits coordinated by the Risk and Compliance Department as part of the Company's ISO certifications.

South West Water has the following accreditations/certifications:

- ISO 9001: 2015 (quality management)
- ISO 14001: 2015 (environmental management)
- ISO 27001: 2013 (information security)
- ISO 17025: 2005 (laboratories and sampling)
- ISO 50001: 2011 (energy management)

These specific areas are also subject to periodic external reviews (such as ISO external reviews).

SOUTH WEST WATER'S 2019/20 SUMMARY ASSURANCE REPORT

In July 2020, South West Water will publish its annual 'summary assurance report,' which will again detail assurance work which has been performed in areas which it has identified following consultation as significant areas for assurance, which includes annual reporting. This report will be available at www.southwestwater.co.uk/report2020.

THE SUSTAINABILITY COMMITTEE

Designed to add value and resilience to our business, our sustainability strategy was refreshed in 2018/19 and is integrated with Company's business, people and health & safety strategies. It clearly sets out our long-term objectives, three-year targets and our associated KPI's 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 the Company'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 Pennon 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 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.

SUSTAINABILITY COMMITTEE COMPOSITION AND MEETINGS

Four meetings of the South West Water Sustainability Committee were held during the year. Members of the Committee and their attendance were as follows:

Membership	Role	Attendance
Iain Evans	Chairman	4/4
Gill Rider	Non-Executive Director	4/4
Lord Matthew Taylor	Non-Executive Director	4/4
Jon Butterworth	Non-Executive Director	4/4
Chris Loughlin	Managing Director	4/4

All members of the Committee served throughout the year.

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, South West Water remains on track to achieve all of its three year targets. Full details of the sustainability performance against these targets is shown on page 6.

During the year the Committee continued to note the Pennon Group'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.

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 South West Water 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 Company 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 Company'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 Company's approach to community relations, community benefit and investment
- Performance against the Company's workplace policy, within its people strategy, including the results of the latest Company-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 VERIFICATION

South West Water's sustainability performance and reporting has been audited by Jacobs (a global provider of technical, professional and scientific services, including engineering, architecture, construction, operations and maintenance) as part of its audit of performance data contained within the Annual Performance Report. Jacobs utilise water industry specialists in the audit of our non-financial data.

South West Water considers that Jacobs's method of verification – which includes testing the assumptions, methods and procedures that are followed in the development of data and auditing that data to ensure accuracy and consistency – complements the best practice insight gained through South West Water's membership of Business in the Community.

Jacobs will provide a technical auditor's report within the Annual Performance Report and Regulatory Reporting outlining its opinion and key findings (published in July and available at www.southwestwater.co.uk/report2020).

BENCHMARKING

The Pennon Group (including South West Water) 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.

SOUTH WEST WATER SUSTAINABILITY REPORT

South West Water's sustainability reporting is integrated throughout the strategic report and specifically in the following sections:

- Chairman's statement (pages 3 to 5)
- Business model (page 14)
- Strategic priorities (page 14)
- Our people (pages 17 to 20)
- Our operations (pages 21 to 26)
- Sustainability targets (pages 8 and 9)

Further details of our operational performance, including in respect of sustainability will be provided in our Annual Performance Report, available at www.southwestwater.co.uk/report2020, published in July.

THE NOMINATION COMMITTEE

The Nomination Committee met three times during the year to fulfil the duties set out in its terms of reference.

Only the members of the Committee are entitled to attend the meetings of the Committee. Other regular invitees to the Committee during the year included the Managing Director, the Pennon 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 policy on Diversity, Respect and Inclusion and the Company's progress on diversity
- A review of succession planning for Non-Executive Directors and a horizon scanning exercise for potential Non-Executive Directors to compliment the current Board
- A review of the time spent by Non-Executive Directors in fulfilling their duties
- A review of the Company's succession plans, leadership of the Company and the Company's approach to succession planning
- A review of the gender pay disclosure for 2019 and ongoing action plan
- Discussions around the ethnic diversity ambition
- Introducing a general monitoring tool
- A review of the Committee's performance in the year
- 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.

NOMINATION COMMITTEE COMPOSITION AND MEETINGS

Director	Role	Attendance
Sir John Parker	Chairman	3/3
Lord Matthew Taylor	Non-Executive Director	3/3
Martin Hagen	Non-Executive Director	3/3
Neil Cooper	Non-Executive Director	3/3
Gill Rider	Non-Executive Director	3/3

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.

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: ensuring the continued effectiveness of the Board and the Company's governance framework; the Company'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 Company'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 Company are areas on which the Committee continues to focus. The Committee, supported by the Group HR Director, 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 Company.

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 for 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 Company 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 Company's senior management team.

The Committee is pleased to report that as at 31 March 2020, 25% of the Board's Directors were women, as disclosed on pages 18 and 63.

Action is being taken to improve diversity across the workforce, which will assist in increasing female representation at senior management level as described on page 18. In support of this aim, both our Chairman and our Managing Director 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.

Our parent company Pennon Group plc was also listed in Bloomberg's gender equality index, representing 325 companies globally, for its pro-woman brand, female leadership and talent pipeline, equal and gender pay, inclusive culture and sexual harassment approach.

The Committee and the Board will continue to monitor and promote diversity across the Company 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 of the workforce is provided on page 18.

THE REMUNERATION COMMITTEE

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 Company's strategy, reflects our values 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 Company
- advising the Board on the framework of executive remuneration for the Company
- determining the remuneration and terms of engagement of the Chairman, the Executive Directors and senior executives of the Company
- 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.

Remuneration of employees other than Executive Directors is considered by Executive Directors and senior management. Trade Unions recognised by the Company are consulted as part of the annual pay review processes. All employees of South West Water are members of a bonus scheme which takes into account Company performance (both financial and non-financial) as well as personal performance.

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
- Monitored external developments in remuneration
- Undertook a pensions review, with a view to ensuring alignment of Executive Directors' pensions with that 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 Company
- Agree executive remuneration ensuring it remains appropriate and meets all regulatory requirements, including meeting Ofwat requirements
- Reviewing the wider workforce remuneration using a pay dashboard, 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 reviewing 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 Executive to deliver the Company's strategic goals, deliver the PR19 regulatory commitments and create 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
- 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.

REMUNERATION COMMITTEE COMPOSITION AND MEETINGS

There were five meetings of the South West Water Remuneration Committee during the year. Members of the Committee and their attendance were as follows:

Membership	Date of appointment	Position	Attendance
Gill Rider	1 April 2016	Chairman	5/5
Neil Cooper	1 April 2016	Non-Executive Director	5/5
Martin Hagen	1 September 2013	Non-Executive Director	5/5

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 Pennon Group Chief Executive Officer (who is also a member of the South West Water Board) 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. The Committee is also supported by the Group Director of Human Resources and the Group General Counsel and Company Secretary.

DIRECTORS' REMUNERATION AT A GLANCE

COMPANY PERFORMANCE

- Cumulative return on Watershare regulated equity over K6 (2015-20) of 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

LINK BETWEEN STRATEGY AND REMUNERATION

		Link to strategy			Link to variable remuneration	
		1	2	3	Annual bonus	LTIP
Long-term	Earnings per share [#]	✓	✓	✓		✓
	Dividend per share [#]	✓	✓	✓		✓
	Return on capital employed (RoCE) [#]		✓	✓		✓
Annual	Profit before tax (PBT) [#]	✓	✓	✓	✓	
	Return on regulated equity (RoRE)	✓	✓	✓	✓*	
	ODI net rewards	✓		✓	✓*	
Sustainable business	Customer satisfaction with overall service	✓		✓	✓*	
	Employee engagement	✓		✓	✓*	
	Health & safety	✓		✓	✓*	
	Carbon emissions	✓		✓	✓*	

[#]Pennon Group metrics

*Reflected in bonus operational and individual metrics

1	Leadership in UK water and waste infrastructure	We aim to lead in the water and waste sectors by capitalising on Group strengths, capabilities, best practice and synergies and achieving the right balance between risk and reward.
2	Leadership in cost base efficiency	We are focused on driving down overheads and operating in the most efficient way to minimise costs.
3	Driving 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	➤ Significant portion of executive remuneration linked to performance of the business
Performance pay – appropriately aligned with customer interests	➤ Annual bonus includes customer and operational measures linked to metrics assessed by our regulator, customers, communities and wider stakeholders
Bonus and long term incentives – substantial link to stretching performance delivery for customers	➤ Stretching targets – motivate management to deliver sustainable performance ➤ Safeguard mechanisms in place to ensure outcomes reflect underlying performance

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 Penon are closely aligned to our business strategy and vision. Delivery of awards in shares delivered over 3-5 years and shareholding guidelines ensure focus on sustainable performance

ANNUAL STATEMENT FROM THE CHAIRMAN OF THE REMUNERATION COMMITTEE

The Company delivered another year of robust financial and operating performance in 2019/20.

South West Water finished the K6 (2015-2020) regulatory period with a cumulative return on Watershare 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.

The Company 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 industry.

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 Company continues to have significant cash and liquidity and has not taken any Government support measures.

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 page 88.

Overall, the annual bonus earned in respect of the year is 78.0% of salary for the Managing Director and 53.6% of salary for the Finance Director. The Committee is satisfied that the bonus outcome is fully supported by performance in the year.

Half of the bonus earned is deferred into shares which affirms Executives 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 Pennon Group metrics: EPS growth (40%), dividend growth (40%) and return on capital employed (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 105. This is reflective of EPS growth of over 9.5% and returns of 9.6% for the Pennon Group.

Vested shares for Executive Directors will remain subject to an additional two-year holding period.

POLICY REVIEW

Our previous remuneration policy was approved in 2017. Under the normal three-year renewal cycle, and reflecting our commitments in our PR19 business plan we have established a new policy from 2020.

The key points to note in respect of the policy are:

- No material changes to structure – the conventional bonus and LTIP structures will be retained
- Bonus metrics – change to provide greater alignment with customer priorities and operational delivery targets alongside ensuring financial sustainability. No change is proposed to the maximum of 75% of salary for the Finance Director. 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. Half of the award would continue to be deferred into shares for three years
- LTIP metrics – changes to reflect long-term customer delivery based on Return on Regulated Equity (RoRE), sustainable dividends and customer service metric (CMex). No change is proposed to maximum (80% of salary)
- Pensions – for new hires pensions will be aligned with arrangements offered to wider employees
- Malus and clawback – provisions have been strengthened to align with best practice.

Further detail on pay arrangements is provided in the main body of the remuneration report and the changes to the remuneration of the Managing Director are shown in the Pennon annual report (reflecting his role as CEO of Pennon Group plc).

DIRECTORS' REMUNERATION POLICY

INTRODUCTION

The previous remuneration policy was approved in 2017. Under the normal three-year renewal process, a new remuneration policy, as described in this part of the report.

The policy is displayed in its entirety on the South West Water website and is also 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 and the commitments made in our PR19 Business Plan. Throughout the Committee's deliberations on pay matters, careful consideration is given to the strategic priorities of the business, evolving market practice and regulatory 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 change in pension benefits for newly appointed Executive Directors to be aligned with arrangements offered to employees in the wider organisation;
- Changes in the metrics used for annual bonus and LTIP schemes
- 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	<p>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.</p> <p>Base salary reflects the scope and responsibility of the role as well as the skills and experience of the individual.</p>
Operation	<p>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.</p> <p>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.</p>
Maximum	<p>When reviewing salaries the Committee has regard to the following factors:</p> <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 • Other factors it considers relevant. <p>There is no overall maximum.</p>

Base salary	
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 staff since 2008. 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.
Performance framework	None.

Variable pay and share-based remuneration	
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 on deferred shares during this period. Awards are subject to malus and clawback provisions. Further details are set out on page 95.
Maximum	The maximum bonus potential for the Finance Director is 75% of base salary and for the Managing Director 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 96.

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 and customer delivery.
Operation	Annual grant of conditional shares (or equivalent). Share awards vest subject to the achievement of specific performance conditions measured over a performance period of no less than three years.

	<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 will 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 80% of base salary.
Performance framework	<p>Performance criteria are linked to our long-term strategy focused on customer and financial sustainability.</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 96.</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	
Purpose and link to strategy	Create alignment between Executives and stakeholders and promote long-term stewardship. During the course of their tenure, Executive Directors are expected to build up a shareholding equivalent to 100% of salary.
Operation	The Committee retains discretion to waive this guideline in certain cases (e.g. compassionate circumstances).

Notes to the 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 Pennon Group EPS growth, a sustainable dividend metric (comprising dividend growth and dividend cover) and return on capital employed (RoCE). The Committee chose these measures as they were closely aligned with South West Water's strategic focus on the delivery of sustained earnings and related cash flows and the long-term capital returns generated. As noted previously the metrics for the LTIP awards are being changed to give greater focus on long-term customer delivery and financial sustainability for 2020 LTIP awards later in the year. The performance targets are set in the context of the Company's forecasts and regulatory commitments, 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 Company, 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.

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. 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 2014 (the date the Company's first Directors' remuneration policy came into effect); (ii) before the policy set out above came into effect, provided that the terms of the payment were consistent with the 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 Company. 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 Company are entitled to base salary and pension provision including life assurance. In addition, all staff in South West Water 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.

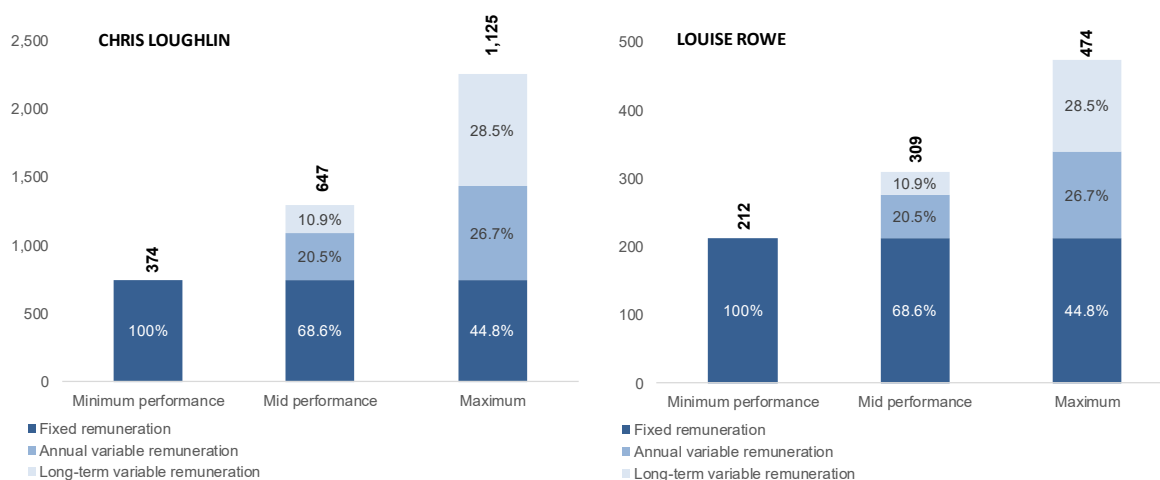
Future policy table – Non-Executive Directors

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 Company's strategy.
Fees	
Operation	<p>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.</p> <p>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.</p> <p>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.</p>
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⁽¹⁾ that could result from the proposed remuneration policy, based on salaries for 2020/21 is shown below.



- (1) Chris Loughlin is Managing Director of South West Water and is also a Director of Pennon Group plc. 50% of his full remuneration is rechargeable to South West Water through group recharges. For further detail please see page 107 of the Pennon Group Annual Report 2020.

Scenario	Assumptions
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 102) 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% of the annual bonus and 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 Managing Director and £541,635 for the Finance Director. 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 Managing Director and £406,467 for the Finance Director.

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 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 future policy.

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 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 96.

DATE OF DIRECTORS' SERVICE CONTRACTS/LETTERS OF APPOINTMENT

The dates of Directors' service contracts and letters of appointment and details of the unexpired terms are shown below.

Executive Directors	Date of service contract	Notice period
Louise Rowe*	1 February 2015	At age 65 (15 January 2047)
Chris Loughlin	1 January 2006	12 month notice period

* The Executive Directors' service contract is subject to 12 months' notice on either side.

Non-Executive Directors	Date of letter of appointment	Expiry date of appointment
Sir John Parker	19 March 2015	31 March 2021
Lord Matthew Taylor	1 March 2010	31 July 2020
Jon Butterworth	28 September 2017	28 September 2020
Martin Hagen	1 September 2010	31 July 2020
Neil Cooper	1 April 2016	31 August 2020
Gill Rider	1 April 2016	31 August 2021

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 three months' 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.

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 Pennon 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 Company. The Committee considers annual summary reports of employee remuneration and the terms and conditions of employment 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 Pennon Group 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 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.

ANNUAL REPORT ON REMUNERATION

IMPLEMENTATION OF REMUNERATION POLICY IN 2020/21

The proposed changes to the remuneration policy are set out on pages 92 to 97. This section sets out how the policy will be implemented for the year 2020/21.

<p>Base salary</p>	<p>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.</p> <p>Salaries for 2020/21 were increased by 1.5%, which was in line with or lower than increases for all employees:</p> <p>Louise Rowe – £168,960 Chris Loughlin – £273,312 (50% of Pennon Group recharge)</p>
<p>Benefits</p>	<p>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.</p>
<p>Pension-related benefits</p>	<p>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.</p> <p>Current annual pension contribution or cash allowance is 15% of salary for incumbent Executive Directors.</p>
<p>Annual bonus</p>	<p>The maximum bonus potential for the Finance Director is 75% of base salary and for the Managing Director 125% of base salary, with deferral of 50% of any bonus into shares for three years. Malus and clawback provisions apply.</p> <p>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. For the Managing Director, this is disclosed in the Pennon annual report. The bonus structure for the finance director has changed and for 2020/21 reflects:</p> <ul style="list-style-type: none"> ➤ 80% of bonus is linked to specific customer delivery targets: <ul style="list-style-type: none"> - 70% for 6 key performance metrics identified each year which reflect customers' top priorities (EPA and wastewater pollution incidents, internal sewer flooding, bathing water quality, leakage, interruptions to supply) with targets based on achieving business plan commitments. Underpin of 90% of the basket of other ODIs being met. - 10% for delivery of the 'New Deal', the introduction of a share scheme for customers (WaterShare+) ➤ 20% linked to financial delivery targets that support financial sustainability: <ul style="list-style-type: none"> - 10% profit before tax - 10% net debt/gearing <p>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.</p>
<p>Long-term incentive plan (LTIP)</p>	<p>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.</p> <p>The maximum annual award is 80% of base salary for the Finance Director and 150% of base salary for the Managing Director. The basis for the Finance Director has been updated and reflects:</p> <ul style="list-style-type: none"> - 1/3 Return on Regulated Equity (RoRE) - 1/3 sustainable dividend measures - 1/3 C-MeX

	<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. Malus and clawback provisions apply.</p> <p>Once finalised, we intend to publish the performance metrics and targets on our website.</p>
Shareholding requirements	100% of salary for the Finance Director and 200% of salary for the Managing Director.
All-employees share plans	<p>Executive Directors may participate in HMRC approved all-employee plans on the same basis as employees.</p> <p>The maximum is as prescribed under the relevant HMRC legislation governing the plans.</p>

NON-EXECUTIVE DIRECTOR'S FEES

Non-Executive Director fees for 2020/21 are set out below. They include a 1.5% increase for the Non-Executive Directors.

	2020/21 £000
Sir John Parker, Chairman	140
Lord Matthew Taylor	62
Jon Butterworth	58
Martin Hagen	58
Neil Cooper	35
Gill Rider	39

The Chairman, Sir John Parker, Neil Cooper and Gill Rider's fees are set by Pennon Group plc and 50% of these are charged to South West Water through group recharges. The table above outlines the 50% fee charges for 2020/21.

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 South West Water'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 Finance Director and Managing Director in 2020 was 1.5%, in line with the general increases across the Company.
Pension and benefits	All employees of South West Water are entitled to pension provision, including life assurance. Certain benefits are generally available only to more senior employees at management level and above.

	The Pennon 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. 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 Group pay dashboard	<ul style="list-style-type: none"> • The Pennon Group (incorporating South West Water) has 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 South West Water has published Gender Pay Gap data for the business • As a Company 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 Company-wide we have an average Gender Pay Gap of 5%, below the latest published UK average.

Employee engagement

Across South West Water 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 Engagement Forums. We have increased the frequency of Big Chat events during the year which provides employees the opportunity to dial-in to a Pennon Group-wide call with the senior executives 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 Company and motivate and engage our employees. One of the key priority areas for discussion during the last year has been on reward and remuneration. Our Trust Index © of 62% saw a slight decline from the 2018 score of 63% but remains well above the national average of 56% for large employers. We have also conducted our largest ever consultation with employees regarding our proposals to modernise pension arrangements across the Company.

SINGLE TOTAL FIGURE OF REMUNERATION TABLES (AUDITED INFORMATION)

	Base salary /fees (£000)		Benefits ⁽³⁾ (including sharesave) (£000)		Annual bonus (cash bonus and deferred shares) (£000)		Performance and co-investment plan ⁽⁸⁾ (£000)		Pension ⁽⁹⁾ (£000)		Total remuneration (£000)	
	2019/20	2018/19	2019/20	2018/19	2019/20	2018/19	2019/20	2018/19	2019/20	2018/19	2019/20	2018/19
Executive Directors												
Louise Rowe ⁽¹⁾	166	163	18	16	89	119	170	57	25	24	468	379
Stephen Bird ⁽²⁾	21	248	-	26	-	236	-	109	4	44	25	663
Chris Loughlin ⁽⁵⁾	269	264	19	17	210	240	515	104	81	79	1,094	704
Non-Executive Directors												
Sir John Parker, Chairman ⁽⁴⁾	135	135	-	-	-	-	-	-	-	-	135	135
Lord Matthew Taylor, Senior Independent Director	61	60	-	-	-	-	-	-	-	-	61	60
Jon Butterworth	57	56	-	-	-	-	-	-	-	-	57	56
Martin Hagen	57	56	-	-	-	-	-	-	-	-	57	56
Martin Angle ⁽⁴⁾⁽⁶⁾	-	26	-	-	-	-	-	-	-	-	-	26
Neil Cooper ⁽⁴⁾	35	35	-	-	-	-	-	-	-	-	35	35
Gill Rider ⁽⁴⁾	39	39	-	-	-	-	-	-	-	-	39	39
Iain Evans ⁽⁷⁾	-	20	-	-	-	-	-	-	-	-	-	20

- (1) The Finance Director received a discretionary bonus for services to the Pennon Group during the year relating to the Strategic Review of 30% of salary. The Committee is satisfied that services provided did not reduce the effectiveness of the Director's provision of services to the Company
- (2) Stephen Bird served as Managing Director until he passed away on 10 May 2019. The above table shows one month of remuneration
- (3) Benefits comprise a car allowance, fuel allowance and medical insurance
- (4) These directors are also Directors of Pennon Group plc. The disclosures above reflect 50% of their full remuneration which is rechargeable to South West Water through group recharges. The full single total figure of remuneration tables are shown on page 107 of the Pennon Group plc Annual Report and Accounts 2020
- (5) Chris Loughlin was a Non-Executive Director of the board in 2018/19 and in his capacity as Managing Director of South West Water is an Executive Director in 2019/20. The disclosure above reflects 50% of full remuneration which is rechargeable to South West Water through group recharges. The full single total figure of remuneration tables are shown on page 107 of the Pennon Group plc Annual Report and Accounts 2020
- (6) Retired from the Board on 31 December 2018
- (7) Iain Evans was appointed to the Board on 1 September 2018 and resigned on 27 March 2019
- (8) For 2019/20, the 2017/18 LTIP has been valued based on the average Pennon share price during the 3 month period to March 2020 of 1,093.66p and a vesting outcome of 86.6%, as referred to on page 90 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.
- (9) See page 108 for further information.

NOTES TO THE SINGLE FIGURE TABLE

ANNUAL BONUS OUTTURN FOR 2019/20

The performance targets set and the performance achieved in respect of the annual bonus for 2019/20 in respect of each Executive Director is set out below.

Louise Rowe

Group financial measures – 45% weighting

Measure	Threshold	Target	Maximum	Actual outturn	Bonus outturn (% of max)
Underlying profit before tax (37.5% weighting)	£277m	£283m	£297m	£287.6m	64%
RoRE (7.5% weighting)	8%	9%	11%	11.8%	100%

Customer and operational measures – 15% weighting

Measures	Target	Actual outturn	Target achieved	Bonus outturn (% of max)	
Water metrics					
Customer measure	Upper quartile	Median	No	70%	
Bathing water quality	0 beaches failing	0 beaches failed	Yes		
Leakage (megalitres per day / (Ml/d)	84 Ml/d	84 Ml/d	Yes		
Wastewater pollution incidents					
Category 1-2	0	1	No		
Category 3-4	145	296			
Average duration of interruptions to supply	0.161 hours per property	0.158 hours per property	Yes		
Water and wastewater reliability	Stable	Stable	Yes		
Personal objectives for 2019/20 were aligned to the delivery of strategic objectives, including: <ul style="list-style-type: none"> the personal leadership and embedding of the Group's health & safety programme HomeSafe continued momentum around a number of Board priorities including the PR19 programme 				73%	

The Finance Director received a discretionary bonus for services to the Pennon Group during the year relating to the Strategic Review of 30% of salary. The Committee is satisfied that services provided did not reduce the effectiveness of the Director's provision of services to the Company.

Chris Loughlin is Managing Director of South West Water and is also a Director of Pennon Group plc. His remuneration is based on the metrics above relating to South West Water Limited as well as additional metrics relating to the performance of other Pennon Group companies in his capacity as Chief Executive Officer of Pennon Group. Details of his performance and remuneration can be found on pages 107 to 115 of the Pennon Group annual report 2020.

Summary of bonus outcome

	Weighting	Bonus outturn
		Finance Director
Group financial measures	45%	31.7%
Customer and operational measures	15%	10.5%
Individual objectives	15%	11.0%
Total outturn	75%	53.2%

LONG-TERM INCENTIVE OUTTURN 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 return on capital employed (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)		Vesting outcome
EPS growth (40% of award)	6% p.a	10% p.a	9.5% 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 Company 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.

RETIREMENT BENEFITS AND ENTITLEMENTS (AUDITED INFORMATION)

Details of Directors' pension entitlements and pension related benefits during the year are as follows:

	Contributions to defined contribution arrangements (£000)	Cash allowances in lieu of pension (£000)	Total value for the year	Normal retirement age and date (for pension purposes)
Louise Rowe ⁽¹⁾	13	12	25	65 (15 January 2047)
Chris Loughlin ⁽²⁾	-	81	81	67 (20 August 2019)

⁽¹⁾ Louise Rowe is a member of Pennon Group's defined contribution arrangement and received an overall pension benefit from the Company equivalent to 15% of her salary

⁽²⁾ Chris Loughlin is not a member of any of the Group's pension schemes and receives a sum in lieu of entitlement of 30% of salary. He is Managing Director of South West Water and is also a Director of Pennon Group plc. 50% of his full remuneration is rechargeable to South West Water through group recharges. For further detail please see page 107 of the Pennon Group Annual Report 2020.

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. 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

RELATIVE IMPORTANCE OF SPEND ON PAY

	2019/20 £m	2018/19 £m	Percentage change (%)
Overall expenditure on pay⁽¹⁾	60.5	57.9	4.5%
Distributions to Parent Company (excluding special dividend)	119.7	123.1	(2.8%)
Net interest charges	71.1	70.5	0.9%
Purchase of property, plant and equipment (cash flow)	172.2	140.7	22.4%

⁽¹⁾ Excludes employer's social security costs and non-underlying items.

The above table illustrates the relative importance of spend on pay compared with distributions to shareholders and other Company outgoings. The distributions to Parent Company, interest charges and the purchase of property, plant and equipment (cash flow) have been included as these were the most significant outgoings for the Company in the last financial year.

ALL EMPLOYEE, PERFORMANCE AND OTHER CONTEXTUAL INFORMATION

Remuneration of the Managing Director

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Managing Director single figure remuneration (£000)	378	461	553	493	663	1,094 ⁽¹⁾
Annual Bonus payout (% of maximum)	89.6%	78.3%	65.8%	85%	90%	78%
LTIP (PCP) vesting (% of maximum)	0%	34.5%	43.7%	0%	44%	86.6% ⁽²⁾

⁽¹⁾ Chris Loughlin is Managing Director of South West Water and is also a Director of Pennon Group plc. The disclosure above reflects 50% of his full remuneration which is rechargeable to South West Water through group recharges. For further detail please see page 107 of the Pennon Group Annual Report.

⁽²⁾ The LTIP vesting percentage is an estimate as at 20 May 2020.

MANAGING DIRECTOR PAY RATIO

The table below shows the ratio of the Managing Director's pay for 2019/20 using the single figure total of remuneration (as disclosed on page 105) to the comparable earnings of employees at the 25th, 50th and 75th percentiles.

Year	Method	25th percentile (P25) pay ratio	50th percentile (P50) pay ratio	75th percentile (P75) pay ratio
2019/20	Option A	91:1	64:1	53:1

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 in the calculation 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 £24,009, £32,670, and £41,360, respectively.

The base salary of 2019/20 for the employees identified at P25, P50 and P75 is £20,522, £22,546, and £38,750, respectively.

The remuneration arrangements for senior executives, including the Managing Director, fluctuates 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 AWARD 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 ⁽¹⁾	Type of interest	Basis of Award	Face value £000	Percentage vesting at threshold performance	Performance period end date
Louise Rowe	LTIP	80% of salary	133	25% of maximum	3 July 2022
Louise Rowe	Deferred bonus	50% of bonus awarded	55	N/A	23 July 2022

⁽¹⁾ Chris Loughlin is Managing Director of South West Water and is also a Director of Pennon Group plc. Details of share awards granted to Chris Loughlin can be found on pages 107 to 115 of the Pennon Group annual report. 50% of his full remuneration is rechargeable to South West Water through group recharges. The full single total figure of remuneration tables are shown on page 107 of the Pennon Group plc Annual Report and Accounts 2020.

LTIP awards were calculated using the Pennon Group plc share price of £7.5272p (being the average closing price over the five dealing days preceding the date of grant, which was 4 July 2019). LTIP awards are subject to an additional two-year holding period. Deferred bonus awards were calculated using the average Pennon Group share price at which shares were purchased on the market on 23 July 2019 in order to satisfy the award, which was £7.555356p.

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 Pennon Group plc shareholders.

To support this, the Committee operates shareholding guidelines. For 2019/20, this guideline was 100% of salary for the Finance Director and 200% for the Managing Director. In line with best practice guidelines, deferred bonuses and LTIP awards subject to a holding period may only count towards the guidelines on a net tax basis. The Executive Directors are expected to build up a shareholding in the Company within the first five years of joining the Company.

The beneficial interests of the Executive Director in the ordinary shares (40.7p each) of Pennon Group plc as at 31 March 2020 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	Unvested awards				Vested LTIP awards in holding period	Share-holding guideline (to be accrued over five years)	Share-holding guideline met?
			Performance shares (subject to performance conditions)	SAYE	Deferred Bonus shares				
Chris Loughlin	394,102	359,265	304,293	2,196	87,876	20,343	200%	Yes	
Louise Rowe	13,759	11,434	50,162	2,834	20,049		100%	Yes	

Since 31 March 2020, 6,277 additional ordinary shares in Pennon Group have been acquired by Chris Loughlin as a result of participation in the Pennon Group's Dividend Reinvestment Plan (DRIP) and the Pennon Group's Share Incentive Plan and 27 additional ordinary shares in Pennon Group have been acquired by Louise Rowe as a result of participation in the Pennon Group's Share Incentive Plan.

Non-Executive Directors' shareholding

The beneficial interests of the Non-Executive Directors, including the beneficial interests of their spouses, civil partners, children and step-children, in the ordinary shares (40.7p) of the Pennon Group, are shown in the table below:

Director	Shares held at 31 March 2020	Shares held at 31 March 2019
Sir John Parker, Chairman	27,027	27,027
Lord Matthew Taylor	-	-
Jon Butterworth	-	-
Martin Hagen	3,600	3,600
Neil Cooper	-	-
Gill Rider	2,500	2,500

There is no formal shareholding guideline for the Non-Executive Directors; however they are encouraged to purchase shares in Pennon Group plc. 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 19 June 2020.

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 (40.7p each) of Pennon Group plc 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 ^(iv)	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
Louise Rowe								
01/07/16	12,173	-	920.00p	4,467	33	4,467 ⁽ⁱⁱ⁾	30/06/19	30/06/21
25/08/17	15,946	-	802.70p	-	-	15,946	24/08/20	24/08/22
02/07/18	16,524	-	790.12p	-	-	16,524	01/07/21	01/07/23
04/07/19	-	17,692	752.72p	-	-	17,692	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
- (iv) Chris Loughlin is Managing Director of South West Water and is also a Director of Pennon Group plc. Details of share awards granted to him can be found on pages 107 to 115 of the Pennon Group annual report. 50% of his full remuneration is rechargeable to South West Water through group recharges. The full single total figure of remuneration tables are shown on page 107 of the Pennon Group plc Annual Report and Accounts 2020.

PAYMENTS TO PAST DIRECTORS

No payments to past Directors were made during the year.

(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 Pennon Group plc 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	Conditional awards held at 1 April 2019	Conditional awards made in year	Market price of each share upon award in year	Released in year	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
Chris Loughlin⁽²⁾							
04/07/16	18,759	-	950.14p	18,759 ⁽¹⁾	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	-	-	-	23/07/22
Louise Rowe							
04/07/16	3,994	-	950.14p	3,994 ⁽¹⁾	30	-	03/07/19
30/08/17	5,929	-	808.691p	-	-	5,929	29/08/20
25/07/18	6,803	-	761.36p	-	-	6,803	24/07/21
24/07/19	-	7,317	755.5386p	-	-	7,317	23/07/22

⁽¹⁾ These shares were released on 25 July 2019 at 758.0p per share

⁽²⁾ Chris Loughlin is Managing Director of South West Water and is also a Director of Pennon Group plc. Details of share awards granted to him can be found on pages 107 to 115 of the Pennon Group annual report. 50% of his full remuneration is rechargeable to South West Water through group recharges. The full single total figure of remuneration tables are shown on page 107 of the Pennon Group plc Annual Report and Accounts 2020

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*; Louise Rowe £7,805.

*Chris Loughlin received his dividend in the form of ordinary shares (40.7p each) in Pennon Group as a result of participation in the Pennon Group's dividend reinvestment plan. These shares are included in the figure given for additional ordinary shares (40.7p each) in the Pennon Group that he acquired since 31 March 2019 given on page 110.

(c) Sharesave scheme

Details of options to subscribe for ordinary shares (40.7p each) of Pennon Group plc under the all-employee sharesave scheme were:

Director and date of grant	Options held at 1 April 2019	Granted in year	Exercised /lapsed 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
C. Loughlin 24/06/15	2,196	-	-	683.00p	-	1,085.5p	2,196	01/09/20- 28/02/21
L. Rowe 03/07/18	2,834	-	-	635.00p	-	1,085.5p	2,834	01/09/21- 28/02/22

THE REMUNERATION COMMITTEE AND ITS ADVISERS

Gill Rider, Neil Cooper and Martin Hagen 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 (Pennon 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 LLPs fees for the Pennon Group 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 Company. 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.

BOARD OF DIRECTORS AND COMPANY INFORMATION

CHAIRMAN	Sir John Parker
MANAGING DIRECTOR	C Loughlin (Pennon Group Chief Executive)
FINANCE DIRECTOR	L F Rowe
SENIOR INDEPENDENT DIRECTOR	Lord Taylor of Goss Moor (Non-Executive)
NON-EXECUTIVE DIRECTORS	J Butterworth MBE N Cooper M J Hagen G Rider CB
COMPANY SECRETARIES	S Pugsley K Senior
REGISTERED OFFICE	Peninsula House Rydon Lane Exeter Devon EX2 7HR
INDEPENDENT AUDITOR	Ernst & Young LLP Apex Plaza Forbury Road Reading RG1 1YE
COMPANY'S REGISTERED NUMBER	02366665
PRINCIPAL ACTIVITIES	The principal activities of the Company are the provision of water and sewerage services. The Company holds the water and sewerage appointments for Cornwall and Devon and parts of Somerset and Dorset. It also provides water supply services to parts of Dorset, Hampshire and Wiltshire.

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 53 to 87 and 115 to 117 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:

- risk management systems (page 34 to 37 of the strategic report)
- likely future developments of the Company (page 5 of the strategic report)
- certain employee matters (pages 17 to 19 of the strategic report), as well as the disclosures below.

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 financial statements)
- financial instruments (pages 27 to 33 of the strategic report and notes 16 and 20 of the notes to the financial statements).

BOARD OF DIRECTORS

The Directors in office as at the date of this report (all of whom served during the year) are named on page 114. Dr Stephen Bird, Managing Director, served during the year until his death on 10 May 2019.

FINANCIAL RESULTS AND DIVIDEND

A total dividend for the year of £249.7 million was paid during the year (2018/19: £123.1 million). The Report of the Finance Director on pages 27 to 33 analyses the Company'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 and the Company has maintained throughout the year Directors' and Officers' liability insurance for the benefit of the Company, the Directors and its Officers. The Company has entered into qualifying third party indemnity arrangements for the benefit of all its Directors in a form and scope which comply with the requirements of the Companies Act 2006 and which were in force throughout the year and remain in force.

EMPLOYMENT POLICIES AND EMPLOYEE INVOLVEMENT

South West Water has a culture of continuous improvement through investment in people at all levels within the Company. It 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 Company.

The Company has policies in place covering health & safety, equal opportunities, diversity and inclusion, ethics and employee relations. In addition, the Board has a diversity policy, details of which are set out in the report of the Nomination Committee on page 83. Information regarding the diversity of the workforce is provided on page 18.

South West Water 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, through consultation groups or by means of their elected representatives at the Employee Engagement Forum. 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 Company and the Pennon Group as a whole. South West Water also cascades information monthly to all employees to provide them with important and up to date information about key events and to obtain feedback from them. Further information about workforce engagement and employment matters relating to the Company is set out on pages 17 to 20 of the strategic report.

South West Water and the Pennon Group as a whole encourages share ownership among its employees in Pennon Group plc by operating an HM Revenue & Customs approved Sharesave scheme and Share Incentive Plan. Following Pennon shareholder approval at the 2014 AGM, these were amended to provide for the increased savings limits approved by Government. At 31 March 2020 around two thirds of South West Water's employees were participating in these plans.

HUMAN RIGHTS AND ANTI-SLAVERY

South West Water is fully supportive of the principles set out in the UN Declaration of Human Rights, and the Pennon Group Code of Conduct outlines the high standards of employment practice with which everyone in the Company is expected to comply. The Company also supports the International Labour Organization's core conventions for the protection and safety of workforces wherever they may be throughout the Company.

The Company's commitment to ensuring the human rights of its employees are not infringed extends to those of its suppliers. Supplier codes of conduct are in place to ensure that people are treated fairly and with respect and dignity.

In addition, 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 have been completed to ensure compliance with the Modern Slavery Act across the Company and our anti-slavery and human trafficking web-based statement for the year, which is completed at a Group level, is available at www.southwestwater.co.uk.

GREENHOUSE GAS EMISSIONS

The Company has taken advantage of the exemption offered under the Companies Act 2006 and has not reported details of Greenhouse gas emissions during the financial year. Details of South West Water's greenhouse gas emissions can be found in the Annual Performance Report and Regulatory Reporting, published in July 2020 (www.southwestwater.co.uk/report2020).

RESEARCH AND DEVELOPMENT

The development and testing of innovative techniques and processes will continue to play a role in the further improvement and provision of cost effective services.

Research and development expenditure amounted to £0.1 million during the year (2018/19: £0.2 million).

OVERSEAS BRANCHES

The Company has no overseas branches.

DONATIONS

During 2019/20 the Company provided a total of £200,000 in charitable donations (2018/19: £210,000).

No political donations were made or political expenditure incurred and no contributions were made to a non-EU political party (2018/19: nil).

GOING CONCERN

At 31 March 2020, the Company had access to undrawn committed funds and cash and cash deposits totalling £519.1 million (£293.2 million excluding restricted cash). Having considered the Company's strong funding position 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 Company has adequate resource to continue in operational existence for the period of at least 12 months from the date of 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.

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 community 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 Company 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 site safety and minimising environmental impact.

FINANCIAL DISCIPLINE

Board meetings review executive management's focus around fiscal discipline, and delivery of solid and stable earnings.

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 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 furthers both the long-term financial success of the Company 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 54.

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 6, 13, and 14).
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 12 and 17-20).
The need to foster the Company's business relationships with suppliers, customers and others	<p>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 page 13).</p> <p>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 13).</p> <p>Open dialogue and transparent engagement with our regulatory bodies, policy makers and other stakeholders who shape our social contract (see page 13).</p>
The impact of the Company's operations on the community and the environment	<p>Committed to providing educational programmes and community sponsorships and engaging in charity support initiatives and events across our region (see pages 12, 25 and 26).</p> <p>Regular engagement and close relationships with our environmental stakeholders, partners and interest groups in the areas in which we operate (see page 12).</p> <p>Our Sustainable Financing Framework supports investment across our key activities, namely pollution prevention and control; sustainable water and wastewater management; and climate change adaption (see page 9).</p>
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 Company are regularly updated to ensure the highest of standards are adhered to (see pages 19 and 68).
The need to act fairly as between members of the Company	Regular engagement with our stakeholders to ensure they are well informed of our business strategy and key developments (see page 11).

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 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 Company and of the profit or loss of the Company 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 that are reasonable and prudent
- state whether applicable International Financial Reporting Standards (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 Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of 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 page 65, confirms that, to the best of his or her knowledge:

- i) 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 Company.
- ii) The strategic report (pages 3 to 33) and the Directors' report (53 to 87 and 115 to 117) include a fair review of the development and performance of the business during the year and the position of the Company at the year end, together with a description of the principal risks and uncertainties they face.
- iii) Following receipt of advice from the Audit Committee, that the annual report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the shareholders to assess the Company's performance, business model and strategy.

The Directors are responsible for the maintenance and integrity of the Company's website www.southwestwater.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 COMPANY'S AUDITOR

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

b) each of the Directors has taken all the steps that each Director ought to have taken 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 53 to 87 and 115 to 117 was approved by the Board on 19 June 2020.

By Order of the Board



SIMON A F PUGSLEY

Group General Counsel and Company Secretary

19 June 2020

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTH WEST WATER LIMITED

Opinion

We have audited the financial statements of South West Water Limited for the year ended 31 March 2020 which comprise the Income Statement, Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Equity and Cash Flow Statement and the related notes 1 to 39, 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.

In our opinion, the financial statements:

- ▶ give a true and fair view of the Company's affairs as at 31 March 2020 and of its profit for the year then ended;
- ▶ have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- ▶ have been prepared in accordance with the requirements 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 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 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 39 to 49 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 40 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 117 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 provisions C.1.3 and C.2.2 is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 50 to 52 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 Valuation of the provision for doubtful debts Valuation of plant, property and equipment Impact of the COVID-19 pandemic
Materiality	<ul style="list-style-type: none"> Overall materiality of £8.7m which represents 5% of profit before tax before non-underlying items

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	Risk direction	Our response to the risk	Key observations communicated to the Audit Committee
<p>Revenue recognition, specific to accrued income (£571.6 million, PY comparative £582.4 million)</p> <p><i>Refer to the Audit Committee Report (page 76); Accounting policies (pages 134 & 135); and Note 4 of the Financial Statements (page 143)</i></p> <p>Revenue relates to the provision of water and sewerage services. ISAs (UK & Ireland) presume there is a risk of fraud relating to revenue recognition. For the Company, 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 area, where there is opportunity to overstate revenue:</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</p>		<p>Our procedures included:</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- 	<p>We concluded that the estimation process undertaken by management to calculate the measured income accrual reflected latest operational factors in the key assumptions and that the income accrual was appropriately determined.</p>

Risk	Risk direction	Our response to the risk	Key observations communicated to the Audit Committee
weather patterns. The accrued income balance at 31 March 2020 is £83.8 million (2019: £88.9 million).		system postings and those raised in the last two weeks of the year.	
<p>Valuation of the provision for doubtful debts (South West Water) (£91.6 million, PY comparative £86.8 million)</p> <p><i>Refer to the Audit Committee Report (page 76); Accounting policies (page 138); Note 4 of the Financial Statements (pages 142 & 143) and included within Note 19 of the Financial Statements (page 152)</i></p> <p>The South West Water provision is 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 £2.8m for South West Water (this amount are included in the total figures noted above).</p> <p>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.</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 the relevant key controls; • We tested the operating effectiveness of key controls over the integrity of data and the report utilised to generate the ageing and categorisation of debt within South West Water's billing system; • 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; • 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, together with information on actual 	<p>We have concluded that the South West Water doubtful debt provision of £91.6 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>

Risk	Risk direction	Our response to the risk	Key observations communicated to the Audit Committee
		<p>collections since the balance sheet date; and</p> <ul style="list-style-type: none"> We tested the appropriateness of journal entries and adjustments impacting the doubtful debt provision, particularly those raised close to the balance sheet date. 	
<p>Impact of the COVID-19 pandemic</p> <p><i>Refer to the Audit Committee Report (page 76) and Accounting policies (page 134)</i></p> <p>COVID-19 has presented a significant impact on the macro-economic conditions in which the Company is operating. The company is a regulated business, with an agreed business plan for the five year price period commencing on 1 April 2020, setting out the basis of allowed annual tariff changes. However, the pandemic has impacted demand from customers since the year end, increasing consumption by household customers and reducing consumption from non-household customers. In addition increasing the risk over collection of receivables, as set out above.</p> <p>We focused on this area given the potential for a material impact on operations and on future cashflows.</p>	NEW	<p>Our procedures included:</p> <ul style="list-style-type: none"> We understood management's process for assessing the impact of COVID-19 on the Company We evaluated management's stress test modelling and the Company's liquidity. We evaluated management's historical accuracy of forecasting. We confirmed the facilities available to supporting documentation. We tested the extent of changes in assumptions required to give rise to a covenant breach. We assessed the disclosures in the financial statements against applicable accounting standards and evaluated the consistency of the disclosures with our knowledge of the Company. 	We concur with management, based on the available facilities and current forecasts, that it is appropriate to adopt the going concern basis.

The key audit matters for the current year are consistent with matters included in our prior year auditor's report, with the exception of an additional key audit matter relating to the impact of COVID-19.

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 the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed.

Changes from the prior year

No changes to the scope of the audit from the prior year.

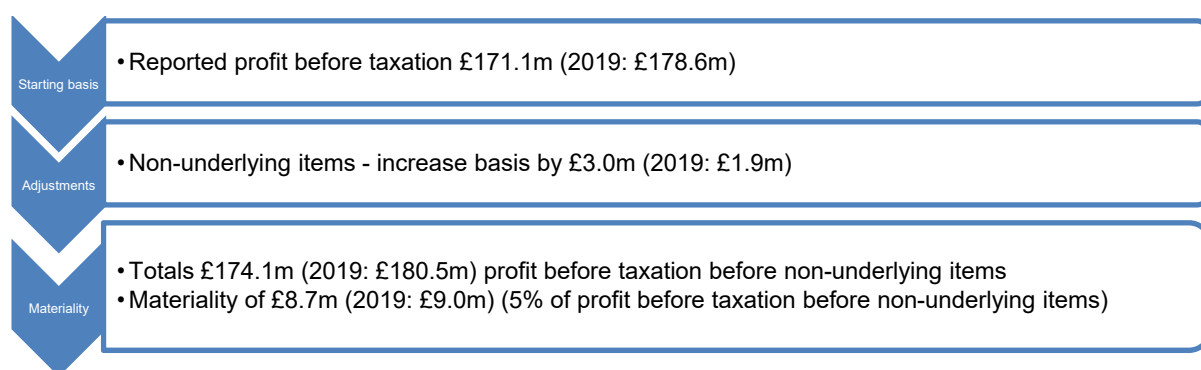
Our application of materiality

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 materiality for the Company to be £8.7 million (2019: £9.0 million), which is 5% (2019: 5%) of profit before taxation before non-underlying items. We believe that profit before taxation before non-underlying items provides us with an appropriate measure of the underlying performance of the Company. 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 Company. We also note that market and analyst commentary on the performance of the Company 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.



During the course of our audit, we reassessed initial materiality and explain reason for change in final materiality from original assessment at planning.

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 Company's overall control environment, our judgement was that performance materiality was 75% (2019: 75%) of our planning materiality, namely £6.5m (2019: £6.7m). We have set performance materiality at this percentage based on our assessment of the Company'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.

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 £0.4m (2019: £0.4m), 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.

Other information

The other information comprises the information included in the annual report, set out on pages 3 to 121, 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.

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 Company's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting set out on pages 73 to 79** – 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 72** – the parts of the directors' statement relating to the Company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor (specifically C.1.1, C.2.1 and C.2.3 and C3.1 to C.3.8) 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, 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
- ▶ the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or directors' report.

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, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements 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

Voluntary reporting matters

Directors' remuneration report

The Company voluntarily prepares a Report of the directors on remuneration in accordance with the provisions of the Companies Act 2006. The directors have requested that we audit the part of the Report of the directors on remuneration specified by the Companies Act 2006 to be audited as if the Company were a quoted company.

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

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 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 Company or to cease operations, or have no realistic alternative but to do so.

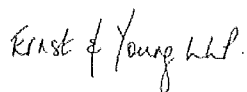
Auditor's responsibilities for the audit of the financial statements

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.

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.

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
19 June 2020

Notes:

1. The maintenance and integrity of the South West Water Limited 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.

INCOME STATEMENT

FOR THE YEAR ENDED 31 MARCH 2020

	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
Revenue	5	571.6	-	571.6	582.4	-	582.4
Operating costs	7		-				
Employment costs		(50.0)	-	(50.0)	(48.6)	-	(48.6)
Raw materials and consumables		(14.9)	-	(14.9)	(14.9)	-	(14.9)
Other operating expenses		(142.8)	-	(142.8)	(151.9)	-	(151.9)
Earnings before interest, tax, depreciation and amortisation		363.9	-	363.9	367.0	-	367.0
Depreciation and amortisation	7	(118.7)	-	(118.7)	(116.0)	-	(116.0)
Operating profit before exceptional items		245.2	-	245.2	251.0	-	251.0
Exceptional items		-	(3.0)	(3.0)	-	(1.9)	(1.9)
Operating profit		245.2	(3.0)	242.2	251.0	(1.9)	249.1
Finance income	8	2.3	-	2.3	2.3	-	2.3
Finance costs	8	(73.4)	-	(73.4)	(72.8)	-	(72.8)
Net finance costs		(71.1)	-	(71.1)	(70.5)	-	(70.5)
Profit before tax		174.1	(3.0)	171.1	180.5	(1.9)	178.6
Taxation (charge)/credit	9	(34.7)	(28.3)	(63.0)	(29.5)	0.3	(29.2)
Profit for the year		139.4	(31.3)	108.1	151.0	(1.6)	149.4

The notes on pages 134 to 169 form part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 MARCH 2020

	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
Profit for the year		139.4	(31.3)	108.1	151.0	(1.6)	149.4
Other comprehensive income/(loss)							
Items which will not be reclassified to profit or loss							
Re-measurement of defined benefit obligations	25	2.7	-	2.7	(6.2)	-	(6.2)
Income tax on items that will not be reclassified	9, 27	1.6	-	1.6	1.1	-	1.1
Total items that will not be reclassified to profit or loss		4.3	-	4.3	(5.1)	-	(5.1)
Items that may be reclassified subsequently to profit or loss							
Cash flow hedges		(11.2)	-	(11.2)	(3.9)	-	(3.9)
Income tax credit on items that may be reclassified	9, 27	2.5	-	2.5	0.3	-	0.3
Total items that may be reclassified subsequently to profit or loss		(8.7)	-	(8.7)	(3.6)	-	(3.6)
Other comprehensive loss for the year net of tax		(4.4)	-	(4.4)	(8.7)	-	(8.7)
Total comprehensive income for the year		135.0	(31.3)	103.7	142.3	(1.6)	140.7

The notes on pages 134 to 169 form part of these financial statements.

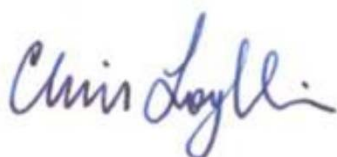
BALANCE SHEET

AS AT 31 MARCH 2020

	Notes	2020 £m	2019 £m
Assets			
Non-current assets			
Goodwill	13	51.3	51.3
Other intangible assets	14	-	0.5
Property, plant and equipment	15	3,089.0	3,013.3
Investment in subsidiary undertakings	17	3.3	3.3
Retirement benefit obligations	25	7.1	-
		3,150.7	3,068.4
Current assets			
Inventories	18	4.9	4.9
Trade and other receivables	19	145.2	144.2
Current tax asset	26	3.4	-
Cash and cash deposits	21	284.1	329.4
		437.6	478.5
Liabilities			
Current liabilities			
Borrowings	23	(57.9)	(87.9)
Derivative financial instruments	20	(6.2)	(10.9)
Trade and other payables	22	(85.5)	(109.6)
Current tax liabilities	26	-	(15.3)
Provisions	28	(0.6)	(1.1)
		(150.2)	(224.8)
Net current assets			
		287.4	253.7
Non-current liabilities			
Borrowings	23	(2,533.4)	(2,304.1)
Other non-current liabilities	24	(122.9)	(116.1)
Derivative financial instruments	20	(24.4)	(9.1)
Retirement benefit obligations	25	-	(21.9)
Deferred tax liabilities	27	(263.8)	(230.8)
		(2,944.5)	(2,682.0)
Net assets			
		493.6	640.1
Equity			
Called up share capital	29	250.9	250.9
Retained earnings and other reserves	31	242.7	389.2
Total Equity			
		493.6	640.1

The notes on pages 134 to 169 form part of these financial statements.

The financial statements on pages 129 to 169 were approved and authorised for issue by the Board of Directors on 19 June 2020 and were signed on its behalf by:



C Loughlin
Managing Director

Registered office: Peninsula House, Rydon Lane, Exeter, Devon, England EX2 7HR
Registered Number: 02366665

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 MARCH 2020

	Called up share capital (note 29) £m	Retained earnings and other reserves (note 31) £m	Total Equity £m
At 31 March 2018	250.9	370.5	621.4
Profit for the year	-	149.4	149.4
Other comprehensive income for the year	-	(8.7)	(8.7)
Total comprehensive income for the year	-	140.7	140.7
<i>Transactions with owners</i>			
Dividends paid	-	(123.1)	(123.1)
Share based payments (net of tax)	-	1.1	1.1
Total transactions with owners	-	(122.0)	(122.0)
At 31 March 2019	250.9	389.2	640.1
Profit for the year	-	108.1	108.1
Other comprehensive loss for the year	-	(4.4)	(4.4)
Total comprehensive income for the year	-	103.7	103.7
<i>Transactions with owners</i>			
Dividends paid	-	(249.7)	(249.7)
Share based payments (net of tax)	-	1.3	1.3
IFRS16 opening reserves adjustment (net of tax)	-	(1.8)	(1.8)
Total transactions with owners	-	(250.2)	(250.2)
At 31 March 2020	250.9	242.7	493.6

The notes on pages 134 to 169 form part of these financial statements.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 MARCH 2020

	Notes	2020 £m	2019 £m
Cash flows from operating activities			
Cash generated from operations	32	319.1	346.7
Interest paid		(58.3)	(53.0)
Tax paid		(43.6)	(12.2)
Net cash generated from operating activities		217.2	281.5
Cash flows from investing activities			
Interest received		0.6	0.7
Purchase of property, plant and equipment		(172.2)	(140.7)
Receipt of grants and contributions		3.6	3.6
Proceeds from sale of property, plant and equipment		0.6	1.9
Net cash used in investing activities		(167.4)	(134.5)
Cash flows from financing activities			
Deposit of restricted funds	21	(21.5)	(20.6)
Proceeds from new borrowing		241.5	50.0
Repayment of borrowings		(35.0)	(32.0)
Repayments of intercompany borrowings		(50.0)	-
Finance lease sale and lease back		115.0	74.9
Finance lease principal repayments		(118.7)	(15.9)
Dividends paid	10	(249.7)	(123.1)
Net cash used in financing activities		(118.4)	(66.7)
Net (decrease)/increase in cash and cash equivalents		(68.6)	80.3
Cash and cash equivalents at beginning of the year		126.8	46.5
Cash and cash equivalents at end of the year	21	58.2	126.8

The notes on pages 134 to 169 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. GENERAL INFORMATION

South West Water Limited is a company registered in the United Kingdom under the Companies Act 2006. The address of the registered office, the nature of the Company's operations and its principal activities are set out on page 114.

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 transfers of assets from customers and certain financial instruments as described in accounting policy note (u) 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 the financial statements as stated by the Directors on page 117. At 31 March 2020, the Company had access to undrawn committed funds and cash and cash deposits totalling £519.1 million (£293.2 million excluding restricted cash). Having considered the Company's strong funding position 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 Company has adequate resource to continue in operational existence for a period of at least 12 months from the date of 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 IFRS16 which is explained in note 37, the 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 Company.

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) Exemption from consolidation

The Company is exempt under the provisions of section 400 of the Companies Act 2006 from the requirement to produce group financial statements as it is a wholly-owned subsidiary of Pennon Group plc which is registered within the European Economic Area and which itself produces consolidated financial statements. Accordingly consolidated financial statements have not been prepared and the financial information presented is for the Company as an individual undertaking. Group financial statements are included in the Annual Report of Pennon Group plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.

(c) Revenue recognition

Revenue is recognised following delivery of performance obligation 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) or 'over time' as the performance obligations to the customer are satisfied. For each obligation satisfied over time, the Company applies a revenue recognition method that accurately reflects performance in transferring control 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 Company 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.

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.

2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(c) Revenue recognition (continued)

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 Company or assets transferred to the Company, 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 Company.

Contract assets and liabilities

A trade receivable is recognised when the Company has an unconditional right to receive consideration in exchange for performance obligations already fulfilled. A contract asset is recognised when the Company has fulfilled some of its performance obligations but has not yet obtained an unconditional right to receive consideration. The amounts of contract assets is disclosed within note 19 (Trade and other receivables - current). A contract liability is recognised when consideration is received in advance of the Company performing its performance obligations to customers, including, when appropriate, transfers of assets from customers (per paragraph (u) below). The value of contract liabilities is disclosed within note 22 (Trade and other payables - current) and note 24 (Other non-current liabilities) as appropriate.

(d) Segmental reporting

The Directors believe that the whole of the Company's activities constitute one single segment. Operating segments are reported in the manner consistent with internal reporting to the Chief Operating Decision Maker, which has been identified as the Board of Directors.

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

In accordance with IFRS 15, revenue has been disaggregated based on the services of supplying clean water, removal and treatment of wastewater and retail and other services. Further details are contained in note 5 (Revenue).

(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 or group of cash generating units, that is expected to benefit from the synergies of the combination. Each unit or group of units to which goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal reporting purposes. Goodwill is allocated and monitored at the reportable operating segment level. Further details are contained in accounting policy (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 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.

2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(g) Property, plant and equipment

Cost includes the original purchase price of the asset and costs attributable to bringing the asset to its working condition for its intended use. The cost of assets includes directly attributable labour and overhead costs which are incremental to the Company.

- 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 at cost, less accumulated depreciation. Expenditure to increase capacity or enhance infrastructure assets is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the Company. The cost of day to day servicing of infrastructure components is recognised in the income statement as it arises.

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

Infrastructure assets are depreciated evenly over their estimated 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.

- ii) *Other assets (including property, overground plant and equipment)*

Other assets are included at cost less accumulated depreciation.

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

Land and buildings - freehold buildings	30 – 60 years
Land and buildings - leasehold buildings	Over the estimated useful life or the finance lease period, whichever is shorter
Operational properties	40 – 80 years
Fixed plant	20 – 40 years
Vehicles, mobile plant and computers	4 – 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 Company. 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 (u).

The assets residual value and useful lives are reviewed annually.

Gains or losses on disposals are determined by comparing the proceeds of sale with the carrying amount and are recognised within 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 Company'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 Company 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.

2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(h) Leased assets (continued)

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 Company regularly uses sale and lease back transactions to finance its capital programme. A sale and leaseback transaction is where the Company 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 2019 is set out in note 37.

IFRS 16 policy applied from 1 April 2019

The impact of the adoption of IFRS 16 'Leases' on 1 April 2019 is discussed in paragraph (a) above and note 37.

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

(j) Grants and contributions

Grants and contributions receivable in respect of property, plant and equipment are deducted from the cost of those assets.

Grants and contributions receivable in respect of expenditure charged against profits in the year have been included in the income statement.

(k) Investment in subsidiary undertakings

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

(l) 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.

(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 Company 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 the instruments are derecognised or impaired. Premia, discounts and other costs and fees are recognised in the income statement through amortisation.

2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(n) Financial instruments (continued)

Borrowings are classified as current liabilities unless the Company 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, the Company performs an impairment analysis at each reporting date to measure the ECLs. The Company does not track changes in credit risk but instead recognises a loss allowance based on lifetime ECLs at each reporting date. The Company 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.

iii) Receivables due from fellow subsidiary undertakings

Amounts owed by fellow 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.

iv) Trade payables

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

v) Derivative financial instruments and hedging activities

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

To qualify for hedge accounting, the Company is required to document in advance the relationship between the item being hedged and the hedging instrument. The Company 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 or liabilities based on the remaining maturity of the hedging derivative.

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

(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 Company is part of the Pennon Group for tax purposes and accordingly may use the tax group relief provisions 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.

2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(p) Provisions

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

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

(q) Contingent liabilities

The Company is subject to litigation from time to time as a result of its activities. The Company establishes provisions in connection with 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.

There are contingent liabilities that arise in the normal course of business which, if realised, are not expected to result in a material liability to the Company.

(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 shareholder. Interim dividends are recognised when paid; final dividends when approved by the shareholder at the Annual General Meeting.

(s) Employee benefits

i) Retirement benefit obligations

The Company operates defined benefit and defined contribution pension schemes through its parent company.

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 the plans assets exceeds the present value of its obligations, the resulting surplus is only realised if the Company 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, 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 Company'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 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 to which they arise.

Defined contribution scheme

Costs of the defined contribution pension scheme are charged to the income statement in the period in which they arise. The Company has no further payment obligations once the contributions have been paid.

ii) Share-based payment

The Company participates in a number of equity-settled share-based payment plans for employees operated by its parent company Pennon Group plc. The fair value of the employee services acquired in exchange for the grant is recognised as an expense over the vesting period of the grant.

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

At each balance sheet date, the Company revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

(t) Fair values

The fair value of the 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 Company for similar financial instruments.

2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

(u) 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 the 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.

(v) 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 Company's financial performance.

3. FINANCIAL RISK MANAGEMENT

(a) Financial risk factors

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

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

These risks and treasury operations are managed 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 Company does not engage in speculative activity.

i) Market risk

The Company has both interest bearing assets and interest bearing liabilities. The Company has a policy of maintaining, after the effect of interest rate swaps, at least 60% of interest bearing liabilities at fixed rates. At the year end, 52% (31 March 2019: 68%) of net borrowings were at fixed rates and 25% (31 March 2019: 25%) were index-linked. This level is below our policy of maintaining at least 60% of interest-bearing liabilities at fixed rates. Whilst South West Water has entered into a number interest rate swaps over the past 12 months on a path to meet its policy, the ongoing market volatility due to COVID-19, has resulted in a pause to this phased approach. Since the 31 March 2020 this phased approach has been reinitiated benefiting from the current low levels of interest rates. The Company uses a combination of fixed rate and index-linked borrowings and fixed rate interest swaps as cash flow hedges of future variable interest payments to achieve this policy. 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 Company. These instruments are analysed in more detail in note 20.

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

The Company 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 Company's income and cash generated from operations (note 32) 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 £0.6 million (2019: £1.2 million), for the equity sensitivity fair value, derivative impacts are 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).

ii) Liquidity risk

The Company actively maintains a mixture of long-term and short-term committed facilities which are designed to ensure the Company 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 uncommitted facilities are provided in note 23.

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Financial risk factors (continued)

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

31 March 2020

	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
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	38.8	42.7	127.9	943.5	1,152.9
Interest payments on borrowings	27.7	27.0	78.9	564.5	698.1
Lease liabilities including interest	39.5	94.4	150.9	1,750.6	2,035.4
Trade and other payables	85.4	-	-	-	85.4
Derivative financial liabilities					
Derivative contracts – net payments	6.4	6.6	18.8	0.4	32.2

31 March 2019

	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
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	35.0	35.0	121.1	798.5	989.6
Interest payments on borrowings	26.9	26.7	78.4	599.5	731.5
Lease liabilities including interest	78.0	42.9	206.6	1,994.7	2,322.2
Trade and other payables	109.6	-	-	-	109.6
Derivative financial liabilities					
Derivative contracts – net payments	8.3	0.8	1.3	0.3	10.7

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 note 19.

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 Company has no other significant concentration of credit risk. Surplus funds of the Company are usually placed in short-term fixed interest deposits or the overnight money markets. Deposit counterparties must meet a board approved minimum criteria based on their short-term credit rating.

(b) Capital risk management

The Company's objectives when managing capital are to safeguard the Company'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 Company's policy is to have a minimum of 12 months pre-funding of projected capital expenditure. At 31 March 2020 the Company had cash and committed facilities excluding restricted funds of £293 million (31 March 2019: £525 million), meeting this objective.

The Company monitors capital on the basis of the gearing ratio, which is calculated as net borrowings divided by total capital. Net borrowings is analysed in note 33 and is calculated as total borrowings less cash and cash deposits. Total capital is calculated as equity plus net borrowings.

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

(b) Capital risk management (continued)

The gearing ratios at the balance sheet date were:

	Note	2020 £m	2019 £m
Net borrowings	33	2,307.2	2,062.6
Total equity		493.6	640.1
Total capital		2,800.8	2,702.7
Gearing Ratio		82.4%	76.3%

Consistent with the industry peer group, the Company is also monitored on the basis of the ratio of its net debt to Regulated Capital Value (RCV). South West Water's net debt to RCV has increased to 64.6%, which compares to Ofwat's K6 target for efficient gearing of 62.5%.

	Note	2020 £m	2019 £m
Regulatory Capital Value		3,572.5	3,504.7
Net borrowings	33	2,307.2	2,062.6
Net borrowings / Regulatory Capital Value		64.6%	58.9%

RCV does not include an adjustment for IFRS16; if IFRS16 were excluded from net debt, gearing would be 63.6%.

The Company has entered into covenants with lenders and, whilst terms vary, these typically provide for limits on gearing and interest cover. The Company has been in compliance with its covenants during the year. Existing covenants are not impacted by subsequent changes to accounting standards.

(c) Determination of fair values

The Company 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 Company's financial instruments are valued principally using level 2 measures as analysed in note 20.

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

The fair value of financial instruments that are 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 value less impairment provision of trade receivables and payables are assumed to approximate their fair values.

4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The Company'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:

Provision for expected credit losses

The Company has a material level of exposure to collection of trade receivables. Provisions in respect of these balances are calculated based on assumptions of 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 Company applies a simplified approach in calculating expected credit losses (ECLs) for trade receivables and contract assets. Therefore, the Company does not track changes in credit risk but instead recognises a loss allowance based on lifetime ECLs at each reporting date. South West Water 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.

4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (CONTINUED)

Provision for expected credit losses (continued)

In light of the broad economic challenges caused by 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 and past experience of behaviours in challenging economic times. The precise quantum of the impact of the pandemic on the Company's 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 Company's current trade receivables were £208.4 million (2019: £199.7 million), against which £91.6 million (2019: £86.8 million) had been provided for ECLs (note 19). The provision for ECLs includes a non-underlying charge of £2.8 million in relation to the impact of COVID-19.

Retirement benefit obligations

The Company operates defined benefit pension schemes, through its parent company, for which actuarial valuations are carried out as determined by the trustees at intervals of not more than three years. The last valuation of the main scheme was at 31 March 2016. The valuation at March 2020 is ongoing.

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 25 of the financial statements.

Taxation

The Company's current tax provision relates to management's judgement of the amount of tax payable.

During the year, management reassessed the critical estimates and resolved that the following were no longer considered critical:

Revenue recognition

The Company recognises revenue as performance obligations are satisfied. Payments received in advance of performance obligations being satisfied are recorded as a contract liability.

The Company raises bills and recognises revenue in accordance with its entitlement to receive revenue in line with the limits established by the Periodic Review price-setting process. For water and waste water customers with water meters, revenue recognised is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the year-end. Estimated usage is based on historic data, judgement and assumptions. The accrued income balance in this area at the balance sheet date which represents the unconditional right to consideration was £83.9 million (31 March 2019: £89.8 million). Each year, a review of the actual amounts billed in comparison with the metered accrual recognised at the previous year end is undertaken to ensure that the methodology continues to be supported by historic experience.

Property, plant and equipment

The Company's accounting policy for property, plant and equipment is detailed in note 2(g) of the financial statements. The carrying value of property, plant and equipment as at 31 March 2020 was £3.089.0 million. In the year ended 31 March 2020, additions to property, plant and equipment totalled £161.0 million and the depreciation charge was £122.5 million. Estimated useful economic lives of property, plant and equipment are based on management's judgement and experience.

Judgements

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.

5. REVENUE

In accordance with IFRS 15, revenue has been disaggregated based on the services of supplying clean water, removal and treatment of wastewater and other services.

	2020 £m	2019 £m
Water	255.6	261.7
Wastewater	281.4	284.4
Other services	34.6	36.3
Total	571.6	582.4

6. NON-UNDERLYING ITEMS

Non-underlying items are those that in the Directors' view are required to be separately disclosed by virtue of their size or incidence to enable full understanding of the Company's financial performance in the year and business trends over time.

	Note	2020 £m	2019 £m
Pensions past service cost	25	0.2	1.9
COVID-19 provision for expected credit losses		2.8	-
Net operating costs		3.0	1.9
Tax credit arising on non-underlying items	9	(0.6)	(0.3)
Deferred tax change in rate	9	28.9	-
Net non-underlying charge		31.3	1.6

£0.2 million of past service costs relating to the Defined Benefit pension scheme have been classified as non-underlying due to their nature. 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 continue to implement economic measures to support the wider economy. As a result of the review, a provision of £2.8 million has been recognised. The charge is considered non-underlying due to its size and nature.

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 charge in the year of £28.9 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.

In the prior year, a £1.9 million charge was recognised in relation to pension benefits (Guaranteed Minimum Pension equalisation).

7. OPERATING COSTS BEFORE NON-UNDERLYING ITEMS

	Note	2020 £m	2019 £m
Employment costs before non-underlying items	11	50.0	48.6
Raw materials and consumables		14.9	14.9
<i>Other operating expenses include</i>			
Profit on disposal of property, plant and equipment		(0.4)	(1.7)
<i>Operating lease rentals payable:</i>			
Plant and machinery		-	1.3
Property		-	1.7
Short term/low value asset lease expense		1.1	-
Research and development expenditure		0.1	0.2
Provision for expected credit losses before non-underlying items	19	2.9	2.3
<i>Depreciation of property, plant and equipment:</i>			
Owned assets		72.3	75.9
Under finance leases		44.5	39.6
Under operating leases		1.4	-
		118.2	115.5
Amortisation of other intangible assets	14	0.5	0.5
Total Depreciation		118.7	116.0

7. OPERATING COSTS BEFORE NON-UNDERLYING ITEMS (CONTINUED)

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

	2020 £000	2019 £000
Fees payable to the Company's auditors and its associates for the audit of the financial statements	233	174
Fees payable to the Company's auditors and its associates for other services:		
All other services	102	102
Total fees	335	276

Expenses reimbursed to the auditors in relation to the audit of the Company were £15,000 (2018/19: £16,000).

A description of the work of the Audit Committee is set out in its report on page 73 to 78 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

	2020 Finance cost £m	2020 Finance income £m	Total £m	2019 Finance cost £m	2019 Finance income £m	Total £m
Cost of servicing debt						
Bank borrowings and overdrafts	(17.0)	-	(17.0)	(15.8)	-	(15.8)
Interest element of finance lease rentals	(34.5)	-	(34.5)	(35.5)	-	(35.5)
Interest element of operating lease rentals	(1.2)	-	(1.2)	-	-	-
Other finance costs	(2.6)	-	(2.6)	(2.4)	-	(2.4)
Interest receivable	-	2.3	2.3	-	2.3	2.3
Intercompany interest to subsidiaries	(17.9)	-	(17.9)	(18.3)	-	(18.3)
Working capital adjustment	(73.2)	2.3	(70.9)	(72.0)	2.3	(69.7)
Notional interest						
Retirement benefit obligations (note 25)	(0.2)	-	(0.2)	(0.8)	-	(0.8)
Finance (costs)/income	(73.4)	2.3	(71.1)	(72.8)	2.3	(70.5)

In addition to the above, finance costs of £2.0 million (2018/19: £2.9 million) have been capitalised on qualifying assets included in property, plant and equipment.

9. TAXATION

	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 year tax charge	24.9	-	24.9	28.2	-	28.2
Deferred tax charge/(credit)	9.8	(0.6)	9.2	1.3	(0.3)	1.0
Deferred tax arising on change of rate of corporation tax	-	28.9	28.9	-	-	-
Total deferred tax charge/(credit)	9.8	28.3	38.1	1.3	(0.3)	1.0
Tax charge/(credit) for year	34.7	28.3	63.0	29.5	(0.3)	29.2

UK Corporation tax is calculated at 19% (2018/19: 19%) of the estimated assessable profit for the year.

UK corporation tax is stated after a credit relating to prior year current tax of £2.1 million (2019: credit of £3.9 million) and a prior year deferred tax charge of £3.7 million (2019: charge of £2.9 million).

9. TAXATION (CONTINUED)

The tax for the year differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK of 19% (2018/19: 19%). The differences are explained below:

	2020 £m	2019 £m
Reconciliation of total tax charge		
Profit before tax	171.1	178.6
Profit before tax multiplied by the standard rate of corporation tax in the UK of 19% (2018/19: 19%)	32.5	34.0
<i>Effects of:</i>		
Expenses not deductible for tax purposes	0.3	0.4
Profit on the disposal of non-qualifying assets	(0.1)	(0.3)
Change in rate of corporation tax	28.9	-
Adjustments to tax charge in respect of prior years	1.6	(6.8)
Depreciation charged on non-qualifying assets	0.3	1.9
Other	(0.5)	-
Tax charge for year	63.0	29.2

The average effective tax rate excluding non-underlying items for the year was 20% (2018/19: 16%).

The current tax charge for the year differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK of 19% (2018/19: 19%). The differences are explained below:

	2020 £m	2019 £m
Reconciliation of current tax charge		
Profit before tax	171.1	178.6
Profit before tax multiplied by the standard rate of corporation tax in the UK of 19% (2018/19: 19%)	32.5	34.0
<i>Effects of:</i>		
Relief for capital allowances in place of depreciation	(21.6)	(22.0)
Disallowance of depreciation charged in the accounts	19.4	18.6
Expenses not deductible for tax purposes	0.2	0.1
Adjustments to tax charge in respect of prior years	(2.1)	(3.9)
Depreciation charged on non-qualifying assets	0.3	1.9
Relief for capitalised interest and foreign exchange gains/losses	(0.4)	(0.5)
Other timing differences	(3.4)	-
Tax charge for year	24.9	28.2

South West Water'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 Company to plan major investment and consequentially to maintain lower customers bills, as corporation tax relief is given against the investments made.

Following the Chancellor's Budget on 11 March 2020, the UK headline 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 calculated to crystallise at 19%, giving a non-underlying deferred tax charge of £28.9 million. The change was substantively enacted on 17 March 2020.

The adjustment to the tax charge in respect of prior years represents a current tax credit of £2.1 million and a deferred tax charge of £3.7 million. These reflect agreements reached with the tax authorities in respect of historic liabilities and the true-up of the previous year's provision to the tax computations filed with HMRC.

9. TAXATION (CONTINUED)

In addition to the amounts recognised in the income statement the following tax charges and credits were also recognised:

	2020 £m	2019 £m
Amounts recognised directly in other comprehensive income		
Deferred tax credit on defined benefit pension schemes	(1.6)	(1.1)
Deferred tax credit on cash flow hedges	(2.5)	(0.3)
Amounts recognised directly in equity		
Deferred tax credit on share based payments	(0.6)	(0.1)

10. DIVIDENDS

	2020 £m	2019 £m
Amounts recognised as distributions to equity holders in the year:		
Outperformance dividend of 2.2p per ordinary share in respect of 2016/17 paid 30 April 2018	-	5.5
Base dividend of 23.1p per ordinary share in respect of 2018/19 paid 24 August 2018	-	57.9
Outperformance dividend of 23.8p per ordinary share in respect of 2017/18 paid 24 August 2018	-	59.7
Base dividend of 24.1p per ordinary share in respect of 2019/20 paid 30 August 2019	60.5	-
Outperformance dividend of 23.6p per ordinary share in respect of 2018/19 paid 30 August 2019	59.2	-
Special dividend of 51.8p per ordinary share in respect of 2019/20 paid 30 August 2019	130.0	-
	249.7	123.1

11. EMPLOYMENT COSTS

The average number of persons (including Executive Directors) employed by the Company was 1,452 (2019: 1,389).

	2020 £m	2019 £m
	Note	
Wages and salaries	52.1	49.6
Social security costs	5.2	5.0
Pension costs	7.4	7.3
Share-based payments	1.0	1.0
Total employment costs	65.7	62.9
Charged as follows:		
Employee costs	50.0	48.6
Capital schemes	15.7	14.2
Research and development	-	0.1
Total employment costs	65.7	62.9

Details of Directors' emoluments are set out in note 12. There are no personnel other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Company.

12. DIRECTORS' EMOLUMENTS

	2020 £000	2019 £000
Executive Directors:		
Salary	456	412
Performance-related bonus paid or payable	149	171
Share-based payments	359	311
Other emoluments, including payments in lieu of pension provision	147	116
Non-Executive Directors (including Chairman)	384	1,027
Total emoluments	1,494	2,037

More detailed information concerning Directors' emoluments (including pensions and the highest paid Director) and share interests is shown in the Annual Report on Remuneration on pages 102 to 113. This report also details arrangements with Pennon Group plc for the payment and recharging of emoluments relating to Directors who serve as Directors of both Pennon Group and South West Water. The cost of share-based payments represents the amount charged to the income statement, as described in note 30.

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).

At 31 March 2020 there were no Directors accruing retirement benefits under defined benefit pension schemes (2019: one Director)
At 31 March 2020 there was one Director accruing benefits under defined contribution pension schemes with contributions of £12,693 made during the year (2018/19: £14,835).

13. GOODWILL

	2020 £m	2019 £m
Cost		
At 1 April	51.3	51.3
At 31 March	51.3	51.3

The goodwill of £51.3 million was recognised on acquisition of Bournemouth Water in 2016/17. It is attributable to synergies and outperformance arising from the merger of operating activities.

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, for which goodwill was recognised on the acquisition of Bournemouth Water in 2016, 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.

14. OTHER INTANGIBLE ASSETS

	2020 £m	2019 £m
Cost:		
At 1 April	2.0	2.0
At 31 March	2.0	2.0
Accumulated amortisation		
At 1 April	1.5	1.0
Charge for period	0.5	0.5
At 31 March	2.0	1.5
Net book value		
At 1 April	0.5	1.0
At 31 March	-	0.5

Other acquired intangible assets relate to computer software and arose on the acquisition of Bournemouth Water. The weighted average useful life at 31 March 2020 was 5 years (31 March 2019: 5 years).

15. PROPERTY, PLANT AND EQUIPMENT

	Freehold land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Total £m
Cost:						
At 31 March 2018	51.3	1,835.0	726.5	1,729.6	174.9	4,517.3
Additions	0.2	16.4	2.2	49.8	85.4	154.0
Assets adopted at fair value	-	10.0	-	-	-	10.0
Grants & contributions	-	(2.1)	-	-	-	(2.1)
Disposals	-	(1.2)	-	(1.8)	-	(3.0)
Transfers/reclassifications	1.0	36.1	20.0	54.6	(111.7)	-
At 31 March 2019	52.5	1,894.2	748.7	1,832.2	148.6	4,676.2
IFRS 16 transition adjustment	31.1	-	-	0.8	-	31.9
At 1 April 2019 (adjusted for IFRS 16)	83.6	1894.2	748.7	1,833.0	148.6	4,708.1
Additions	0.1	27.8	1.8	53.9	77.4	161.0
Assets adopted at fair value	-	8.1	-	-	-	8.1
Grants & contributions	-	(1.8)	-	-	(0.9)	(2.7)
Disposals	-	(0.6)	-	(1.3)	-	(1.9)
Transfers/reclassifications	1.7	17.3	19.1	68.0	(106.1)	-
At 31 March 2020	85.4	1,945.0	769.6	1,953.6	119.0	4,872.6
Accumulated depreciation:						
At 31 March 2018	11.3	253.4	258.3	1,023.8	-	1,546.8
Charge for year	1.7	21.5	13.6	82.2	-	119.0
Disposals	-	(1.3)	-	(1.6)	-	(2.9)
At 31 March 2019	13.0	273.6	271.9	1,104.4	-	1,662.9
Charge for year	2.9	23.0	13.6	83.0	-	122.5
Disposals	-	(0.6)	-	(1.2)	-	(1.8)
At 31 March 2020	15.9	296.0	285.5	1,186.2	-	1,783.6
Net book value:						
At 31 March 2018	40.0	1,581.6	468.2	705.8	174.9	2,970.5
At 31 March 2019	39.5	1,620.6	476.8	727.8	148.6	3,013.3
At 31 March 2020	69.5	1,649.0	484.1	767.4	119.0	3,089.0

Out of the total depreciation charge for the Company of £122.5 million (2018/19: £119.0 million), the sum of £2.6 million (2018/19: £1.5 million) has been charged to capital projects, £1.7 million (2018/19: £1.5 million) has been offset by deferred income and £118.2 million (2018/19: £116.0 million) against profits.

Asset lives and residual values are reviewed annually.

During the year borrowing costs of £2.0 million (2018/19: £2.9 million) have been capitalised on qualifying assets, at an average borrowing rate of 3.4% (2018/19: 3.7%).

15. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

Right of use assets held under leases included above were:

	Freehold land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Total £m
Cost:						
At 31 March 2019	3.3	428.4	471.1	490.2	5.2	1,398.2
IFRS 16 transition adjustment	31.1	-	-	0.8	-	31.9
At 1 April 2019 (adjusted for IFRS 16)	34.4	428.4	471.1	491.0	5.2	1,430.1
Additions	0.7	5.7	22.9	85.8	-	115.1
Transfers/reclassifications	-	-	5.2	-	(5.2)	-
Disposals	-	(29.3)	(17.7)	(58.0)	-	(105.0)
At 31 March 2020	35.1	404.8	481.5	518.8	-	1,440.2
Accumulated depreciation:						
At 31 March 2019	0.1	68.2	126.7	255.0	-	450.0
Charge for year	1.3	10.0	8.3	26.3	-	45.9
At 31 March 2020	1.4	78.2	135.0	281.3	-	495.9
Net book value:						
At 31 March 2019	3.2	360.3	344.4	235.2	5.2	948.2
At 31 March 2020	33.7	326.6	346.6	237.4	-	944.3

The net book value of right of use assets at 1 April 2019 was £980.1 million, comprising an adjustment upon transition to IFRS 16 of £31.9 million, and assets previously held under finance leases under IAS 17 of £948.2 million. Refer to note 37 for additional information relating to the Company's implementation of IFRS 16 'Leases'.

16. FINANCIAL INSTRUMENTS BY CATEGORY

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

	Note	Fair value Derivatives used for cash flow hedging £m	Amortised cost Loans and receivables £m	Trade receivables and trade payables £m	Total £m
31 March 2020					
Financial assets					
Trade and other receivables	19	-	14.4	116.8	131.2
Cash and cash deposits	21	-	284.1	-	284.1
		-	298.5	116.8	415.3
Financial liabilities					
Borrowings	23	-	(2,591.3)	-	(2,591.3)
Derivative financial instruments	20	(30.6)	-	-	(30.6)
Trade and other payables	22	-	(5.3)	(52.3)	(57.6)
		(30.6)	(2,596.6)	(52.3)	(2,679.5)

	Note	Fair value Derivatives used for cash flow hedging £m	Amortised cost Loans and receivables £m	Trade receivables and trade payables £m	Total £m
31 March 2019					
Financial assets					
Trade and other receivables	19	-	19.0	112.9	131.9
Cash and cash deposits	21	-	329.4	-	329.4
		-	348.4	112.9	461.3
Financial liabilities					
Borrowings	23	-	(2,392.0)	-	(2,392.0)
Derivative financial instruments	20	(20.0)	-	-	(20.0)
Trade and other payables	22	-	(9.3)	(68.5)	(77.8)
		(20.0)	(2,401.3)	(68.5)	(2,489.8)

17. INVESTMENTS

	2020 £m	2019 £m
At 31 March:		
Subsidiary undertakings	3.3	3.3

The Company has three wholly-owned trading subsidiaries, Peninsula Properties (Exeter) Limited, South West Water Finance plc and Source Contact Management Limited. The Company also has eight wholly-owned dormant subsidiaries, Bournemouth Water Investments Limited and its subsidiaries, BWH Enterprises Limited, Bournemouth Water Limited, Alderney Water Limited, West Hampshire Water Limited, Avon Valley Water Limited and Aquacare (BWH) Limited.

All of these subsidiaries are registered at Peninsula House, Rydon Lane, Exeter, Devon, England, EX2 7HR and are also incorporated and operate in England. The Company also has a minority shareholding in Landlord Tap Limited, which is incorporated, registered and operates in England.

Consolidated financial statements have not been prepared, as explained in note 2(b).

In the opinion of the Directors, the total value of the investments in subsidiaries is not less than the amount at which they are shown in the balance sheet.

18. INVENTORIES

	2020 £m	2019 £m
Raw materials and consumables	4.9	4.9

19. TRADE AND OTHER RECEIVABLES – CURRENT

	2020 £m	2019 £m
Amounts receivable from customers	208.4	199.7
Less: provision for expected credit losses	(91.6)	(86.8)
Net trade receivables	116.8	112.9
Amounts owed by fellow subsidiary companies	14.4	19.0
Other receivables	8.6	4.4
Prepayments and accrued income	5.4	7.9
Trade and other receivables – current	145.2	144.2

Trade receivables include accrued income relating to customers with metered budget plans.

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 Company 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 Company 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. As at 31 March, an analysis of the aging of gross trade receivables is as follows:

	2020 £m	2019 £m
Not due	33.1	37.2
Past due 1 - 30 days	8.2	7.6
Past due 31 - 120 days	12.0	9.8
More than 120 days	155.1	145.1
Total trade receivables	208.4	199.7

The aged trade receivables above are taken directly from the Company's sales ledger records before the deduction of credit balances and other adjustments.

The Company specifically reviews separate categories of debt to identify an appropriate allowance for expected credit losses as outlined in note 2(n). South West Water 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 expected credit loss provision has been recognised in respect of amounts owed by fellow subsidiary undertakings.

The movement in the allowance for expected credit losses in respect of trade receivables was:

	2020 £m	2019 £m
At 1 April	86.8	89.7
Provision for expected credit losses	5.7	2.3
Net Receivables written-off during the year as uncollectable	(0.9)	(5.2)
At 31 March	91.6	86.8

Receivables in respect of wholesale water and wastewater services retailed by fellow group subsidiaries are included as amounts owed by fellow subsidiary companies.

20. DERIVATIVE FINANCIAL INSTRUMENTS

	2020 £m	2019 £m
Derivatives used for cash flow hedging:		
Current liabilities	6.2	10.9
Non-current liabilities	24.4	9.1
Total liabilities	30.6	20.0

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

The ineffective portion recognised in the income statement arising from cash flow hedges was £nil (2018/19: £nil).

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 60%, after the effect of interest rate swaps, of net borrowings is at fixed rate. At 31 March 2020, 52% (31 March 2019: 68%) of net borrowings were at a fixed rate.

At 31 March 2020 interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £1,063.0 million existed, with a weighted average maturity of 4.0 years (31 March 2019: £1,459.5 million, with 3.1 years). The weighted average interest rate of the swaps was 1.42% (31 March 2019: 1.74%).

The periods for which cash flow hedges are expected to affect future profit or loss as follows:

	<1 year £m	1-2 years £m	2-5 years £m	Over 5 years £m	Total £m
31 March 2020					
Liabilities	6.2	6.2	17.8	0.4	30.6
31 March 2019					
Liabilities	10.9	2.1	5.4	1.6	20.0

Valuation hierarchy

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

	2020 £m	2019 £m
Level 2 inputs		
Liabilities		
Derivatives used for cash flow hedging	30.6	20.0

The Company 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.

21. CASH AND CASH DEPOSITS

	2020 £m	2019 £m
Cash at bank and in hand	33.2	46.8
Short-term bank deposits	30.0	80.0
Other deposits	225.9	202.6
Cash and cash deposits	284.1	329.4

Overnight deposits have an average maturity of one working day. Other short-term bank deposits have an average maturity of 84 days.

Other deposits include £225.9 million (31 March 2019: £202.6 million) of restricted funds to settle long-term lease liabilities (note 23).

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

	2020 £m	2019 £m
Cash and cash deposits as above	284.1	329.4
Less: deposits with a maturity of three months or more (restricted funds)	(225.9)	(202.6)
Cash and cash equivalents	58.2	126.8

22. TRADE AND OTHER PAYABLES – CURRENT

	2020 £m	2019 £m
Trade payables	52.3	68.5
Amounts owed to subsidiary companies	4.2	5.0
Amounts owed to parent undertaking	1.1	4.3
Other tax and social security	2.0	1.6
Other payables	11.2	10.2
Accruals	12.7	18.0
Contract liabilities	2.0	2.0
	85.5	109.6

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

The movement in the current and non-current contract liabilities was:

	2020 £m	2019 £m
At 1 April	118.1	110.6
Revenue recognised in the year	(1.3)	(2.6)
Consideration received in advance of completion of performance obligations	8.1	10.1
At 31 March	124.9	118.1

The analysis of contract liabilities between current and non-current is:

	2020 £m	2019 £m
Current	2.0	2.0
Non-current (note 24)	122.9	116.1
	124.9	118.1

Performance obligations related to the current contract liabilities closing balance above are expected to be satisfied, and revenue will be recognised, within the financial year ended 31 March 2021.

23. BORROWINGS

	2020 £m	2019 £m
Current		
European Investment Bank	27.0	27.0
Other external loans	7.5	8.0
Loan from subsidiary company (note 36)	4.2	-
	38.7	35.0
Leases (IAS 17 finance)	18.2	52.9
Leases (IAS 17 operating)	1.0	-
Total current borrowings	57.9	87.9
Non-current		
European Investment Bank	237.4	264.4
Other external loans	382.4	270.0
Loan from subsidiary company (note 36)	494.3	420.3
	1,114.1	954.7
Leases (IAS 17 finance)	1,384.2	1,349.4
Leases (IAS 17 operating)	35.1	-
Total non-current borrowings	2,533.4	2,304.1
Total borrowings	2,591.3	2,392.0

Refer to note 37 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 loan from subsidiary company represents loans from South West Water Finance plc, a UK company whose purpose is to raise borrowings for South West Water Limited. The fair value of the non-current borrowings were:

	2020 Book value £m	2020 Fair value £m	2019 Book value £m	2019 Fair value £m
European Investment Bank	237.4	220.9	264.4	235.7
Other external loans	382.4	435.5	270.0	320.5
Loan from subsidiary company	494.3	657.2	420.3	575.4
	1,114.1	1,313.6	954.7	1,131.6
Leases	1,419.3	-	1,349.4	1,288.1
	2,533.4	1,313.6	2,304.1	2,419.7

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:

	2020 £m	2019 £m
Between 1 and 2 years	113.4	53.2
Over 2 and less than 5 years	206.1	257.2
Over 5 years	2,213.9	1,993.7
	2,533.4	2,304.1

The weighted average maturity of non-current borrowings was 20.4 years (31 March 2019: 21.9 years).

23. BORROWINGS (CONTINUED)

The maturity of lease liabilities was:

	2020 £m	2019 £m
Within 1 year	19.2	52.8
Over 1 year and less than 5 years	148.9	154.3
Over 5 years	1,270.4	1,195.2
	1,438.5	1,402.3

Included above is £nil (31 March 2019: £0.2 million) due to Peninsula Leasing Limited (a fellow Pennon Group subsidiary), under finance lease agreements of which £nil (31 March 2019: £0.2 million) is repayable within one year.

The discount rate used to calculate the lease liabilities above involves estimation. Where there is no rate implicit in the lease, the Company uses an estimated Incremental Borrowing Rate (IBR). At 31 March 2020, the range of IBRs used 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.1.2% 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 £1,355.7 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 £164.9 million (2018/19: £160.7 million), of which £1.0 million (2018/19: £0.7 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 of £107.9 million at 31 March 2020 (31 March 2019: £97.5 million) are being held to settle the lease liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

The period for repayment of certain existing leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposit at 31 March 2020 of £118.0 million (31 March 2019: £105.1 million) is being held to settle the lease liability at the end of the lease term, subject to rights to release by negotiation with the lessor. The deposits are subject to a registered charge given as security to the lessor for the outstanding balance.

Undrawn committed borrowing facilities at the balance sheet date were:

	2020 £m	2019 £m
Floating rate:		
Expiring after one year	235.0	195.0
	235.0	195.0

In addition, the Company has undrawn uncommitted short-term bank facilities of £nil (31 March 2019: £nil).

24. OTHER NON-CURRENT LIABILITIES

	2020 £m	2019 £m
Contract liabilities	122.9	116.1

Non-current contract liabilities relate to consideration received in advance of the Company performing its performance obligations to customers where performance obligations will not be completed within twelve months of the balance sheet date. The overall movement in total contract liabilities is disclosed in note 22. Contract liabilities reflect the fair value of assets transferred from customers.

25. RETIREMENT BENEFIT OBLIGATIONS

The Company's employees are eligible to participate in a defined contribution scheme, operated by the parent company, Pennon Group plc. The Company is also a member of the Pennon Group defined benefit scheme which was closed to new members on or before 1 April 2008.

The assets of the Pennon 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 the schemes' trustees is determined by the schemes' trust documentation. The Pennon 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 £1.5 million (2018/19: £1.6 million).

Defined benefit schemes

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	2.0	2.0	2.0
Rate used to discount schemes' liabilities and expected return on scheme assets	2.3	2.4	2.7
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 2018 actuarial tables with an allowance for future longevity improvement.

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

	2020	2019	2018
Male	24.7	23.9	24.9
Female	26.9	26.3	27.3

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%	+/- 0.2%
Rate of increase in current and future pensions	+/- 0.5%	+/- 6.3%
Rate used to discount schemes' liabilities	+/- 0.5%	+/- 8.8%
Inflation	+/- 0.5%	+/- 6.4%
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 scheme's membership. This is the same approach as has been adopted in previous years.

The amounts recognised in the balance sheet were:

	2020	2019
	£m	£m
Present value of financial obligations	(636.0)	(659.4)
Fair value of plan assets	643.1	637.5
Net asset recognised in the balance sheet	7.1	(21.9)

25. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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	(659.4)	637.5	(21.9)	(639.7)	617.1	(22.6)
Current service cost	(5.7)	-	(5.7)	(5.6)	-	(5.6)
Interest (expense)/income	(16.2)	16.0	(0.2)	(17.0)	16.2	(0.8)
Past service cost and gains and losses on settlements	(0.2)	-	(0.2)	(1.9)	-	(1.9)
	(22.1)	16.0	(6.1)	(24.5)	16.2	(8.3)
Remeasurements:						
(Loss)/return on plan assets excluding amounts included in interest expense	-	(14.9)	(14.9)	-	13.9	13.9
(Loss)/gain from change in demographic assumptions	(3.5)	-	(3.5)	28.9	-	28.9
Gain/(loss) from change in financial assumptions	28.2	-	28.2	(48.9)	-	(48.9)
Experience losses	(7.1)	-	(7.1)	(0.1)	-	(0.1)
	17.6	(14.9)	2.7	(20.1)	13.9	(6.2)
Contributions:						
Employers	-	32.4	32.4	-	15.2	15.2
Payments from plans:						
Benefit payments	27.9	(27.9)	-	24.9	(24.9)	-
	27.9	4.5	32.4	24.9	(9.7)	15.2
At 31 March	(636.0)	643.1	7.1	(659.4)	637.5	(21.9)

Employer contributions are made into the scheme by South West Water and other companies within the Pennon Group based upon pensionable pay of employees in each section of the scheme. Full details of the scheme are included within the Pennon Group plc financial statements (see note 30).

The assets in the schemes and the expected long-term rates of return at year end 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	100.8	-	16	121.6	-	19
Property	51.2	-	8	55.5	-	9
Bonds	337.5	-	52	303.5	-	48
Diversified Growth Fund	99.1	-	15	101.1	-	16
Insurance linked securities	44.3	-	7	41.5	-	6
Other	10.2	-	2	14.3	-	2
	643.1	-	100	637.5	-	100

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

25. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

Through the Pennon Group defined benefit pension plan, the Company 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 scheme holds a significant proportion of growth assets (equities, diversified growth funds and property) which are expected to outperform corporate bonds in the long-term while providing volatility and risk in the short-term. The allocation to growth assets is monitored such that it is aligned with the scheme's long-term objectives.

Changes in bond yields: A decrease in corporate bond yields will increase the value placed on the scheme's liabilities for accounting purposes, although this will be partially offset by an increase in the value of the scheme's bond holdings.

Inflation risk: The majority of the scheme's 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 effect of changes in inflation will be partially offset by changes in the value of the Scheme's liability matching investments.

Life expectancy: The majority of the scheme's 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 advisors, the trustees have structured the scheme's investments with the objectives of balancing investment returns and levels of risk. The asset allocation has three principal elements:

- holding of cash funds and bonds which is expected to be less volatile than most other asset classes and reflects market movements in the scheme's liabilities;
- a proportion of equities, with fund managers having freedom in making investment decisions to maximise returns and
- investment of a relatively small proportion of the Scheme's assets in alternative asset classes which give the potential for diversification (currently property and diversified growth).

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

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 increase of £53 million. The Company made a deficit recovery contribution of £28.5 million to the main scheme during the year reflecting three years of contributions for 2020-22 (2018/19: £11.4 million). Pennon Group plc monitors funding levels on an annual basis and expects to pay total contributions of around £nil during the year ended 31 March 2020. This is in line with our regulatory commitments.

26. CURRENT TAX ASSET/(LIABILITIES)

	2020	2019
	£m	£m
Current year receivable/(creditor)	0.3	(16.4)
Prior year tax items	3.1	1.1
At 31 March	3.4	(15.3)

27. DEFERRED TAX LIABILITIES

Deferred tax is provided in full on temporary differences under the liability method using enacted tax rates. Movements on deferred tax were:

	2020	2019
	£m	£m
Liabilities at 1 April	230.8	231.3
Opening adjustment on adoption of IFRS 16	(0.4)	-
Charged to the income statement	9.8	1.0
Credited to equity/other comprehensive income	(2.5)	(1.5)
Change of rate in equity/other comprehensive income including change of tax rate	(2.2)	-
Change of rate in income statement – non-underlying	28.9	-
Other non-underlying charges in the income statement	(0.6)	-
At 31 March	263.8	230.8

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 Company's deferred tax asset is expected to be recovered over more than one year. All deferred tax assets and liabilities within the same jurisdiction are offset.

The movements in deferred tax assets and liabilities were:

Deferred tax liabilities	Accelerated tax depreciation
	£m
At 31 March 2018	240.5
Charged to the income statement	0.2
At 31 March 2019	240.7
Opening adjustment on adoption of IFRS 16	(0.4)
Charged to the income statement	6.8
Non-underlying charge to the income statement	27.3
At 31 March 2020	274.4

Deferred tax assets

	Provisions	Retirement benefit obligations	Derivatives	Share based payments	Total
	£m	£m	£m	£m	£m
At 31 March 2018	(2.0)	(3.8)	(3.0)	(0.4)	(9.2)
Charged/(credited) to the income statement	1.0	(0.2)	-	-	0.8
Credited to other comprehensive income/equity	-	(1.1)	(0.3)	(0.1)	(1.5)
At 31 March 2019	(1.0)	(5.1)	(3.3)	(0.5)	(9.9)
Charged/(credited) to the income statement	0.2	2.9	-	(0.1)	3.0
Non-underlying (credit)/charge to the income statement	(0.6)	1.6	-	-	1.0
Credited to other comprehensive income/equity	-	(1.6)	(2.5)	(0.6)	(4.7)
At 31 March 2020	(1.4)	(2.2)	(5.8)	(1.2)	(10.6)

27. DEFERRED TAX LIABILITIES (CONTINUED)

Deferred tax credited to other comprehensive income/equity during the year was:

	2020 £m	2019 £m
Remeasurement of defined benefit obligations	1.6	1.1
Share-based payments	0.6	0.1
Cash-flow hedges	2.5	0.3
	4.7	1.5

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 Company's continuing capital expenditure programme, it is unlikely that the deferred tax liability will crystallise in the near future.

The different accounting treatment of property, plant and equipment for tax and accounting purposes means that the taxable income of the Company 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 provisions, retirement benefit obligations and derivatives 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, short term liabilities including provisions will typically crystallise in the following year and share based payments will crystallise over the period of the share schemes which is up to 5 years.

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.

28. PROVISIONS

	2020 £m	2019 £m
Restructuring		
At 1 April	1.1	2.7
Utilised during year	(0.5)	(1.6)
At 31 March	0.6	1.1

The restructuring provision is expected to be utilised within one year.

29. CALLED UP SHARE CAPITAL

	2020 £m	2019 £m
Authorised		
500,000,000 Ordinary shares of £1 each	500.0	500.0
Allotted and fully paid		
250,923,000 Ordinary shares of £1 each	250.9	250.9

30. EMPLOYEE SHARE SCHEMES

The Company participates in a number of share plans for the benefit of employees operated by Pennon Group plc. Details of each plan are set out below.

i) Sharesave Scheme

An all-employee savings related plan is operated that enables employees 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 c.17% discount to the market value at the start of the savings period, at the third, fifth or seventh year anniversary of the option being granted. Options expire six months following the exercise date and, except for certain specific circumstances such as redundancy, lapse if the employee leaves the Pennon Group before the option exercise period commences.

Outstanding options to subscribe for Pennon Group plc Ordinary shares of 40.7p each under the Sharesave scheme are:

Date granted	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	-	79
24 June 2015	683p	2018 – 2020	98	106
29 June 2016	709p	2019 – 2021	36	212
28 June 2017	767p	2020 – 2022	161	191
03 July 2018	635p	2021 – 2023	624	702
09 July 2019	620p	2022 – 2024	436	-
			1,355	1,290

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	1,290	669	1,179	695
Granted	450	620	726	635
Exercised	(230)	674	(406)	658
Expired	(155)	675	(209)	719
At 31 March	1,355	651	1,290	669

The weighted average share price at the date of exercise of Sharesave options during the year was 820p (2018/19: 750p). The options outstanding at 31 March 2020 had a weighted average exercise price of 651p (31 March 2019: 669p) and a weighted average remaining contractual life of 1.9 years (31 March 2019: 2.1 years).

The aggregate fair value of Sharesave options granted during the year was £0.5 million (2018/19: £0.4 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	765p	801p
Weighted average exercise price	620p	635p
Expected volatility	20.0%	20.0%
Expected life	3.4 years	3.4 years
Risk free rate	0.5%	0.5%
Expected dividend yield	5.2%	5.2%

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

30. EMPLOYEE SHARE SCHEMES (CONTINUED)

ii) Performance and Co-investment Plan

Executive Directors and Senior Management receive a conditional award of Ordinary shares in Pennon Group plc, and are also required to hold a substantial personal shareholding in Pennon Group plc. 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 have been 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	68	920	127	869
Vested	(21)	920	-	-
Lapsed	(47)	920	(59)	810
At 31 March	-	-	68	920

The awards outstanding at 31 March 2020 had a weighted average exercise price of nil (31 March 2019: 920p) and a weighted average remaining contractual life of nil years (31 March 2019: 0.3 years).

No awards were granted during the year.

iii) Long Term Incentive Plan

Executive Directors and Senior Management receive a conditional award of Ordinary shares in Pennon Group plc. 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	140	797	86	803
Granted	52	753	66	790
Lapsed	(56)	796	(12)	803
At 31 March	136	780	140	797

The awards outstanding at 31 March 2020 had a weighted average exercise price of 780p (31 March 2019: 797p) and a weighted average remaining contractual life of 1.3 years (31 March 2019: 1.8 years).

The aggregate fair value of awards granted during the year was £0.2 million (2018/19: £0.2 million), determined from market value. No option pricing methodology is applied since the vesting of the shares depend on non-market performance vesting conditions.

30. EMPLOYEE SHARE SCHEMES (CONTINUED)

iv) Annual Incentive Bonus Plan – Deferred Shares

Awards under the plan to Executive Directors and Senior Management involve the release of Ordinary shares in Pennon Group plc to participants. There is no performance condition since vesting is conditional upon continuous service with the Pennon Group for a period of three years from the award.

The number and weighted average price of shares in the 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	140	830	130	845
Granted	45	755	51	761
Vested	(38)	950	(34)	790
Lapsed	(21)	782	(7)	808
At 31 March	126	775	140	830

iv) Annual Incentive Bonus Plan – Deferred Shares

The awards outstanding at 31 March 2020 had a weighted average price of 775p (31 March 2019: 830p) and a weighted average remaining contractual life of 1.5 years (31 March 2019: 1.5 years). The Group's share price at the dates of the awards ranged from 761p to 950p.

The aggregate fair value of awards granted during the year was £0.3 million (2018/19: £0.4 million), determined from market value. No option pricing methodology is applied since dividends declared on the shares are receivable by the participants in the scheme.

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

31. RETAINED EARNINGS AND OTHER RESERVES

	Hedging reserve £m	Retained earnings £m	Total £m
At 31 March 2018	(12.5)	383.0	370.5
Profit for the year	-	149.4	149.4
Other comprehensive loss for the year	(3.6)	(5.1)	(8.7)
Dividends paid	-	(123.1)	(123.1)
Share-based payments (net of tax)	-	1.1	1.1
At 31 March 2019	(16.1)	405.3	389.2
Profit for the year	-	108.1	108.1
Other comprehensive loss for the year	(8.7)	4.3	(4.4)
Dividends paid	-	(249.7)	(249.7)
Share-based payments (net of tax)	-	1.3	1.3
IFRS16 opening reserves adjustment (net of tax)	-	(1.8)	(1.8)
At 31 March 2020	(24.8)	267.5	242.7

The hedging reserve is used to record the portion of the gain or loss on a hedging instrument in a cash flow hedge that is determined to be an effective hedge.

32. CASH FLOWS FROM OPERATING ACTIVITIES

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

	2020 £m	2019 £m
Continuing operations		
Profit for the year	108.1	149.4
Adjustments for:		
Share based payments	1.0	1.0
Profit on disposal of property, plant and equipment	(0.4)	(1.7)
Depreciation charge	118.3	115.5
Amortisation of intangible fixed assets	0.4	0.5
Finance income	(2.3)	(2.3)
Finance costs	73.4	72.8
Taxation	63.0	29.2
Non-underlying pensions past service cost	0.2	1.9
Non-underlying provision charge	2.8	-
Changes in working capital:		
Decrease in inventories	-	-
Increase in trade and other receivables	(8.)	(26.5)
(Decrease)/increase in trade and other payables	(10.4)	18.1
Decrease in retirement benefit obligations	(26.5)	(9.6)
Decrease in provisions	(0.4)	(1.6)
Cash generated from operations	319.1	346.7

During the year the Company completed a number of sale and leaseback transactions in respect of infrastructure assets as part of its ongoing financing arrangements. Cash proceeds of £115 million were received and a gain of £nil was recognised. These assets are primarily being leased back over an initial term of 10-years at market rentals.

33. NET BORROWINGS

	2020 £m	2019 £m
Cash and cash deposits	284.1	329.4
Borrowings – current		
Other current borrowings	(38.7)	(35.0)
Lease obligations (IAS 17 finance)	(18.2)	(52.9)
Lease obligations (IAS 17 operating)	(1.0)	-
Total current borrowings	(57.9)	(87.9)
Borrowings – non-current		
Other non-current borrowings	(1,114.1)	(954.7)
Lease obligations (IAS 17 finance)	(1,384.2)	(1349.4)
Lease obligations (IAS 17 operating)	(35.1)	-
Total non-current borrowings	(2,533.4)	(2,304.1)
Total net borrowings	(2,307.2)	(2,062.6)

34. CONTINGENT LIABILITIES

	2020 £m	2019 £m
Guarantee of borrowings of subsidiary undertaking	439.8	410.5

Guarantees in respect of performance bonds, the last of which expire in 2057 and which will be reduced in line with repayments of the borrowings of the subsidiary undertaking, are entered into in the normal course of business. No liability is expected to arise in respect of the guarantees.

The Company is subject to litigation from time to time as a result of its activities. The Company establishes provisions in connection with 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.

35. CAPITAL COMMITMENTS

	2020 £m	2019 £m
Contracted but not provided	72.0	68.1

36. RELATED PARTY TRANSACTIONS

	2020 £m	2019 £m
Parent company		
Purchase of goods and services		
– Group expenses	7.6	1.1
Payment for provision of finance		
- Loan interest	0.3	-
Sale of goods and services		
– Administrative services	0.6	8.0
Dividends paid	249.7	123.1

	2020 £m	2019 £m
Subsidiaries of the Company		
Purchase of goods and services		
– Property consultancy	0.2	0.2
– Billing and collection services	10.5	9.8
Payment for provision of finance		
– Loan interest	17.6	18.2
Sale of goods and services (administrative services)	1.3	1.3

	2020 £m	2019 £m
Fellow subsidiaries of the Pennon Group		
Purchase of goods and services		
– Management charges	0.9	2.1
– Waste disposal	0.5	0.3
Sale of goods and services		
– Non-household services	106.4	119.5
– Tankered waste and trade effluent charges	1.7	4.6

	2020 £m	2019 £m
Year end balances		
Borrowings		
– Loan from subsidiary	498.5	420.3
– Finance lease balances with fellow subsidiary	-	0.2
Receivables		
– Fellow subsidiaries	14.4	19.0
Payables		
– Parent company	1.1	4.3
– Subsidiaries	4.2	3.4
– Fellow subsidiaries	-	1.6

37. 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 Company'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 Company 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 lease payments, discounted using the Company's weighted average Incremental Borrowing Rate (IBR).

Following adoption of IFRS 16, the Company 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 Company 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 Company will present right-of-use assets and lease liabilities within property, plant and equipment and borrowings respectively. This approach is consistent with the Company's previous presentation of Finance leases under IAS 17.

At 31 March 2019 the Company had non-cancellable operating lease commitments of £55.8 million. These predominantly relate to leases of properties occupied by the Company in the course of carrying out its businesses.

On transition on 1 April 2019, the Company recognised the following items in the balance sheet:

- right-of-use assets – increase by £31.9m
- prepayments – decrease by £0.5m
- lease liabilities – increase by £36.4m
- accruals – decrease by £2.9m
- deferred tax assets – increase by £0.4m
- retained earnings – decreased by £1.8m.

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 Company's estimated Incremental Borrowing Rate (IBR) for each lease. The IBR is determined with reference to applicable reference rate borrowing curves (e.g. LIBOR or its successor), credit margins and lease terms. At the commencement of new leases discount rates are updated to ensure the Company 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 3.8%. If the weighted average rate used was increased by 10bps, this would result in a c.1.2% reduction in the present value of lease liabilities recognised at 1 April 2019.

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	55.8
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)
Less: Impact of discounting at weighted average discount rate of 3.8%	(17.7)
Operating lease liability recognised as at 31 March 2019	36.4
Add: finance lease liabilities recognised at 31 March 2019	1,402.3
IFRS16 lease liability recognised at 1 April 2019	1,438.7
Of which:	
Current lease liabilities	53.7
Non-current lease liabilities	1,385.0
	1,438.7

Associated right-of-use assets for selected land and building leases were measured on a retrospective basis as if the 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.

37. CHANGE IN ACCOUNTING POLICY ON LEASES (CONTINUED)

Adjustments recognised on the adoption of IFRS 16

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	36.4
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	(2.1)
Right-of-use assets on first application of IFRS 16	31.9

In applying IFRS 16 for the first time, the Company 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
- account 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 £2.1 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 £118.7 million and interest payments of £1.9 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 150)
- Interest on lease liabilities (see page 8)
- Short-term and low value lease expense (see page 144)
- Maturity analysis of lease liabilities (see page 156).

Based on the additional lease liability and associated assets recognised at 1 April 2019, 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
- A reduction in corporation tax of £0.1 million.

EBITDA increased as operating lease costs previously charged against EBITDA under IAS 17 have 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.

38. EVENTS AFTER THE REPORTING PERIOD

Impact of covid-19

The World Health Organisation (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 Company's financial year end of 31 March 2020, the Directors have taken the impact of these events into account when making their 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 Company's operational response to COVID-19 is set out throughout the strategic review section of the annual report on pages 3 to 33. In addition, the risk report on pages 39 to 49 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 117 and 50 respectively.

39. PARENT COMPANY

The parent company, and ultimate controlling party, is Pennon Group plc which is registered in England. Group financial statements are included in the Annual Report of Pennon Group plc which is available from Peninsula House, Rydon Lane, Exeter, Devon, England, EX2 7HR.