2019
Annual Report and
Financial Statements

South West
Water

SOUTH WEST WATER LIMITED
ANNUAL REPORT AND
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2019

southwestwater.co.uk bournemouthwater.co.uk

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CHAIRMAN'S STATEMENT

I am pleased to report once again that the Company achieved a strong performance during the year. We achieved a sector-leading return on regulated equity (RoRE) and our 2020-25 business plan received a fast track green light from Ofwat, the water industry regulator, making South West Water the only company to have achieved fast-track status for two consecutive price reviews. We are proud of the energy and commitment that went into producing our innovative plan and we were encouraged that the regulator regarded it in such a positive light.

TRANSPARENT STAKEHOLDER ENGAGEMENT

We welcome the changes to the UK Corporate Governance Code (which the Company voluntarily complies with to the extent possible within the Pennon Group context) requiring companies to better understand the views of key stakeholders and report how their interests have been considered and taken into account. This move to increased transparency fully aligns with our values and we continue to develop strong relationships with our full range of stakeholders. We have a particularly close dialogue with our regulators, as well as excellent communications with government, investors, customers and employees. We engage with our stakeholders to understand their needs and priorities, which in turn shape our strategy and purpose.

AMBITIOUS HEALTH AND SAFETY ROAD MAP

The Pennon Group set an ambitious road map for our HomeSafe initiative. Designed to deliver the highest standards of health and safety performance, HomeSafe enjoys high visibility across our operations. We have been pleased to see that the investment we are making has resulted in such strong engagement from our people. We are determined to sustain the momentum and, in September, a longer-term HomeSafe strategy was announced with ambitious targets and independent benchmarking which I believe will help us achieve our goal to be the health and safety leader in the UK water industry by 2025.

SUSTAINABILITY IS AT THE HEART OF WHAT WE DO

Sustainability has always been at the heart of what we do and I am pleased to report that the Board has given its wholehearted support to a new long-term sustainability strategy. The new strategy is backed up by initial three-year objectives, targets and action plans and ties together the knowledge of Environment, Social and Governance (ESG) requirements that exist across both South West Water and the entire Pennon Group.

We continue to invest and focus management efforts on further improvements to environmental performance. 2018/19 saw the lowest number of serious and significant (Category 1 and 2) pollution incidents for 10 years. We expect our substantial investments and measures to ensure further reductions across all wastewater pollution categories to meet our ambitious targets.

In addition to the HomeSafe and People strategies, South West Water utilises Pennon's pioneering Sustainable Finance Framework, which was implemented during the year and complements the refreshed sustainability strategy. This framework formally recognises our commitment to investments which bring significant environmental and social benefits across a range of areas. It allows us to access future funding opportunities in a manner that is aligned with green loan principles, green bond principles and social bond principles.

GIVING CUSTOMERS A STAKE AND A SAY

We work hard to build strong relationships with our customers and to deliver excellent services to those served by South West Water and Bournemouth Water. The 2020-25 business plan we submitted to Ofwat was all about empowering customers and offering a 'New Deal'.

A striking feature of the 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 customers the option of a shareholding in our parent company, Pennon Group, along with a greater say in how South West Water is run through a separate customer Annual General Meeting. This is unique in the water industry and I wholeheartedly support this bold and imaginative initiative.

In addition, we continue to share our success with customers through South West Water's innovative WaterShare mechanism with £110 million of total cumulative benefits identified since 2015 to be shared through future bill reductions, service improvements, reinvestment or our 2020-25 WaterShare+ scheme.

STRONG GOVERNANCE

Our governance structure has matured and is performing well as we continue to refine Board processes. We have a transparent corporate structure and our Board is focused on providing strong financial control, sound administration and good governance. I am particularly pleased with the professional debates we have in the South West Water Board. The Board continues to operate as a separate independent body in accordance with its own schedule of matters reserved thus ensuring compliance with Ofwat's principles on board leadership, transparency and governance.

EXPERIENCED BOARD

It is fundamentally important to ensure our Board has a broad skill set and deep experience.

As announced in last year's Annual Report, Martin Angle stood down in December 2018.

DR STEPHEN BIRD

In May 2019, we were shocked and saddened by the death of our Managing Director, Dr Stephen Bird. Stephen joined us in 1992 as a Regulation Manager and subsequently moved up through Operations to become Operations Director in 2000 and was appointed to the South West Water Board. In 2016, Stephen was appointed Managing Director. Stephen made an immense contribution to South West Water, the region and the water industry in his twenty seven year career with us. A proud Plymothian, Stephen's commitment to the communities we serve was an inspiration. Stephen is greatly missed by all his colleagues at South West Water.

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 and with consideration given to the benefits of gender and ethnic diversity.

DEVELOPING AND RETAINING TALENT

More than a year ago we announced our new vision – Bringing resources to life – with its strong supporting values of 'trusted, responsible, collaborative and progressive'. Good work was done during the year in embedding these values.

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. The Government's apprenticeship reforms and apprenticeship levy, introduced in 2017, are also helping us prioritise development programmes for employees. We are particularly proud of our apprenticeship scheme and started 93 apprentices through this route in 2018/19, which brings the total number of apprentices recruited to 242. Many of these apprentices have now completed their apprenticeships and secured full-time employment with the Company.

OUTLOOK: DELIVERING FOR ALL OUR STAKEHOLDERS

As we look ahead, South West Water is well-placed for the future as we draw on many strengths. With our fast-track status, we expect to make a strong start to the next regulatory period beginning in April 2020. We are making strong progress in our health and safety strategy as we work towards our goal of being a health and safety leader in the water industry by 2025.

Our people strategy to attract and retain top talent is seeing growing achievements and we believe our strong culture will enable us to deliver a high level of service to our customers and lead to outstanding business performance. We continue to operate in the interests of all our stakeholders delivering significant community and investment benefit.

From April 2020, this will include giving customers a stake and a say in our business with Watershare+ offering customers the opportunity to receive shares in our parent company, Pennon Group.

The new Pennon Group sustainability strategy will deliver focus on the big strategic themes of our time, from climate change to plastics and biodiversity. Over the coming years, this strategy will deliver benefit to all our stakeholders as we pursue our vision and live our values.

I remain confident that the South West Water Board, working together with the Executive and our people will continue to ensure we are not just a successful Company, but a responsible and trusted one too.

We remain committed to transparency, independent governance and sharing financial outperformance with our customers. As we pursue our vision and live our core values, I am confident the Board, the Executive and South West Water's people will deliver the broadest range of benefits to all our stakeholders.

SUSTAINABILITY AT OUR CORE

This year we have structured our report around our sustainability strategy. The ESG framework is centred around how we positively impact the communities we serve, from global issues including climate change and biodiversity, through to local benefits, customer satisfaction and employee wellbeing. Our strategy, objectives and targets set out how we will drive improvements and performance in the years ahead.

As we deliver our purpose – bringing resources to life – we aim to do so in a trusted, collaborative, responsible and progressive way. We work in long-term partnerships and seek to deliver outstanding service to customers and communities.

We know that there are obvious benefits to a clear, strategic and long-term approach to sustainability. This enhances our business performance, helps strengthen business resilience, protects our ongoing licence to operate via regulatory compliance and is integral to our risk management processes.

We have conducted a full materiality assessment and have identified, within our ESG framework, the nine focus areas most relevant to our business. In each we have defined our strategic objectives out to 2030. We have also set three-year targets and will monitor and report progress on each objective.

As well as resetting our sights through a refreshed sustainability strategy, we have been delivering improvements in our focus areas throughout 2018/19.

OUR SUSTAINABILITY STRATEGY FOCUS AREAS AND OBJECTIVES

ENVIRONMENT:

ENVIRONMENTAL LEADERSHIP

- Leadership in minimising carbon emissions and developing climate change adaption strategies
- Ensure a positive economic, social and environmental impact and continuous positive action to prevent pollution, and ensure regulatory compliance.

HEALTHY PLACES AND HABITATS

- Proactively protect and enhance biodiversity in our operational areas through quality habitat creation, good stewardship and environmental partnerships.

RESOURCE EFFICIENCY AND NATURAL CAPITAL STEWARDSHIP

- Leadership in resource productivity and stewardship, best practice in waste prevention, resource and water efficiency
- Services and innovative solutions for society that help to protect natural capital and resources.

SOCIAL:

COMMUNITY INVESTMENT AND BENEFIT

- Measurable positive investment and support for local business and communities through our services, active sponsorship, partnership and donation programmes, education services and employee volunteering scheme.

HEALTH, SAFETY AND WELLBEING

- Strive for the highest standards of health, safety and wellbeing in the workplace

- Continuously improve performance to create a safe and healthy working environment for our employees, contractors and visitors.

SKILLS, DIVERSITY AND DEVELOPMENT

- Achieve a diverse and productive workforce reflecting the communities in which we work
- Develop, upskill and empower our employees. Treat them fairly and ensure that they are fully engaged in all aspects of our objectives and high standards.

GOVERNANCE:

QUALITY SERVICES AND SATISFIED CUSTOMERS

- Aim to exceed expectations and engage with our customers and other stakeholders to build good relationships and to continuously improve our services
- Work with and support our most vulnerable customers.

RESPONSIBLE SUPPLY CHAIN

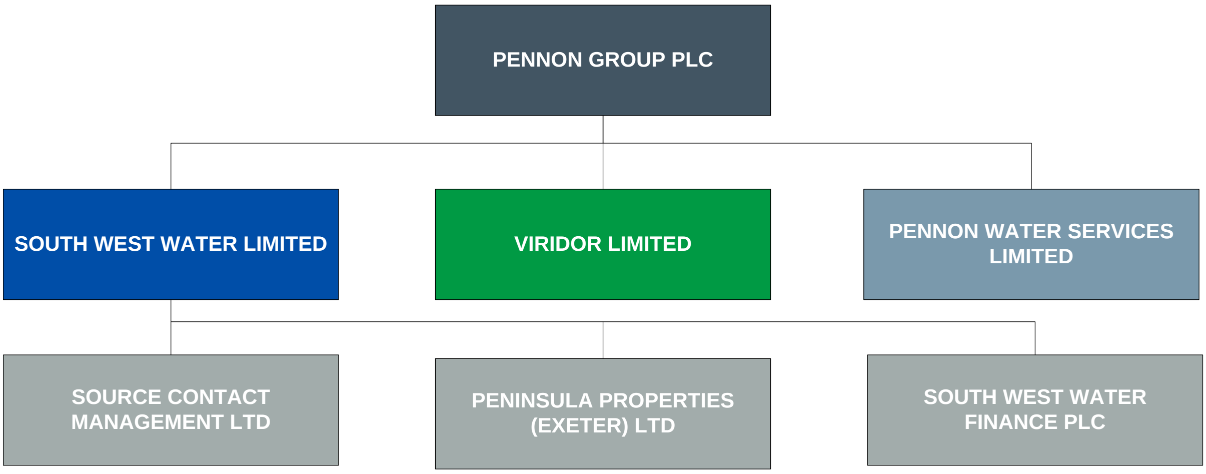
- Enable sustainable supply chain practice and partnerships including human rights, equal opportunities, and positive social and environmental values.

GOOD GOVERNANCE ENABLING INVESTMENT, INNOVATION AND SUSTAINABLE GROWTH

- A sustainable and successful business with transparency, respect and integrity for the benefit of our customers, shareholders, employees and other stakeholders
- Continue to invest in vital infrastructure and innovation for strong performance and sustainable growth, via Pennon Group’s Sustainable Financing Framework.

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 250 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 140).

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 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.

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 practises 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.

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 shapes 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 the environment in which we operate

Our board – reviews the impact of its decisions on stakeholder interests

Our customers

We supply water to a population of 2.2m and wastewater services to a population of 1.7m.

We engage regularly with our customers on service quality, cost of service, value for money and our strategy. We regularly conduct customer satisfaction surveys, providing ongoing feedback to our teams to reward good service and make improvements where needed. We engage with key customer bodies including the Consumer Council for Water, Citizens Advice and the WaterFuture Customer Panel.

We also have our well-established independent water customer challenge panel which represents customer views and engages with the Executive.

Find out more on page 20.

Our customer service[1] score is:

SWW: 88pts
BW: 88pts

[1] Service Incentive Mechanism (SIM) score

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 the annual employee trust and engagement survey as our cornerstone and we have an established staff engagement forum where staff representatives discuss business challenges. Every other month, all employees are invited to Group-wide calls to hear directly from the Pennon Group Executive, asking any questions they wish.

Find out more on page 15.

Our engagement score is:

67%

Our communities

Our operations run through 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 good causes in communities where we operate.

We engage regularly with our communities on local projects and initiatives. We use print, digital and social media channels to great effect with our behavioural change campaigns including 'Love your Loo', Think Sink and water efficiency. 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 22.

c.2 million
visitors to our recreational sites

Our environment

We work closely with a range of environmental partners including South West Lakes Trust, Wildlife & Rivers Trusts and various Non-Governmental Organisations (NGOs) to ensure we deliver our environmental commitments.

We meet regularly with our environmental stakeholders on resource efficiency and natural capital stewardship. We hold a twice yearly BeachWise forum with key stakeholders including Surfers Against Sewage. We meet regularly with the Wildlife Trusts in our operational areas and with the West Country Rivers Trust. We hold formal and informal meetings with the Environment Agency to assess environmental performance.

Find out more on page 20.

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

Up from 97.9% in 2017/18; 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.

Pennon Group has also launched a sustainable procurement policy and supplier code of conduct during the year.

Find out more on page 22 of the Pennon Annual Report.

82%
of our suppliers paid within 30 days

Our regulators

We have an open dialogue and meet regularly with our regulatory bodies – Ofwat, Defra, Environment Agency, Drinking Water Inspectorate, the Consumer Council for Water 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, trade bodies including Water UK and others.

Find out more on page 23 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:

People and community	Finance and Economy	Water	Service	Environment
Supporting our people and local communities	Resilient business and service	Clean, safe and reliable supplies	Responsive to our customers' needs and priorities	Environmentally sustainable actions and initiatives

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 and 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 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 continued to embed our people strategy, vision and values during the year and announced a health and safety roadmap that builds on our HomeSafe achievements.

EMBEDDING OUR VISION AND VALUES

Having launched the Pennon Group-wide vision of ‘Bringing resources to life’ last year, our focus in 2018/19 was on embedding this more deeply across the Company. We also built a broader understanding of how people at all levels can live our values of trusted, responsible, collaborative and progressive.

We measure the progress we are making in living our values through our employee engagement survey and supported by our HR Strategy.

BECOMING A GREAT PLACE TO WORK

This was the second 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. South West Water had a Trust Index © score of 59% in 2018. Whilst this is a slight fall from the 2017 score of 63% it remains significantly higher than the national average for large employers of 52%. Our Engagement score remains very strong at 67% and although falling 1% during the year remains well ahead of the national average for large employers of 56%. These results show we are continuing to make progress in living our values and in being recognised as a UK Best Workplace™.

High trust cultures enjoy better financial results. 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 innovative.

The 2018 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. South West Water scored 96% favourable in response to the question *‘I understand my safety-related responsibilities’* demonstrating the effectiveness of HomeSafe. For the second year running there were strong results in the area of diversity and inclusion with 89% favourable response to the question *‘People here are treated fairly regardless of their race or ethnic origin’*, with similar results in response of gender, age and sexual orientation demonstrating our inclusive culture. Our biggest improvements on the previous year were for job security, talent management and recognition.

The survey also revealed the areas where continuing focus is required. Communicating our strategy and direction continues to be the biggest opportunity for improvement. Demonstrating that we are living by our values will move the Trust Index forward and we also have work to do in ensuring our employees feel that rewards and benefits are reflective of their efforts.

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.

To ensure employees can share their views, the South West Water Employee Engagement Forum was established in February 2019. Our employees designed the new format which replaces the previously established 'staff council' and nominations for engagement champions are made by peers.

Our Speak Up whistleblowing policy, which operated throughout 2018/19, provides 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 2018, increasing in frequency from four to six times a year. This provides all employees across the Pennon Group the chance to put any question direct to the Pennon Executive. Now in its second year, this initiative has been well received by employees. Topics typically covered in the Big Chat include progress being made against our business plans and strategy, HomeSafe rollout and questions in response to media items concerning Pennon as well as any local operational questions employees may have.

SKILLS, DIVERSITY AND DEVELOPMENT

Building a sustainable, agile and diverse workforce is a key pillar of our HR strategy. 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 are available for employees at a variety of levels. Our aim is to increase productivity, job satisfaction and safety and to equip the next generation of leaders with appropriate knowledge, skills and competencies.

We have always embraced the introduction of the Apprenticeship Levy and since its inception in 2017 have offered 242 apprenticeships. Many of the apprentices have now completed their apprenticeships and the majority have been employed on a full-time basis within the Company.

Our Company turnover rate in 2018/19 was 8.2%.

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

We were pleased that our work in the area has been noted with the Pennon Group winning the Large Employer of the Year category at the South Devon College Apprenticeship Awards recognising our commitment to both the South West and skills development.

COMMUNITY

South West Water has a significant community and sponsorship programme across our region. In addition to delivering 52 outreach events, we have seven learning and education centres.

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

GENDER DIVERSITY AND EQUAL OPPORTUNITIES

The Board promotes equality of opportunity and diversity across all areas, including gender and ethnicity. South West Water has more to do in this area which remains a key focus – see both the Nomination Committee report on page 86 and the Directors' Report on page 106 for further details.

Female membership %		
	2018/19	2017/18
The Board	22	20
Executive Management Team	43	25
Senior Management	14	18
Company	22	22

Note: Senior Management includes members of the Executive Management.

The workforce comprises 78% male and 22% female employees. This gender split reflects the traditionally male dominated nature of our industry.

This was also the second year in which publication of gender pay gaps for larger organisations became mandatory. Our gender pay data for 2018/19 shows a slight reduction in the median pay gap with a slight increase in the mean pay gap. Nonetheless, the mean pay gap of 5.2% is lower than the national average. We believe that improving our overall diversity holds the key to ultimately closing the gender pay gap and we recognise that the pay gap will fluctuate over time. Whilst our diversity landscape is gradually beginning to take shape, and compares more than favourably to our industry peers, we do not intend to become complacent in this area. Instead, our aim is to put ourselves in a prime position to attract the top talent available, thereby further improving our diversity mix.

We have developed a six-point plan which focuses on improving reporting, mentoring, recruitment and training to ensure that this remains a key commitment for South West Water.

RESPONSIBLE EMPLOYER

One of our four values is 'responsible' and to further demonstrate our commitment in this area we have signed up to two employer campaigns in 2018/19. South West Water, as part of the Pennon Group, has joined the Slave-Free Alliance that is part of Hope for Justice, the Global anti-slavery charity. Our membership demonstrates our commitment to the highest employment standards for both our direct employees and those within our supply chain. We also signed up to the Social Mobility Pledge, the cross-party campaign to improve social mobility in the UK established by Rt. Hon Justine Greening MP. This pledge reflects our social commitments through our partnerships with local schools, our open-door approach to visitors and our provision of work experience opportunities.

HEALTH AND SAFETY

During the year, full roll out of the HomeSafe programme progressed. As the name implies, HomeSafe is about ensuring staff get to work safely, enjoy a safe and healthy working environment and arrive home without incident at the end of each working day.

Initial HomeSafe training was conducted on a face-to-face basis but the teaching tools and materials were adapted for e-learning so that staff in back-office roles and working in lower-risk environments could participate fully.

To build on the current momentum and the HomeSafe vision set in March 2017, a longer-term HomeSafe strategy was approved in September 2018. There is now a comprehensive and ambitious roadmap running to 2025 to look after employees and keep them free from harm. A core aim is to improve our key safety measure known as Lost Time Injury Frequency rate (LTIFR[1]) to 0.50 by 2025.

During the year, South West Water delivered a reduction in LTIFR and are targeting further reductions next year. This has come about through the deployment of HomeSafe; bringing refreshed focus to safety leadership, assurance and compliance and by equipping our people to spot hazards, intervene when they observe something unsafe and eliminate risks at source. We have also targeted resources to facilities where upgrades and improvements have been identified. The longer-term HomeSafe strategy is based on six themes: *managing risk, sharing and learning; working together, protecting health, enabling leaders and being resilient*. With the strategy, including appropriate timelines and milestones, everything hones in on the ambitious target of 0.50 LTIFR by 2025 which would place South West Water in the top quartile of our peers.

MEASURING OUR 2025 STRATEGY EFFECTIVENESS

South West Water will measure progress carefully and the Sustainability Committee approved five new key performance indicators in March 2019. These include the core health and safety measure as well as targets on leadership, occupational ill-health, hazard removal and the Engagement Score from the annual Great Places 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

We are 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.

KEY FACTS

- 2.2m total population served
- 1.0m customers served
- 23 raw water reservoirs
- 34 water treatment works
- 18,300 km of drinking water mains network
- 650 wastewater treatment works
- 17,490 km wastewater mains network
- 151 bathing waters and 24 shellfish waters

As we enter the final year of the current regulatory period major progress has been made across all areas of our business and we are delighted that our business plan for 2020-25 was awarded fast-track status by Ofwat.

DELIVERING EXCELLENT CUSTOMER SERVICE

Once again, improving customer service was at the heart of our delivery plans. We achieved our best ever quality service score during the year, with a ranking of second out of all water and sewerage companies in England and Wales. Our customer service score (SIM) improved to 88 points, with no penalty forecast for the K6 (2015-20) period. The SIM score is calculated against a qualitative element (based on a customer survey) across the sector and a quantitative element that includes the number of complaints received in writing or by phone, which have reduced by half since 2015/16. The improvement in service is driven by improved operational performance, an enhanced capability in our call centres to reduce waiting times along with investment in training and systems to improve our ability to resolve customer calls quickly. These have increased customer resolution and expanded the channels that customers can use to contact us to include online and social media. We made all these improvements in consultation with our customers and we were recognised for our excellent customer service in the prestigious 2019 Customer Satisfaction Awards run by the Institute of Customer Research.

We continued to focus on providing support to customers in vulnerable circumstances and those who struggle to pay their bills. At the end of the year, we were providing support to more than 23,000 customers through reduced tariffs with around 57,000 customers supported through this and other programmes and we have extended our Priority Services Register to make it easier to identify customers in vulnerable circumstances. This level of assistance puts us in a good position to deliver on our 2020-25 business plan aim to eliminate water poverty in our region by 2025. Ofwat has described this aim as ‘industry leading’.

WATERSHARE

South West Water continues to share the benefits of business outperformance between customers and shareholders through its unique WaterShare mechanism. We have identified c.£6.0 million of customer benefits during the year.

Since 2015, £110 million of cumulative benefits have been identified to share with customers through investment in services and lower future bills in addition to funding of our new Watershare+ share scheme. This reflects £80 million of totex savings, £11 million of net ODI benefits and £19 million of other benefits (including financing). These totex savings and efficiencies (including the forecast to 2020) have been reflected in the 2020-25 business plan, lowering bills for customers over the next regulatory period.

DRINKING WATER

We demonstrated excellent service resilience during the year. The exceptional cold weather of March 2018 resulted in the first red weather warning for snow ever issued in the South West. With good planning and flexible management, we successfully managed the impact of this freeze-and-thaw weather event. Ofwat praised South West Water in their 'Beast from the East' wrap-up Report quoting "South West Water demonstrated good communication with wider stakeholders to respond to the needs of customers in vulnerable circumstances." We also maintained supplies to customers despite the unprecedented demand during the warmest and driest summer on record. The warm weather resulted in an estimated 20% increase in visitors to the region over the summer period. Water production was increased by around 6% during this period and we were able to distribute water across our flexible strategic water network so that we could maintain supply to our customers whilst also meeting our leakage target of 84 megalitres per day. We supported the Isles of Scilly over the summer months to help them maintain supplies when ground water levels fell to extreme lows. Water resources in the South West Water region remained unrestricted for a 22nd consecutive year and the Bournemouth water region maintained its position of exercising no water restrictions since privatisation. As the weather continued to remain drier than usual, South West Water has been actively conserving and replenishing water resources by operating its artificial recharge storage schemes in order to protect future supplies.

We continued to maintain our high standards of drinking water quality and achieved all our targets. The Drinking Water Inspectorate has confirmed that our water quality was amongst the best in the industry this year.

INVESTMENT IN DRINKING WATER INFRASTRUCTURE

We commenced commissioning of the state-of-the-art Mayflower water treatment works during the year. This important investment will meet the needs of Plymouth's growing population for generations to come. Mayflower is a landmark project for many reasons. The facility uses advanced technology that has not been deployed in the UK before. The construction work was completed without any lost time due to injury with over a million hours of worktime going into the project. South West Water also signed the UK's first green finance lease to support the Mayflower project as part of Pennon's Sustainable Finance Framework which supports positive social, economic and environmental outcomes.

Other investments include the upgrade to water treatment works in Falmouth and improving land management in 11 river catchments as part of our Upstream Thinking strategy for healthier rivers and lower-cost water treatment. South West Water's listing for the Business in the Community (BITC) Environmental Sustainability Award in April 2018 recognised the successful transformation the multi-award-winning Upstream Thinking programme has had on the natural environment of the South West of England.

WASTEWATER

We aim to ensure the safe and efficient removal and disposal of wastewater, while minimising the possibility of sewer flooding or pollution affecting homes, businesses or the environment. To this end we achieved our best ever compliance in wastewater treatment with 99% of our works meeting their permit conditions.

PROTECTING THE ENVIRONMENT

We delivered a reduction in serious pollutions with only two Category 1 and 2 incidents. This was among the lowest number of such incidents in the industry. Disappointingly, the number of less serious incidents (Category 3 and 4) increased on the previous year. We have continued to implement our pollution incident reduction strategy and associated investment which should reduce minor incidents (Category 3 and 4) in future years.

To help address the issue of blocked sewers, we continued our targeted 'Love your Loo' campaigns to increase awareness of the problems caused by flushing inappropriate items. An incident that also focused extensive attention on the issue of keeping sewers clear was the discovery of Devon's largest ever 'fatberg' in a Sidmouth sewer. Our staff worked for several weeks to remove this obstruction which was estimated to be 64 metres long.

HEALTH AND SAFETY

Roll-out of the Group's HomeSafe initiative will continue into next year as we drive for improved standards in health and safety. During the year, South West Water delivered a 23% reduction in our key safety measure known as Lost Time Injury Frequency Rate and are targeting further reductions next year.

INVESTMENT IN WASTEWATER INFRASTRUCTURE

We commissioned our £20 million investment in Plymouth to improve the already high level of bathing water quality. Our largest single wastewater investment in the current K6 programme will help to protect the bathing waters in Plymouth Sound through the installation of our largest ever ultra-violet disinfection facility for treating storm water.

Our investments to protect bathing waters continue to reap benefits with extremely encouraging results for the 2018 bathing water season. Of the 151 bathing waters tested in the South West Water region, 149 (around 99%) were classified as 'sufficient' or better, with more than 78% classified as 'excellent'. Neither of the two bathing waters rated as 'poor' were attributed to any failure of South West Water's assets.

WHOLESALE SERVICES

Since the opening of the non-household retail market in April 2017, South West Water has successfully engaged with 21 different retailers and our wholesale service desk has been operating effectively.

SECTOR-LEADING OUTPERFORMANCE

In 2018/19, we once again delivered sector-leading financial performance with a cumulative return on regulated equity (RoRE) of 11.8% since the start of the K6 (2015-20) regulatory period.

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 our 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 2018/19, we continued to deliver efficiencies with £237 million of cumulative totex savings in the first four years of K6 (2015-20). We are on track to deliver around £300 million of totex savings by 2020 which supported our efficiency position in our K7 business plan.

We use new technology, innovative processes, skills training and equipment to deliver both water and wastewater improvements. Savings are driven by continuing advantages from our strategic alliances including our new water distribution framework and our H5O capital alliance. We are ensuring efficient capital investment through the use of data analytics, optimising capital and operating solutions while promoting efficient off-site build techniques. The integration of Bournemouth Water continues to deliver totex efficiencies with £27m of targeted synergies secured.

This focus on cost efficiency will reduce bills for our customers in 2019/20, and our 2020-25 business plan continues to target cost efficiency, supporting an 11% real reduction in customer bills by 2025.

ODI REWARDS

Operational performance resulted in a net ODI reward of £4.1 million (£11.3 million cumulatively over the four years of K6), reflecting an annual equivalent RoRE outperformance of 0.3% to date.

We have maintained good overall asset reliability and stable serviceability across all water and wastewater areas and received rewards for bathing water quality and water restrictions, as well as significant improvements in external and internal sewer flooding.

The cumulative net reward of £11.3 million comprises £14.4 million of net rewards recognised at the end of the regulatory period and £3.1 million of net penalty which may be reflected during the regulatory period. We are on track to meet all of our ODI commitments for 2020.

GREEN LIGHT FOR 2020-25 BUSINESS PLAN

In September 2018, South West Water submitted its K7 business plan for 2020-25. Ofwat published their initial assessment in January 2019, awarding us 'fast-track' status with our draft price determination received in April 2019.

We are delighted Ofwat's view was that our business plan 'set a new standard for the sector'. South West Water is the only water company to have achieved this status for two consecutive price reviews. Customers can look forward to lower bills, further investment and more control over how their water company is run. We are also addressing key social and sustainability themes of protecting the environment, improving services to customers and ensuring a strong and transparent approach to governance.

The next regulatory period includes specific comparative service and environmental targets which will be measured consistently across the whole industry on an annual basis. Based on existing performance, we are well placed to deliver into the next period.

The ODIs for K7 are a mixture of bespoke performance measures which are proposed and designed by South West Water and 15 measures which are common across all of the water companies. South West Water has a strong base for outperformance in K7 with two thirds of ODIs currently upper quartile or above industry average.

As a responsible and transparent water business, a key feature of our proposals is to deliver a 'New Deal', which will empower our customers by giving them the option of a tangible stake through equity shares in Pennon, our parent company, and the ability to hold us to account through a customer Annual General Meeting. We believe our New Deal redefines the relationship between a water company and its customers and recognises our societal responsibilities.

Key partnerships are already in place, including our strategic consultants and capital delivery partners, wildlife and river trusts, customer groups and charities. Our Resilient Service Improvement (RSI) transformation project is already underway, pilot trials for new water treatment technology have been completed and preparation for the expansion of our licence into the Isles of Scilly are well advanced.

OUR COMMUNITY

As well as providing essential water services, South West Water supports the area's economic sustainability, supporting the employment of some 5,000 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. We are also active supporters of the region's economic aspiration, and contributed to the Local Enterprise Partnership responses to the Government's Industrial Strategy.

SPONSORSHIP

In 2018/19 South West Water provided c.£210,000 of community sponsorship support and charitable donations. This ensures that South West Water is on track to deliver its Business Plan ODI commitment of spending £80,000 per annum as part of its Community Scorecard. In addition, our parent company, Pennon Group, sponsors the Theatre Royal in Plymouth and #BacktheSouthWest regional economic growth campaign for a further c.£60,000.

South West Water's eight sponsorship partners for the current Business Plan period have been chosen to deliver tangible benefit to our communities as well as protecting and enhancing the natural environment. These include The South West Coast Path Association and Beach Schools South West.

Through its charitable donations programme, South West Water supports five charities, including Age UK and the Devon & Cornwall Air Ambulance that have been chosen by employees for their social purpose.

Working with key campaign partners, such as Keep Britain Tidy and ReFill, South West Water is working hard to help in the fight against marine pollutions, particularly single use plastics. Since 2010, our campaign has helped deliver 1,287 beach cleans, with 174 tonnes of waste removed.

Community relations over 2018/19 have benefitted from South West Water's highest ever media profile, helping to promote its behavioural change campaigns Think Sink and Love your Loo, which encourage people to take a responsible approach to fats, oils, greases and wet wipes in order to reduce unnecessary blockages.

Bournemouth Water continued its support of the Hampshire & Isle of Wight Wildlife Trust, the Bournemouth 2026 initiative and the New Forest National Park Authority's Living Waters project.

We also partnered Dorset-based educational charity Life Education Wessex to run curriculum based 'Waterwise' programmes for primary schools in the Bournemouth area.

COMMUNITY ACCESS, CONSERVATION AND RECREATION

Our partnership with South West Lakes Trust ensures that our reservoirs are managed for environmental improvements and for the benefit of our customers and communities. During the year we welcomed more than two million people to our recreational estates.

Our reservoirs continue to offer health and wellbeing opportunities with 71,000 people taking part in organised recreation and 4,600 participants learning new skills at the sites through the Trust's heritage and environmental education programme. We have co-developed projects to ensure all our Sites of Special Scientific Interest are in favourable condition by 2020 and we are also running an awareness campaign at the reservoirs to inform all watersports participants and fishermen about the management and control of invasive non-native species.

REPORT OF THE FINANCE DIRECTOR – FINANCIAL REVIEW

OVERVIEW

South West Water demonstrated continued outperformance in 2018/19 reflecting strong cost control and resilience in the face of extreme conditions during the year.

The Company, including the merged Bournemouth Water, continues to deliver and outperform the sector leading business plan targets for the current K6 regulatory period and achieved a Return on Regulated Equity (RoRE) of 11.6% for the year (11.8% cumulatively). 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. £110 million has been identified for sharing with customers to date.

South West Water has achieved a cumulative totex outperformance of £237m over the K6 period and remains on track for c.£300m of savings to 2020.

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. Additional capital expenditure aimed at reducing leakage has been delivered during 2018/19 and we met our ODI target for leakage reduction.

South West Water submitted its business plan for 2020-25 (K7) in September 2018 and achieved 'fast track' status in the initial assessment announced in January 2019 and confirmed by the Draft Determination being received in April 2019. South West Water are the only water company to have achieved this status for two successive price reviews. 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 3.5% and at 31 March 2019 South West Water continued to have a strong funding position with £524.4 million of cash and committed facilities.

STATUTORY FINANCIAL PERFORMANCE

South West Water's statutory results show growth in profit before tax to £180.5 million (2017/18: £179.8 million) reflecting sector leading efficiencies. In 2018/19 there is a non-underlying charge of £1.9 million relating to the equalisation of benefits under Guaranteed Minimum Pensions (see note 6). In 2017/18, there were no underlying items to disclose.

REVENUE

Total revenue has increased by 1.7% to £582.4 million primarily due to net tariff increases of 1.0%[1] and an increase in customer demand of 1.4% primarily resulting from the hot dry Summer. This increase in revenue is above the regulatory tolerance levels and will result in a penalty of £0.6 million.

82% of our household customers in the South West area are now benefitting from a metered supply, with 5,727 customers opting for a meter in 2018/19 (2017/18: 6,576). 72% of households in the Bournemouth Water region are metered with 1,552 switching in the year (2017/18: 903).

EBITDA

Underlying earnings before interest, tax, depreciation and amortisation (EBITDA) were 1.8% ahead of 2017/18 at £367.0 million (2017/18: £360.5 million). Underlying operating profit increased by 1.6% to £251.0 million (2017/18: £247.1 million) and underlying profit before tax increased by 0.4% to £180.5 million (2017/18: £179.8 million).

As described above, tariff rises and increased customer demand net of meter switchers has driven an increase in revenue. Operating costs increased slightly following the additional costs incurred as a result of the extreme weather. This was offset by continuing efficiencies with the underlying increase in operating costs being less than the 3.1% average inflation for the year. This results from a targeted programme of efficiencies as well as continued benefit from efficiencies following the merger of Bournemouth Water. In addition, South West Water's bad debt performance remains strong with a charge of 0.4% of revenue (2017/18: 0.8%), 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 £1.7 million (2017/18: £2.4 million).

[1] Tariff increase reflects the net position post wholesale revenue forecast incentive mechanism (WRFIM) pass back of £11.8 million.

NET FINANCE COSTS

Underlying net finance costs of £70.5 million were £3.2 million higher than last year (2017/18: £67.3 million). This is primarily due to higher RPI on index-linked debt (3.1% at March 2019).

We have secured funding at a cost that is efficient and effective. RPI funding represents approximately 25% of borrowing resulting in higher interest costs as inflation rates have risen; at 3.5% the Company interest rate on average net debt for 2018/19 remains sector leading (2017/18: 3.5%).

PROFIT BEFORE TAX

South West Water's underlying profit before tax was £180.5 million, an increase of 0.4% compared with the prior year (2017/18: £179.8 million). On a statutory basis, profit before tax was £178.6 million (2017/18: £179.8 million) reflecting a net non-underlying charge before tax of £1.9 million in 2018/19 relating to the equalisation of benefits under Guaranteed Minimum Pensions (see note 6). In 2017/18, there were no underlying items to disclose.

TAXATION

The company's mainstream UK corporation current tax charge for the year (including prior year adjustments) was £28.2 million (2017/18: £25.8 million), reflective of an effective tax rate of 15.8% (2017/18: 14.3%). The lower effective rate of taxation reflects the level of capital allowances claims on its increased capital expenditure. The company had a current tax liability of £15.3 million at 31 March 2019. Tax is payable in four quarterly instalments, two are payable in the financial year and two are payable in the subsequent year. We paid £24.3 million in tax in the year relating to 2017/18 and 2018/19 to HMRC and £6.2m for Group relief in relation to those years. This is offset by a net amount of £17.5 million from other group companies and a refund from HMRC of £0.8 million, both in relation to the years prior to 2017/18.

Underlying deferred tax for the year (including prior year adjustments) was a charge of £1.3 million (2017/18: £5.6 million). This year there is a non-underlying deferred tax credit of £0.3 million (2017/18: £nil). The charge in 2018/19 primarily reflects capital allowances in excess of depreciation charge.

Overall the total tax charge for the year was £29.2 million (2017/18: £31.4 million).

DIVIDENDS AND RETAINED EARNINGS

The statutory net profit attributable to ordinary shareholders of £149.4 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 £123.1 million were paid to the parent undertaking (2017/18: £120.3 million), representing a base dividend of £57.8 million, £5.5m of outperformance dividend based on cumulative outperformance for 2016/17 and £59.8 million of outperformance dividend based on cumulative performance for 2017/18. The dividend was calculated with reference to the projections in the Ofwat 2014 Final Determination and the assumptions for 2018/19 included within the 2015-20 Business Plan.

CAPITAL INVESTMENT

Capital investment was £154.0 million in 2018/19 compared to £184.0 million in 2017/18. The key areas of focus remain:

- improved drinking water quality
- reducing leakage across the network
- ensuring a high level of bathing water quality
- delivering environmental improvements (including a targeted strategy to reduce pollution incidents)

Key large schemes during the year included:

- the finalisation of the innovative Mayflower Water Treatment Works at North Plymouth with c.£10.1 million of expenditure in 2018/19 (2017/18 c.£28 million).
- the reduction of leakage across the network
- the continuation of schemes to support National Environmental Programme requirements

South West Water continues to deliver capital projects in line with Ofwat, Drinking Water Inspectorate and Environment Agency expectations.

CASH FLOW

South West Water's operational cash inflows in 2018/19 at £281.5 million were £14.3 million higher than last year (2017/18: £267.2 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.

In the prior year, following the opening of the retail market, South West Water sold its non-household retail net customer book and related assets together totalling £31.9 million to Pennon Water Services for consideration of £31.9 million.

Corporation tax payments were £12.2 million. Total tax payments reflecting all taxes borne by the Company in 2018/19 are described in more detail in the section on 'Tax Contribution (borne/collected)' on page 29.

LIQUIDITY AND DEBT PROFILE

South West Water has a strong liquidity and funding position with £524.4 million of cash and committed facilities at 31 March 2019. This consists of cash and deposits of £329.4 million (including £202.6 million of restricted funds representing deposits with lessors against lease obligations) and undrawn facilities of £195 million. At 31 March 2019 the Company's borrowings totalled £2,392.0 million. After the £329.4 million held in cash, this gives a net debt figure of £2,062.6 million, a small decrease of £5.5 million during the year (2017/18: £2,068.1 million).

South West Water has a diversified funding mix of 68% fixed, 7% floating and 25% index-linked borrowings. The Company's debt has a maturity of up to 40 years with a weighted average maturity of 21.9 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 for the entire K6 period, in line with the policy to have at least 50% of funding fixed before the start of a regulatory period.

£598 million of South West Water's debt is index-linked at an overall real rate of under 2.0%. 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 2019 the fair value of the Company's non-current borrowings was £115.6 million more than its book value (2018: £35.4 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 decreased by £5.5 million to £2,062.6 million. Cash inflow from operations was a strong £281.5 million. Cash outflows relating to the capital programme totalled £140.7 million, a reduction from the prior year due lower capital expenditure as profiled during the K6 regulatory period. The gearing ratio at 31 March 2019, being the ratio of net debt to (equity plus net debt) was 75.5% (31 March 2018: 76.9%).

The combined South West Water and Bournemouth Water debt to RCV ratio is 58.9% (31 March 2018: 60.3%), which aligns with Ofwat's K6 target for efficient gearing of 62.5%.

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

The increase in RCV reflects planned capital investment during the year and the increase in the Retail Prices Index (RPI) during the year.

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 and a broad spread of business activities. 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.

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 £23.3 million recovered (2017/18: £40.8 million) by South West Water from HMRC. VAT has no material impact on profit before tax.
- Business rates of £28.9 million (2017/18: £28.5 million) paid to local authorities. This is a direct cost to the Company and reduces profit before tax.
- Employment taxes of £20.7 million (2017/18 restated: £18.9 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 £0.7 million (2017/18: £0.9 million) related to transport costs. This reduces profit before tax.
- Payments to Environment Agency and other regulatory bodies total £11.0 million (2017/18: £9.8 million). This reduces profit before tax.
- Carbon Reduction Commitment (CRC) payment for the Company of £0.9 million (2017/18: £2.2 million). This reduces profit before tax.

The corporation tax rate for 2018/19 used to calculate the current year's tax is 19% and will reduce to 17% for the year ending 31 March 2021.

To support the fact that we pay our 'fair' share, this year, Pennon Group 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 2019 the Company's share of the pension schemes showed an aggregate deficit (before deferred tax) of £21.9 million (2017/18: £22.6 million). A deficit recovery payment of £11.4 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 Group to a variety of risks and opportunities which could materially impact our ability to achieve our strategic priorities. The Board are committed to the effective management of both risks and opportunities 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 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.

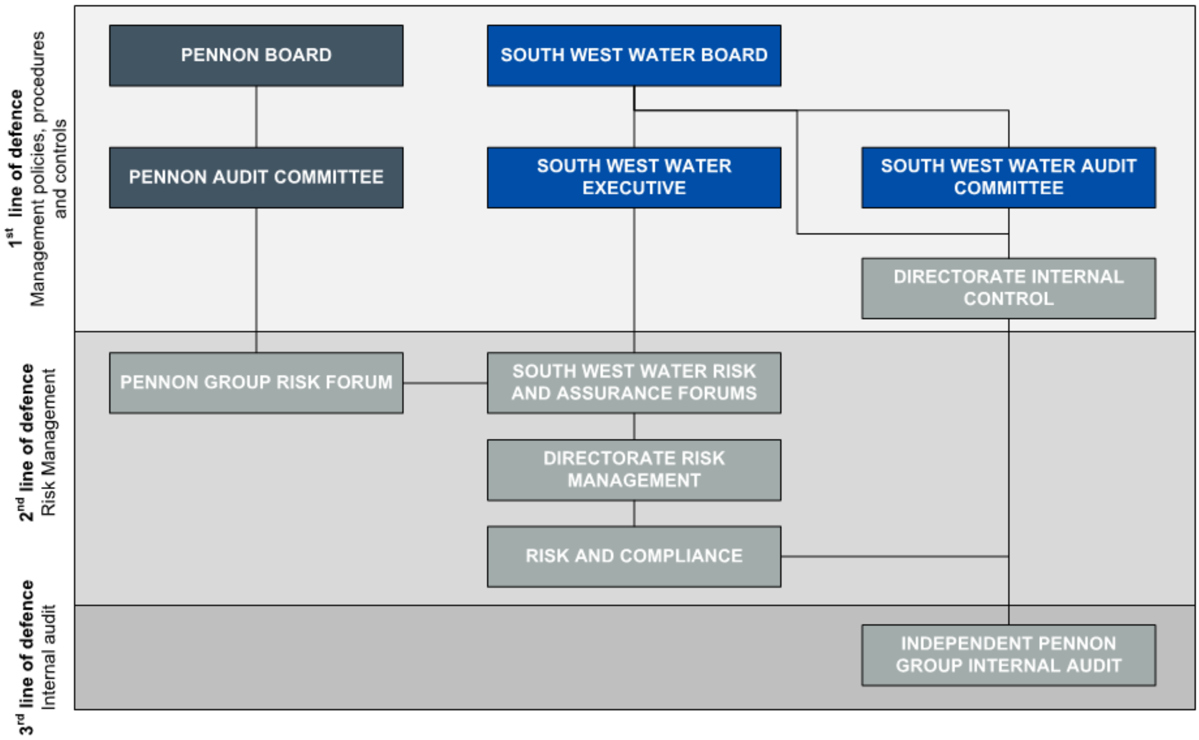
Our risk management framework encompasses both a 'top down' and 'bottom up' approach. This allows risks and opportunities to be cascaded and escalated effectively, while enabling a common understanding of the risks and opportunities that the Company is exposed to and their potential impact on the achievement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

A consistent methodology is applied in the identification, evaluation 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.

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 comfort 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**	• Sets the Company's strategic objectives • Establishes the Company's risk appetite • Determines the Company's principal risks • Ensures an effective internal control framework	• Quarterly reviews of the Company's principal risks against the determined risk appetite
	Audit Committee	• Reviews the effectiveness of the risk management framework • Reviews the adequacy of the internal control framework	• 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	• Day-to-day management of the principal and operational risks • Establish the relevant risk management processes and procedures • Maintaining the internal control framework	• Perform a thorough appraisal of the Company's risk profile quarterly • Monitoring of the Company's performance against KPIs and financial performance • Establishes and reviews policies, procedures and delegated authorities
SECOND LINE OF DEFENCE	**Group Risk Forum**	• 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	• Review of principal risks on a quarterly basis • Deep dive reviews of specific risks. Topics include: cyber security, renationalisation, health and safety and financial markets and liquidity
	South West Water Risk and Assurance Forum	• 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	• 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	• 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	• Review of principal risks on a quarterly basis by executive management teams • Risk and Compliance functions undertake compliance activities over ISO standards and other key business processes • Self-certification of compliance with internal control framework
THIRD LINE OF DEFENCE	**Group Internal Audit**	• Provide independent, risk-based assurance on the effectiveness of the internal control framework • Coordination of independent assurance activities	• 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:

- There is greater coordination and alignment between assurance activities with integrated assurance reporting presented to the Board
- Significant progress has been made in rolling out the HomeSafe initiative across the Company, which has delivered reduced injury frequency rates
- A comprehensive health and safety second line assurance programme has been delivered by the Health Safety Security and Assurance function
- There has been further standardisation of operational and financial processes and controls as part of the corporate shared services structure
- A review has commenced to identify opportunities to further improve the Company's resilience arrangements.

OFWAT'S PRINCIPLES FOR HOLDING COMPANIES – 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 68).

RISK APPETITE

The UK Corporate Governance Code requires companies to determine their risk appetite with respect to the level of risk exposure 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	The Board is committed to fully complying with, and be 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 and safety, where the Board places the highest level of importance on the welfare of our staff, the public and those who work for, or on behalf of, South West Water. 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 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.
Market and economic conditions	The Board recognises that our activities are exposed to changes in macroeconomic and external market conditions, both domestically and internationally. 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.
Operating performance	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 managing of our operational assets. There is greater appetite for well-informed risk taking to develop further markets, subject to this not detrimentally impacting on the level of service that we provide to our existing customer base.
Business systems and capital investment	Whilst capital investment activities contain a degree of inherent risk, all decisions are taken on an informed basis with risks weighted against potential appropriate returns 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.

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; notable the continued uncertainty arising from Britain's exit from the European Union (EU) and the potential renationalisation of the water industry. While the current Government are supportive of the existing regulatory model, in the event of a change of government, it remains the policy of the opposition to renationalise the water industry and Labour has provided further detail of their proposed approach during the year. In the event of this scenario occurring there would be a material impact to the Group's business model and consequently this remains a significant risk to the Company.

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. The Company's principal risks have remained consistent with the 2018 annual report with the exception of one additional principal risk:

- **Non-delivery of regulatory outcomes and performance commitments**: this risk reflects the significance of the ODI regime in the regulatory model. South West Water has the opportunity for reward but also is exposed to risk if performance commitments are not achieved.

Over the past year the business planning process for the 2020-25 period has been ongoing, with Ofwat awarding South West Water's plan 'fast track' status in January 2019. This has reduced overall uncertainty, as reflected in the change of trend in risk B. It has also allowed the Company to commence working to achieve the 'step change' in performance required for the 2020-25 period, however the commitments agreed are more stretching. Therefore, a new principal risk has been recognised in respect of not achieving regulatory outcomes/performance commitments (principal risk N).

The level of risk and uncertainty in respect of political views on the future of the Water industry remains high and continues to appear to influence the priorities of the regulator. This remains recognised at a net 'red' level (principal risk A).

During Summer 2018, a sustained period of dry weather resulted in a number of operational challenges. This carries on a trend of increasing frequencies of more extreme weather events. This increased frequency (which appears to be mirrored by future projections), alongside recent experience of the cost of mitigating the impacts of such events and a reduction in stakeholder appetite, has resulted in an increase to this risk level (principal risk J).

Decreases to bond yields following uncertainty in the Brexit process has resulted in principal risk G now being noted as amber, increasing.

Recent performance in respect of recovery of debt has resulted in a reduction to the level of the risk of non-recovery of customer debt and affordability (principal risk H). As at year end the underlying trend in this risk is however noted as rising due to uncertain external influences which may increase affordability challenges.

BRITAIN'S EXIT FROM THE EUROPEAN UNION

During the year, South West Water has continued to evaluate and monitor the potential risks and opportunities arising from Britain's decision to exit the EU. Cross functional working groups have been established and mitigation plans have been implemented focusing on those activities that are likely to be most impacted in the event of Britain leaving the EU without a withdrawal agreement. The Executive and Board have received regular updates throughout the year on the Company's preparations for a 'no-deal' scenario.

The Company continues to reflect the impact associated with Britain leaving the EU within the relevant principal risks. While no single issue is considered to expose South West Water to material risk, it is recognised that the combination of multiple issues or events could result in some disruption in the period immediately after leaving the EU in the event of a 'no-deal' scenario. Plans have been established which seek to minimise the potential impact on the Company and its operations.

The following issues have been identified as potentially having a significant impact on the Company's principal risks:

- **Availability of chemicals** (linked to principal risk: Business Interruption or significant operational failures / incidents). Detailed analysis has been completed on chemical received from European based suppliers and on South West Water stock levels to ensure they continue to be maximised. Additionally, operational plans have been developed to ensure continued asset availability and that Government and Local Resilience Forum requirements are met. The Company has also been heavily engaged with Water UK in developing a national response. This has involved discussions with the UK Government, regulators and other key stakeholders, developing a 'critical chemicals' action plan jointly with the Chemicals Industry Association and due diligence being undertaken on critical chemical suppliers

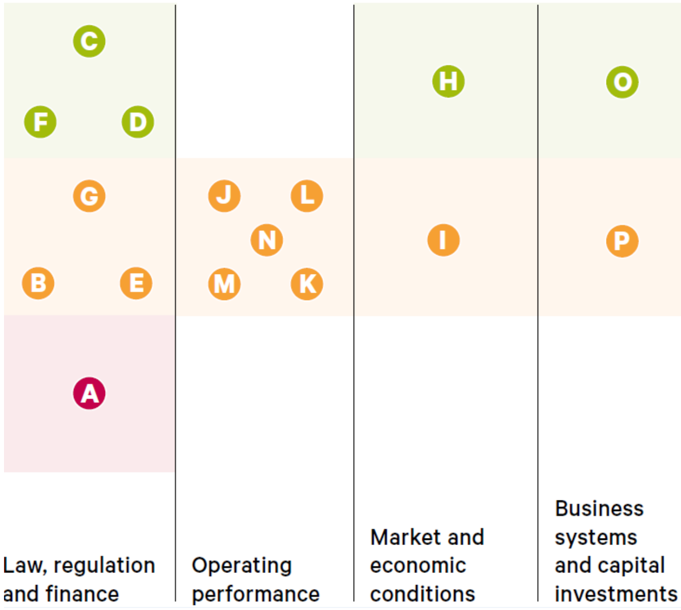
- **Inability to access the same level of funding from the European Investment Bank** (linked to principal risk: Maintaining sufficient finance and funding): Prior to the financial year end funding lines have been put in place which has resulted in cash and committed facilities to fund the Company's capital programme into K7 (2020-25). Furthermore, we have engaged with a variety of UK and European banks who have reaffirmed their appetite for UK infrastructure lending.

- **The ability to attract and employ individuals with the necessary skills are experience** (linked to principal risk: Difficulty in the recruitment, retention and development of skills): While the current position of the UK Government in the event of a 'no-deal' scenario is that EU nationals already in the country will be able to apply for settled status, the Company has been pro-active in reinforcing this to all affected staff. The Company has also sought assurances from temporary employment agencies as to their plans to ensure sufficient availability of temporary resource in the event of a 'no-deal' scenario.

The Directors confirm that during 2018/19 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 49.

REPORTING AN OVERVIEW OF THE PRINCIPAL RISK PROFILE



STRATEGIC IMPACT AND RISK RANKING

Our principal risks link to the strategic focus areas as described on page 12, 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** ↓

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

LAW REGULATION AND FINANCE

<table>
<tr><th>Strategic impact</th><th colspan="2">Mitigation and commentary</th><th>Risk appetite</th></tr>
<tr><td colspan="4">Principal Risk A: Changes in Government policy/renationalisation</td></tr>
<tr><td colspan="2">2019 Net risk and direction: RED, STABLE</td><td colspan="2">2018 Net risk and direction: RED, INCREASING</td></tr>
<tr><td>Finance and economy

Changes in Government policy may fundamentally impact our ability to deliver the Company's strategic priorities.</td><td colspan="2">While the Government is supportive of the existing regulatory model, the renationalisation of the water industry continues to be a central policy of the Labour Party and remains a possibility in the event of a change of Government.

We continue to engage with all political parties, 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.

South West Water's 2020-25 business plan also detailed how we would empower customers further and deliver benefits for our stakeholders over the next regulatory period.</td><td>We recognise that government policy evolves and seek to minimise potential risk whilst maximising opportunities through regular communication and robust scenario planning.</td></tr>
<tr><td colspan="4">Principal Risk B: Regulatory Reform</td></tr>
<tr><td colspan="2">2019 Net risk and direction: AMBER, STABLE</td><td colspan="2">2018 Net risk and direction: AMBER, INCREASING</td></tr>
<tr><td>Environment

Finance and economy

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.</td><td colspan="2">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 during the year on this topic.

This concept was at the heart of South West Water's 2020-25 business plan, entitled 'New Deal', which received fast track status from Ofwat. The draft determination was received from Ofwat in April 2019. This included our commitment to provide customers with a shareholding and a greater say in how South West Water is run.

Additionally, we continue to uphold the highest standards of corporate governance and transparency; including voluntary compliance with the UK Corporate Governance Code (to the extent possible in line with Group structure) and Ofwat's Principles for Board leadership, transparency and governance.</td><td>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.</td></tr>
</table>

Principal Risk C: Compliance with laws and regulations		
2019 Net risk and direction: GREEN, INCREASING	**2017 Net risk and direction: GREEN, STABLE**	
Environment **Finance and economy** South West Water is required to comply with a range of environmental laws and regulations. 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 which could affect shareholder value.	The legal and regulatory landscape continues to become more onerous and complex requiring greater resource and focus. The Company operates a robust and mature regulatory framework which ensures compliance with Ofwat, Drinking Water Inspectorate, Environment Agency and other relevant requirements. A rolling programme of training and guidance to our staff, contractors and partners continues to be provided. This includes data protection training following the implementation of the Data Protection Act 2018 and the General Data Protection Regulation. During the year we have also refreshed our Code of Conduct and launched a specific Supply Chain Code of Conduct, further reinforcing the standards expected of our staff and our partners. The Company participates in Pennon Group's Speak Up whistleblowing process which allows any concerns to be raised confidentially and robust processes are in place for investigating these. Additionally during the year South West Water, as part of the Pennon Group, became a member of the Slave Free Alliance, demonstrating our commitment to eradicating modern slavery.	South West Water has the highest standards of compliance and has no appetite for legal or regulatory breaches.

LAW REGULATION AND FINANCE (CONTINUED)

Strategic impact	Mitigation and commentary	Risk appetite
Principal Risk D: Maintaining sufficient finance and funding, within our debt covenants, to meet ongoing commitments		
2019 Net risk and direction: GREEN, STABLE	**2018 Net risk and direction: GREEN, STABLE**	
Finance and economy Failure to maintain funding requirements could lead to additional finance costs and put our growth agenda at risk. Breach of covenants could result in the requirement to repay certain debt.	South West Water and the entire Pennon Group have mature treasury, funding and cash flow policies in place. We regularly consider how political, economic and regulatory risks may impact on the Company's financing commitments and cash flow. 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. South West Water is prefunded until the end of the 2015-20 period and is already identifying funds into the next regulatory period. The Pennon Group and South West Water now both consider viability over a minimum five year period and extensive work on the viability of the Company over 2020-25 was considered with external assurance provided by KPMG, as part of South West Water's business planning process. In addition, South West Water considers viability over the period to the end of 2030 South West Water successfully participated in a Green-Deal funding agreement and has made its first drawdown under this agreement during the year.	We operate a prudent approach to our financing strategy in order to ensure our funding requirements are fully met.
Principal Risk E: Non-compliance or occurrence of an avoidable health and safety incident		
2019 Net risk and direction: AMBER, STABLE	**2018 Net risk and direction: AMBER, STABLE**	
People and community A breach of health and 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.	The effective management of health & safety risks continues to be a priority for the Board and Executive, as demonstrated by the 2025 HomeSafe strategy. Experienced health & safety professionals are embedded within the Company providing advice, guidance and support to operational staff. The Group-wide HomeSafe programme continues to be rolled out across South West Water with both face-to-face training for operational teams and a programme of e-learning. It is supported by a programme of capital investment for existing assets. The benefits of the HomeSafe programme are already being seen with lost time injury frequency rates falling 7% during the year.	The Board has no appetite for health and safety-related incidents and expects the highest standards of compliance within the Company and third parties.

LAW REGULATION AND FINANCE (CONTINUED)

<table>
<tr><th>Strategic impact</th><th colspan="2">Mitigation and commentary</th><th>Risk appetite</th></tr>
<tr><td colspan="4">Principal Risk F: Taxation compliance and contribution</td></tr>
<tr><td colspan="2">2019 Net risk and direction: GREEN, STABLE</td><td colspan="2">2018 Net risk and direction: GREEN, STABLE</td></tr>
<tr><td>People and community

Finance and economy

Non-compliance may result in financial penalties, legal costs and reputational damage.

Furthermore, the perception that South West Water's overall tax contribution is inadequate could have a detrimental impact on the reputation of the Company.</td><td colspan="2">The Pennon Group has an experienced and professionally qualified in-house tax team, supported, where necessary, by external specialists.

During the year South West Water as part of the Pennon Group became the first water utility to secure 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.

Processes and controls have been reviewed during the year to ensure we are able to continue to meet HMRC requirements.</td><td>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.</td></tr>
<tr><td colspan="4">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</td></tr>
<tr><td colspan="2">2019 Net risk and direction: AMBER, INCREASING</td><td colspan="2">2018 Net risk and direction: GREEN, STABLE</td></tr>
<tr><td>Finance and economy

The Company could be called upon to increase funding to reduce the deficit, impacting our cost base.</td><td colspan="2">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.

During the past year there has been a significant decrease in bond yields resulting from uncertainty over Brexit, which could result in an increased deficit position following the revaluation of the defined benefit pension scheme.</td><td>The Company will ensure that all obligations are met in full but seeks to manage this without unnecessary increased costs to the Company.</td></tr>
</table>

MARKET AND ECONOMIC CONDITIONS

Strategic impact	Mitigation and commentary	Risk appetite
Principal Risk H: Non-recovery of customer debt and affordability		
2019 Net risk and direction: GREEN, INCREASING	**2018 Net risk and direction: AMBER, DECREASING**	
Finance and economy There is a potential impact on revenue as a result of reduced customer debt collection, particularly with regards to vulnerable customers and affordability.	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 past three years. There has been no significant increase in bills for 2019/20 and real-term decreases form part of the business plan for 2020-25. The potential economic impact of Brexit on our customers remains a risk. We work proactively with our customers who are struggling to pay and have a range of affordability schemes and social tariffs to support them including Restart, WaterCare and Freshstart. In addition to household customers, this risk reflects the non-recovery of debt from non-household retailers. In line with market codes, robust procedures have been established to protect South West Water from largescale exposure to retailer default. The risk direction of travel has changed to increasing due to uncertain external influences such as the impact of the UK leaving the European Union on the national economy and known increases on affordability challenges.	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.
Principal Risk I: Macro-economic risks impacting commodity and power prices		
2019 Net risk and direction: AMBER, STABLE	**2018 Net risk and direction: AMBER, INCREASING**	
Finance and economy The economic climate as well as commodity and energy prices have a direct impact upon the amount we pay for goods and services.	South West Water has established procurement procedures to source its goods and services through the most appropriate channels, ensuring quality of provision and price. The Procurement Steering Group (PSG) oversees strategies and policies to promote effective working practices for strategic contracting relationships. Energy usage is minimised (including reduction of usage during periods of increased cost) and where possible on-site renewable generation is undertaken to reduce the requirement to purchase electricity from the grid.	We seek to take well-judged and informed decisions whilst ensuring plans are in place to mitigate the potential impact of macro-economic risks.

OPERATING PERFORMANCE

Strategic impact	Mitigation and commentary	Risk appetite
Principal Risk J: Poor operating performance due to extreme weather or climate change		
2019 Net risk and direction: AMBER, STABLE	**2018 Net risk and direction: GREEN, INCREASING**	
Water **Environment** 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.	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. 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. Key lessons learned from the freeze-thaw event in March 2018 were incorporated into our 2018/19 winter preparedness planning. Extensive modelling and forecasting is also performed to evaluate South West Water's Water resources, both in actively managing resources in periods of dry weather but also managing long term water resources as demonstrated through South West Water's 25 year Water Resources Management Plan.	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.
Principal Risk K: Poor customer service / increased competition leading to loss of customer base		
2019 Net risk and direction: AMBER, STABLE	**2018 Net risk and direction: AMBER, STABLE**	
Service Poor customer service has a direct impact on South West Water's delivery of the PR14 business plan.	There has been a continued focus on customer experience and the customer journey during the year. Enhanced capability within our call centre, investment in training and expanded channels to interact with our customers resulted in South West Water's best ever SIM customer service score with a ranking of second out of all water and sewerage companies in England and Wales. South West Water is also accredited to the Institute of Customer Service's 'ServiceMark' accreditation'. Planning is also underway to evaluate South West Water's performance under the new C-MeX guidance, which will replace SIM from 2020.	We continually seek to improve customer satisfaction.

OPERATING PERFORMANCE (CONTINUED)

<table>
<tr><td colspan="3">Principal Risk L: Business interruption or significant operational failure / incidents</td></tr>
<tr><td colspan="2">2019 Net risk and direction: AMBER, INCREASING</td><td>2018 Net risk and direction: AMBER, INCREASING</td></tr>
<tr><td>Water

Service

Environment

Operational failure could mean that we are unable to supply clean water to our customers or provide safe wastewater processes.

This has a direct impact on the successful delivery of the PR14 business plan.</td><td>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.

These could include:
• water quality deterioration
• contamination of water supplies
• pollution and flooding events
• water resource restrictions.

South West Water maintains detailed contingency plans and incident management procedures which are regularly reviewed and assets are managed through a programme of sophisticated planned and preventive maintenance and effective management of stores.

Extensive Brexit 'no-deal' planning has also been undertaken.

Continued investment alongside South West Water's pollution reduction strategy has resulted in a reduction of serious pollution incidents to two during the year. This was among the lowest number of such incidents in the industry.

A further reduction in the number of pollution events (including more minor incidents) has been identified as a priority and a programme of targeted action is underway to address these risks.</td><td>We operate a low tolerance for significant operational failure or incidents. We seek to mitigate these risks where possible.</td></tr>
<tr><td colspan="3">Principal Risk M: Difficulty in recruitment, retention and development of appropriate skills, which are required to deliver the Company's strategy</td></tr>
<tr><td colspan="2">2019 Net risk and direction: AMBER, STABLE</td><td>2018 Net risk and direction: AMBER, INCREASING</td></tr>
<tr><td>People and community

Failure to have a workforce of skilled and motivated individuals will detrimentally impact all of our strategic priorities.

We need the right people in the right places to share best practice, deliver on our customers' priorities and generate synergies (including through the Group's 'shared services' structure) to move the Company forward.</td><td>The Pennon Group's HR Strategy continues to be embedded across the organisation and a range of initiatives have been delivered during the year to attract, retain and develop our employees.

South West Water's Employee Engagement Forum provides opportunities for employees to regularly discuss business priorities and challenges with business leaders.

Mitigating actions have also been taken to reduce the potential impact of a Brexit 'no-deal' scenario on our workforce.

South West Water's apprenticeship programme also spans all areas of the business and has now seen a number of apprentices successfully attaining full-time roles following completion of their apprenticeships. Succession plans remain in place for key positions.</td><td>Whilst turnover of staff does occur, we ensure the appropriate skills and experience are in place with succession plans providing adequate resilience.</td></tr>
</table>

OPERATING PERFORMANCE (CONTINUED)

Principal Risk N: Non-delivery of regulatory outcomes and performance commitments		
2019 Net risk and direction: AMBER, INCREASING	**2018 N/A –** new risk introduced in line with a higher risk profile for the 2020-25 period	
Water Service People and community Environment Finance and economy South West Water's outcomes and performance commitments span all of our strategic focus areas. Non-delivery of these could result in financial penalties being applied as well as reputational damage.	The regulatory framework has been in place since 1 April 2015 and South West Water has delivered cumulative net ODI rewards of £11.3m. We are on track to meet all of our commitments by 2020. The risk reflects the significance of the ODI regime in the regulatory model. South West Water has the opportunity for reward but is also exposed to risk if performance commitments are not achieved. Following the South West Water 2020-25 business plan being awarded 'fast-track' status, we are already working on plans to deliver a 'step change' in operational performance as well as meeting our 2020 commitments.	We are committed to achieving all of our performance commitments over the length of each regulatory period. Where performance in an individual year falls below expectation we implement action plans and targeted interventions to ensure performance returns to committed levels.

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		
2019 Net risk and direction: GREEN, STABLE	**2018 Net risk and direction: GREEN, STABLE**	
Finance and economy Failure of our assets to cope with extreme weather conditions may lead increased costs and delays and detrimentally impact our ability to meet customers' needs, as well as environmental and reputational damage.	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 complimented by senior oversight and leadership. As a result of the financial challenges experienced by large contractors in the construction sector, there is a reduced appetite for large water and waste construction projects, resulting in a general lack of commercial tension. Regular monitoring is performed on the financial health of key contractors and supply chain partners. The Mayflower Water Treatment Works in Plymouth is now in the commissioning phase. The site will use new technology to provide high quality drinking water to customers in Plymouth in as efficient manner as possible. The project is a major investment for South West Water and forms part of the capital programme in the 2015-20 business plan.	South West Water's investment activities are taken on an informed basis with risks weighed against appropriate returns.

BUSINESS SYSTEMS AND CAPITAL INVESTMENT (CONTINUED)

<table>
<tr><th colspan="3">Principal Risk P: Failure of information technology systems, management and protection including cyber risks.</th></tr>
<tr><th colspan="2">2019 Net risk and direction: AMBER, INCREASING</th><th>2018 Net risk and direction: AMBER, INCREASING</th></tr>
<tr><td>Water

Service

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.</td><td>South West Water and the wider Group operate a mature and embedded governance framework over the business as usual IT environment as well as major project implementations aligned to the ISO27001 standards which South West Water has been certified under for several years and regular internal and external assessments are undertaken to maintain this accreditation.

Disaster recovery plans are in place for corporate and operational technology and these are regularly reviewed and tested.

Cyber threats continue to increase in volume and sophistication. These risks are mitigated by a strong information security framework aligned to guidance issued by the National Cyber Security Centre (NCSC).

A gap analysis of South West Water's drinking water operational technology cyber security controls has been undertaken against the requirements of the Network and Information Systems (NIS) directive utilising external expertise. The outcomes of this exercise have informed future actions where opportunities for further improvement exist.</td><td>We seek to minimise the risk of informational technology failure and cyber security threats to the lowest level without detrimentally impacting on business operations.</td></tr>
</table>

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, its longer-term strategy, the Board's risk appetite and the Company's principal risks and how these are managed, as detailed on pages 35 to 37 of the Risk Report. South West Water is a long-term business characterised by a multi-year investment programme, with an associated revenue stream.

The Company's strategic business plan and associated principal risks are a 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 viability.

Over the course of the year the Audit Committee has considered a deep-dive review of the following principal risks to enable a thorough assessment of the impact of these risks on ongoing viability:

Principal risk	Matters considered by the Audit Committee
Capital projects	Review of the performance of large capital projects
Operational challenges	Ability of South West Water to maintain network resilience in extreme scenarios
Business resilience	A review of business continuity and planning

In stress testing the Company's business plan it was determined that none of the individual risks would in isolation compromise the Company's viability. In performing this stress testing all risks have been monetised with reference to risk weighting, factoring in the likelihood of occurrence and financial impact. In addition, further factors were considered to reverse engineer a scenario that could possibly compromise South West Water's viability, these included:

- all the principal risks occurring in all of the years up to 2030
- lower retail price index (RPI) projections in each of the years up to 2030
- significant one-off costs
- a deterioration in the credit quality of amounts owed to the Company

The four factors above, which are in addition to the principal risks, have been monetised as absolute financial costs and are not risk weighted on likelihood of occurrence.

The Board considered the monetary impact of these scenarios on the Company's viability up to the end of 2030, concluding the reversed engineered scenario remote. The period was chosen given the longer-term nature of South West Water's business, to include the next two regulatory periods 2020-25 and 2025-30.

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
- One-off financial penalty of 1% of revenue.

The Directors concluded 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 making the assessment, the Directors have taken account of the Company's robust capital solvency position, 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 pages 72 to 80, the Directors 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 30, 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 30 was approved by the Board on 4 June 2019.

By Order of the Board

C Loughlin
Managing Director (Interim)
4 June 2019

GOVERNANCE AND REMUNERATION

CONTENTS

CHAIRMAN'S LETTER

I am pleased to introduce the corporate governance report for 2019 on behalf of the Board. This is the principal method of reporting on the Board's governance policies and the practical 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 the Pennon Chief Executive Officer as well as certain Pennon Non-Executive Directors and three South West Water only 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 57.

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.

We actively engage with all our stakeholders including our customers, our communities, our people and our suppliers, our regulators and other stakeholders and maintain appropriate and regular dialogue with those stakeholders to ensure that the rationale for our strategy and our performance objectives reflects their expectations. It also allows stakeholders to provide feedback on the matters they consider to be important and any issues which require addressing. Further detail on stakeholder engagement is contained on pages 20 to 23 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 April 2016 version of the Code. We are mindful of the more recent 2018 version of the Code, but will report more fully in our 2019/20 annual report.

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 71 alongside any additional mitigations deemed necessary.

In addition, South West Water has complied with Ofwat's principles in respect of Board leadership, transparency and governance and our parent company, Pennon Group plc, has complied with Ofwat's principles for Holding Companies.

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 109 and 110 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 2018/19 financial year comprises the Chairman (a Non-Executive Director), our Senior Independent Director (a Non-Executive Director), two Executive Directors, four further Independent Non-Executive Directors and the Pennon Group Chief Executive as a Non-Independent Non-Executive Director. In addition Susan Davy, Pennon Group Chief Financial Officer and Iain Evans, a Pennon Non-Executive Director, attend the South West Water Board. The Board considers the Non-Executive Directors (with the exception of Chris Loughlin who is Chief Executive Officer of Pennon Group plc) 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. During the year, changes to the structure of the Board have occurred as set out on pages 59 to 60.

Sir John Parker Chairman
Appointment Sir John was appointed to the South West Water Board on 31 July 2015. He became Chairman of South West Water on 1 August 2015 and is also Chairman of Pennon Group plc. He is also Chairman of the Nomination Committee.
Skills and experience Sir John is a highly experienced and independent Chairman and brings a wealth of leadership experience across a range of industries. He is widely recognised for his policy work on the value of diversity in the boardroom, having chaired the Government's review on Ethnic Diversity on UK Boards in 2017. Prior to that, he was a member of the Davies Committee – Women on Boards. He has chaired five 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, Deputy Chairman of DP World, joint chair of Mondi and chair of BVT and P&O plc. He was also president of the Royal Academy of Engineering from 2011 to 2014 and is a Visiting Fellow of the University of Oxford.
External appointments Sir John is the Chairman of construction and engineering company Laing O'Rourke. He is also a Non-Executive Director of Carnival Corporation and is a senior adviser to Spencer Stuart.

Chris Loughlin Pennon Group Chief Executive Officer – Non-Independent Non-Executive Director. Currently Managing Director (Interim) SWW
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. Chris is a member of the Sustainability Committee. He is currently Interim Managing Director of South West Water after the passing of Stephen Bird.
Skills and experience Chris has extensive experience of the regulated business environment and the management of major engineering and infrastructure services. He started his career as a chartered engineer working in both the consulting and contracting sectors and, after holding a number of senior positions with British Nuclear Fuels plc, joined its board as an Executive Director. Prior to joining Pennon he was Chief Operating Officer with Lloyds Register and before that Executive Chairman of Magnox Electric plc. He was also a senior diplomat in the British Embassy, Tokyo. Chris has a comprehensive understanding of the water industry. He was previously a board member (and, for a period, president) of the Institute of Water, and between April 2008 and March 2012 was Chairman of Water UK. An enthusiastic advocate of local business, Chris was previously the Vice-Chairman of the Cornwall Local Enterprise Partnership. Since his appointment as Group Chief Executive Officer, Chris has set Pennon on a path of closer collaboration in pursuit of delivery of its strategy, with the constituent parts of the Group now working together to identify synergies, reduce costs and exploit opportunities for growth.
External appointments Chris is currently Chairman of British Water, a director of Water UK and a Director and Trustee of Reall.

Dr Stephen Bird Managing Director
Appointment Stephen was appointed to the Board on 1 March 2000 and was appointed to the position of Managing Director of South West Water on 1 January 2016. On 10 May 2019, Stephen sadly passed away.
Skills and experience Prior to joining South West Water, Stephen held posts in the Welsh Water Authority, National Rivers Authority and Wallace Evans Consultants as an environmental consultant. He was a Fellow of the Chartered Institute of Environmental Managers, fellow of the Institute of Directors and held an MBA.
External appointments Stephen was Director of the Heart of the South West Local Enterprise Partnership and a member of Water UK Council.

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 the Prince of Wales' Accounting for Sustainability's Finance Culture Project. She is also a Non-Executive Director 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 and 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, Director of the Gas Safety Trust 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.
External appointments Martin is an Independent Member of the Audit and Risk Assurance Committee of the Department for Work and Pensions, a Governor and Audit Committee Chair of UWE Bristol and a Board Member and Chair of 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 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 Sustainability Committee and a member of the Audit, Remuneration and Nomination 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 and government. 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, a Non-Executive Director of De La Rue plc and Chair of the council of the University of Southampton. At Accenture she chaired the global corporate responsibility and Foundation giving programme and was instrumental in building sustainability objectives into Accenture's worldwide human capital strategies. 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 currently holds Non-Executive Directorships with Charles Taylor plc, where she is Senior Independent Director, and Intertek Group plc. She is Chairman of both their remuneration committees.

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 and Regulatory 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.

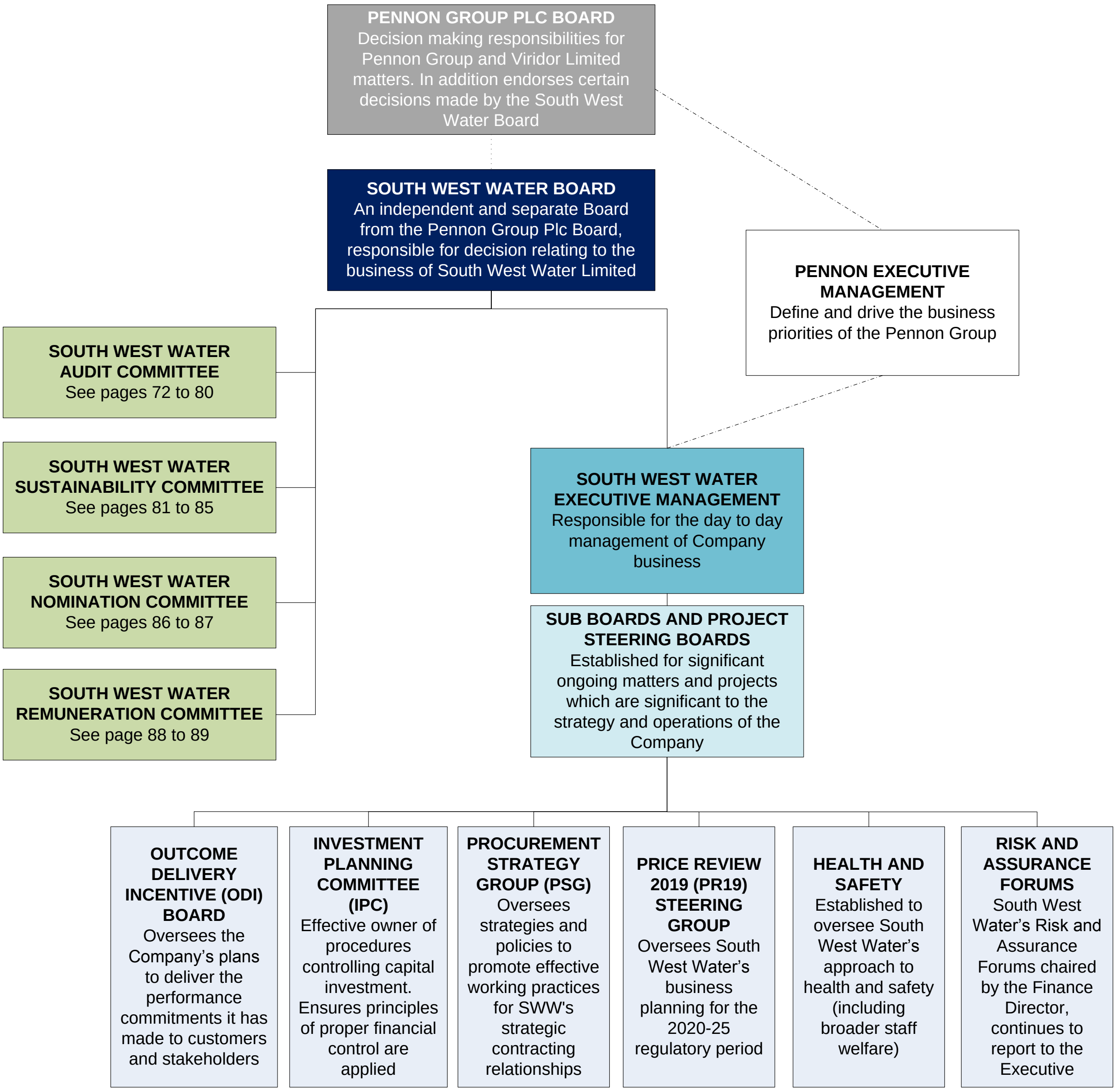
Iain Evans Pennon Group Independent Non-Executive Director
Skills and experience Iain was appointed to the Pennon Board in 1 September 2018. He is Chairman of the Sustainability Committee for South West Water. Iain has 40 years of extensive global experience in advising companies and governments on issues 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 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 acts as an independent corporate strategy consultant.

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 for holding companies 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 70 to 71, 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 Pennon Chief Executive, three 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 54 to 89.

SOUTH WEST WATER BOARD COMPOSITION 2018/19

NAME	POSITION	OTHER GROUP DIRECTORSHIPS	DATES IN POST	OTHER NOTES
Sir John Parker	Chairman	Pennon Group Plc Chairman	1 April 2018 to 31 March 2019 inclusive	None
Lord Matthew Taylor	Senior Independent Non-Executive Director	None	1 April 2018 to 31 March 2019 inclusive	None
Martin Hagen	Independent Non-Executive Director	None	1 April 2018 to 31 March 2019 inclusive	None

NAME	POSITION	OTHER GROUP DIRECTORSHIPS	DATES IN POST	OTHER NOTES
Jon Butterworth	Independent Non-Executive Director	None	1 April 2018 to 31 March 2019 inclusive	None
Gill Rider	Independent Non-Executive Director	Pennon Group Plc Independent Non-Executive Director	1 April 2018 to 31 March 2019 inclusive	None
Neil Cooper	Independent Non-Executive Director	Pennon Group Plc Independent Non-Executive Director	1 April 2018 to 31 March 2019 inclusive	None
Iain Evans	Independent Non-Executive Director	Pennon Group Plc Independent Non-Executive Director	1 September 2018 to 27 March 2019 inclusive	In attendance following 27 March 2019
Martin Angle	Independent Non-Executive Director	Pennon Group Plc Independent Non-Executive Director	1 April 2018 to 31 December 2019 inclusive	Stepped down from the Board on 31 December 2018
Chris Loughlin	Non-Independent Non-Executive Director	Pennon Group Plc CEO	1 April 2018 to 31 March 2019 inclusive	Assumed role of Interim Managing Director of SWW on Stephen Bird's death on 10 May 2019
Stephen Bird	Managing Director	None	1 April 2018 to 31 March 2019 inclusive	Passed away 10 May 2019
Louise Rowe	Finance Director	None	1 April 2018 to 31 March 2019 inclusive	None
Susan Davy	None	Pennon Group Plc Chief Financial Officer	N/A	In attendance

PENNON EXECUTIVE MANAGEMENT

The role of the Pennon Executive is to define and drive the business priorities that will achieve delivery of the strategy. It is responsible for ensuring, to the extent of the authority delegated by the Board, the proper and prudent management of Group resources to create and maximise shareholder value whilst protecting the interests of the wider stakeholder group.

Chaired by the Pennon Chief Executive Officer, the Pennon Executive meets formally on a monthly basis to review and refine recommendations to be presented to both the Pennon and, where applicable, the South West Water Boards. Members of the Pennon Executive in 2018/19 were:

- Chris Loughlin, Pennon Group Chief Executive Officer
- Susan Davy, Pennon Group Chief Financial Officer
- Stephen Bird*, South West Water Managing Director
- Phil Piddington, Viridor Managing Director
- Simon Pugsley, Pennon Group General Counsel & Company Secretary

- Adele Barker, Pennon Group Director of Human Resources
- Steve Holmes, Pennon Group Director of Health, Safety, Security, Assurance (HSSA)
- Ed Mitchell, Pennon Group Director of Environment and South West Water Operations Director (Wastewater Services)
- Sarah Heald, Pennon Group Director of Corporate Affairs & Investor Relations
- Paul Ringham, Viridor Commercial Director

* Current arrangements following the passing of Stephen Bird on 10 May 2019 are, as at the date of this report, set out on pages 59 to 60.

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 comprised Dr Stephen Bird (Managing Director) and Louise Rowe (Finance Director), who were also members of South West Water's Board and whose experience is described on page 55. 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 (Interim)
- Ed Mitchell – Operations Director (Wastewater Services)
- Iain Vosper – Operations Director (Drinking Water Services)

Group support functions in attendance:

- Kevin Nankivell – Head of IT
- Helen Moss – Head of HR (South West Water)

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 2019 (www.southwestwater.co.uk/report2019).

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

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.

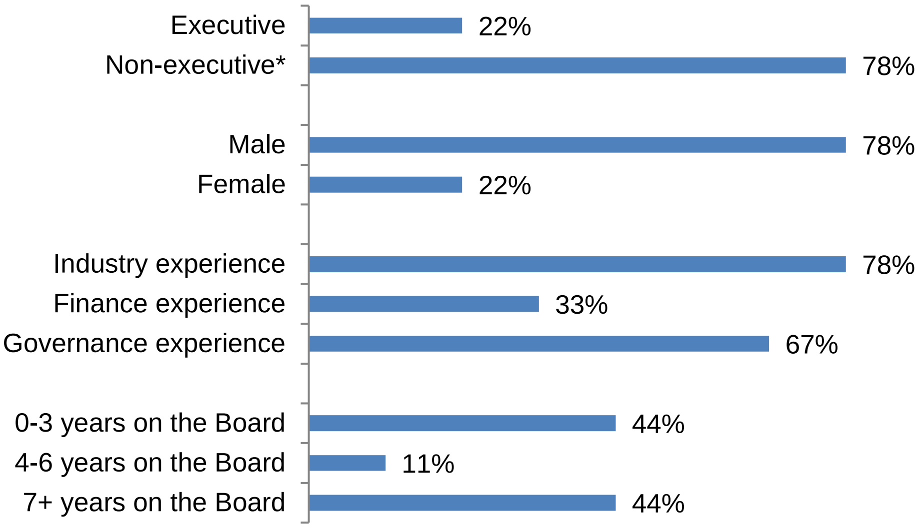
VISION AND VALUES

Our vision of 'Bringing resources to life' and 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 2019)



* including the Chairman and Pennon Group Chief Executive Officer

All of the Non-Executive Directors were considered by the Board to be independent throughout the year (except for Chris Loughlin who is the Chief Executive Officer of Pennon Group plc). None of the relationships or circumstances set out in provision B.1.1 of the UK Corporate Governance Code (the UK Code) applied to the Non-Executive Directors listed on page 105.

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 A.3.1 of the UK Code. At that time, the Board concluded that none of the conditions set out in provision B.1.1 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 B.7.1 of the UK Code. At year end, the Board had 22% female representation, which is less than its 33% female representation target. Further details of gender diversity within the Company are described on page 17 and page 87.

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 54 to 57 and the experience chart on page 63 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 56).

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	• 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	Dr Stephen Bird(1)	• 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	• 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	• 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-Independent Non-Executive Director	Chris Loughlin(2)	• In conjunction with the Managing Director, propose and develop strategy and commercial objectives for consideration by the Board
Non-Executive Directors	Jon Butterworth Martin Hagen Neil Cooper Gill Rider Martin Angle(3)	• Critically reviewing the strategies proposed for the Group • 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

(1) Passed away on 10 May 2019
(2) Has taken on Managing Director (Interim) SWW role from 10 May 2019
(3) Stepped down from the Board on 31 December 2018, attendance includes only meetings during his appointment

BOARD MEMBERSHIP AND ATTENDANCE

The Directors and their attendance at the eight scheduled meetings of the Board during 2018/19 are as follows:

Board membership		Attendance [1]
Chairman		
Sir John Parker	Chairman	6/8
Executive Directors		
Dr Stephen Bird	Managing Director	8/8
Louise Rowe	Finance Director	8/8
Senior Independent Director		
Lord Matthew Taylor	Independent Non-Executive Director	8/8
Non-executive Directors		
Jon Butterworth	Independent Non-Executive Director	8/8
Martin Hagen	Independent Non-Executive Director	8/8
Neil Cooper	Independent Non-Executive Director	8/8
Gill Rider	Independent Non-Executive Director	8/8
Chris Loughlin	Non-Independent Non-Executive Director	8/8
Martin Angle[2]	Independent Non-Executive Director	6/6
In attendance		
Susan Davy	Pennon Group Financial Officer	8/8
Iain Evans[3]	Pennon Group Independent Non-Executive Director	2/3

(1) Sir John Parker missed two meetings during the year due to medical treatment. Lord Taylor chaired the meetings in his absence
(2) Stepped down from the Board on 31 December 2018
(3) Attendance includes only meetings since his appointment on 1 September 2018 and prior to his resignation on 27 March 2019.

In addition to the eight 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 principles on board leadership, transparency and governance.

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 the 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 business plan, annual budgets and certain decisions relating to financing. This approach is compatible with Ofwat's principles for holding companies in respect of Board leadership, transparency and governance.

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 takes into account the impact 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 60 to 61 and within the South West Water Annual Performance Report and Regulatory Reporting, published in July 2019 (www.southwestwater.co.uk/report2019).

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 Group structure, regulatory and legal issues impacting the Company, the Group governance framework and policies, the 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 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.

PERFORMANCE EVALUATION

The Board undertakes a formal and rigorous review of its performance and that of its Committees and Directors each year. Having carried out an externally facilitated evaluation in 2017, this year the evaluation was again carried out by means of an internally facilitated on-line questionnaire. The questions were designed to assess the effectiveness of the Board and its Committees, considering a wide range of issues including strategy, culture and values, obligations to stakeholders, including Group shareholders, overseeing the use of resources, managing the risks inherent in the strategy, plans and the operating environment, and reviewing the general operations of the Board and its Committees. The performance and effectiveness of the Chairman and Board members was also considered.

The results of the review were discussed at a meeting of the Board and at meetings of each of its committees. It concluded that the Board, its Committees and its individual Directors had demonstrated a high degree of effectiveness and that there was a good understanding of opportunities for growth and the threats facing the business. The review also confirmed that the Board fully understood its role in setting South West Water's values and standards to ensure that its obligations to its stakeholders are met.

The Board's commitment to promoting a strong health and safety culture across the Company was noted. Areas for specific focus for 2019 were identified as including succession planning, diversity and the ongoing training and development needs of directors. It is expected that, in 2020, an external evaluation exercise will be undertaken using an external consultancy with no other connection to the Company and this will be reported on in next year's Annual Report.

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 72 to 89 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.

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 2018/19 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 31 to 34 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 and safety, climate change and tax compliance. Details of the key risks affecting the Company are set out in the strategic report (pages 35 to 48).

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 91 to 92). 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 southwestwater.co.uk/report2019).

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 35 to 48.

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 clearly prohibits any employee from offering or accepting bribes, facilitation payments and kickbacks and requires that due diligence checks be carried out before engaging a third party (including a corruption risk assessment including potential business partners of the third party and the nature of the proposed work and transaction). The policy also sets out the employment consequences for breach of the policy and potential legal sanctions under bribery laws. The policy places an obligation on employees to report any breach of the policy or any suspicions of fraud or other irregularities. The whistleblowing policy ('Speak Up') encourages employees to raise concerns and explains how this should be done.

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 250 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.

In response to, and in accordance with Ofwat's 'Board leadership, transparency and governance – principles' (January 2014) and the timetable for meeting those principles, South West Water adopted its own Board leadership, transparency and governance Code (31 March 2014) which sets out how South West Water complies with the Ofwat principles.

The South West Water Code states that the Company will comply with the UK Corporate Governance 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.

INDEPENDENCE OF THE CHAIRMAN

Sir John Parker was considered to be independent at the time of his appointment, in accordance with provision A.3.1 of the Code. At that time, the Board concluded that none of the criteria set out in Provision B.1.1 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 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.

SENIOR INDEPENDENT DIRECTOR

Lord Matthew Taylor is the Senior Independent Director ('SID') for South West Water. Matthew has been a Non-Executive Director of South West Water since 2010 and as SID, provides a sounding board the Chairman and other Directors. He is not a Director of Pennon Group plc and is available to South West Water's stakeholders to discuss any concerns raised.

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.

Provisions C.3.2, C.3.7 of the UK Code state 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 C.3.2 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 C.3.8. 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 D.2.2. 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

Committee members – and the Board as a whole – share a common view of the importance of the Audit Committee as a foundation stone in the governance armoury of the Company and we welcome the opportunity to outline our key activities during the year.

The principal responsibilities of the Committee continue to be focused on three key areas:

- ensuring the appropriateness of the Company's financial reporting; an activity that includes the 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; and
- 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 the calendar of business of the Committee, which is designed to allow sufficient time for their consideration whilst 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 level Risk and Assurance Forum structure continues to assess risk appetite and monitor key risks and their mitigation. The Group's executive risk management forum also oversees risk management, with the Audit Committee subsequently receiving detailed 'deep dive' presentations from senior management on areas impacting our principal risks. During the year, these covered a range of topics including South West Water projects, South West Water network resilience, impacts of a no-deal Brexit and business resilience & business continuity. More detail on our risk management processes, principal risks and their associated mitigation can be found on pages 35 to 48.

Together with this risk-oriented activity, we continue to assess the Company's viability to the end of 2030, which we judge to be aligned with the longer-term nature of our business. Our viability statement is reported on page 49.

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 75. 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.

Finally, during the year the Pennon Group 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 South West Water Audit Committee receives reports from the Pennon Group Director of Risk and Assurance.

SOUTH WEST WATER AUDIT COMMITTEE COMPOSITION AND MEETINGS

Four 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	4/4
Lord Matthew Taylor	Non-Executive Director	4/4
Martin Hagen	Non-Executive Director	4/4
Gill Rider	Non-Executive Director	4/4
Martin Angle(1)	Non-Executive Director	3/3
Iain Evans(2)	Non-Executive Director	3/3

(1) Stepped down from the Board on 31 December 2018
(2) Attendance includes only meetings since his appointment on 1 September 2018 and prior to his resignation on 27 March 2019

Other regular attendees to South West Water Audit Committee meetings during the year included:

- Pennon Group Chief Executive Officer (a member of the South West Water Board)
- Pennon Group Chief Financial Officer
- South West Water Managing Director
- South West Water Finance Director
- Pennon Group Director of Treasury, Tax and Group Finance
- Pennon Group Director of Risk and Assurance
- Pennon Group General Counsel & Company Secretary
- Statutory external financial auditor

In addition, the Board Chairman has an open invitation to attend the Committee meetings. In the last year he attended 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 has recent and relevant financial experience and has competence in accounting. The Board is also satisfied that the Committee, as a whole, has competence relevant to the sectors in which the Company operates. Details of each Director's significant current and prior appointments are set out on pages 54 to 57.

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 Company 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 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 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:

Financial reporting	• Monitored the integrity of the financial statements of the Company and the half year and full year results including reviewing and discussing significant financial reporting judgements contained in the statements • After a detailed review in accordance with its established process, advised the Board that the presentation of the Annual Report and Financial Statements is fair, balanced and understandable in accordance with the reporting requirements and recommended their approval for publication • Internal control and compliance • Review of internal audit reports on core systems and processes within South West Water, for example assurance work on data submissions for Ofwat as part of PR19 and financial controls.
External auditor	• Considered the statutory financial auditor's report on its review of the annual results focusing on key findings • Assessed external auditor effectiveness in respect of the previous year's external audit process • Monitored the provision of non-audit services • Considered and approved the audit plan for the statutory financial auditor • Considered the statutory financial auditor's report on control themes and observations for the year ended 31 March 2018, which did not identify any significant deficiencies 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 83 to 86).
Risk management	• Reviewed the risk management framework and compliance with that framework during the year and after the year-end 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's 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	• Discussed the results of the performance evaluation of the Committee • Reviewed new annual report disclosure requirements including the audit report • Considered and approved accounting policies used in the preparation of the financial statements • Confirmed compliance with South West Water's Code • Regularly held meetings with the external auditor and the Pennon 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 2019 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 111 to 118. 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: The areas of judgement for South West Water continue to be in respect of revenue recognition relating to income from measured water services and estimates of timing of receipt of unmeasured revenue, accounting for revenue. The Committee relied on South West Water’s detailed assessment of water into supply and its track record of assessing an appropriate level of accrual at previous period ends as compared to invoiced revenue. The Committee also loosely 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. In addition, the Committee focused particularly on the implementation of IFRS 15 ‘revenue’ from 1 April 2018, with new judgements required in relation to the classification of revenue for the disaggregation note to the financial statements. The Committee reviewed and discussed management’s paper which had been prepared in conjunction with expert advice and, after modest changes following that discussion, was satisfied the new disclosures were appropriate.

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. 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 was reasonable. The committee noted that the detailed approach applied by management was consistent with the requires of the IFRS 9 effective 1 April which requires the consideration of expected credit loss.

Area of focus by the Committee: Valuation of property, plant and equipment (PPE)
How the matter was addressed by the Committee: Regular updates on progress of the capital investment schemes are received by the Board. The valuation of PPE has been applied consistently and benchmarking of asset lives is considered annually. At the year end the statutory financial auditor reported on the work it had performed, which together with the detailed analysis reported enabled the Committee to conclude that the management’s assessment of the year-end position 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 separately, including forward-looking assessments of covenant compliance and funding levels under differing 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 better enable the committee to 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 Company’s liquidity over the 12-month period from the date of signing either the annual report or half-year results. The Committee has also considered a report from the Finance

Area of focus by the Committee: Going concern basis for the preparation of the financial statements and viability statement
Director and Pennon 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 new UK Corporate Governance Code and Ofwat's requirement for a viability statement to be given by the Board. 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 49 to 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 Financial Reporting Council's ('FRC') Ethical Standard and ensure that our procedures and safeguards meet these standards.

The current external statutory financial auditor, Ernst & Young LLP (EY), was appointed following a comprehensive audit tender process undertaken by Pennon Group plc and approval by shareholders at the Pennon Group plc 2014 AGM. Their reappointment was approved at the 2018 Pennon Group plc Annual General Meeting. Debbie O'Hanlon is the audit partner and has been in that role for five years since Ernst & Young's appointment, and consequently will be rotating off from the Pennon audit. EY have put forward appropriate replacements who have met with committee members and management and have shadowed Debbie through her final year on the Pennon audit to ensure a smooth transition going into next year's audit. The Committee would like to thank Debbie for her valuable input to the committee over the past five years.

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 and 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 Pennon Audit and South West Water Audit Committees' annual performance evaluation. Further details of the performance evaluation are provided on page 67. No issues were raised during that review and the Committees concluded that the auditor was effective during the year. The Pennon Group Audit Committee is responsible for matters relating to appointment and re-appointment of external auditor. It considered that it is appropriate for the external auditor to be re-appointed and has made this recommendation to the Pennon Group Board. The Committee Chairman has also met privately with the statutory financial 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 36.9% of the audit fee, which is well within the Company's 70% non-audit fee limit. The percentage is higher than the previous year due to a limited amount of financial assurance work in respect of the Company's PR19 business plan being deemed necessary to be performed by the Company's statutory auditor. The majority of financial assurance work in respect of the business plan was performed by other specialists.

The Pennon Chief Financial Officer regularly reports to the Committee on the extent of services provided to the Company by the external auditor and the level of fees paid. The fees paid to the external auditor's firm for non-audit services and for audit services are set out in note 7 to the financial statements on page 134.

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 level which makes a significant contribution to the ability of the Committee to deliver its responsibilities.

During the year, 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 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 function was last performed by KPMG LLP in 2016 and concluded that the Company's internal audit function conforms to 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 and Accounts is fair, balanced and understandable (FBU) on page 109, 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 and 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 111 to 118.

In preparing and finalising the 2019 Annual Report and 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 Executive Management. This assisted the Committee in carrying out its own assessment and being able to advise the Board that it considered that the Annual Report and 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.

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 is implementing a programme of activity, including an internal audit programme which commenced in April 2018, aiming to achieve certification to the new ISO45001:2018 'Occupational health and safety' standard in 2019.

OFWAT COMPANY MONITORING FRAMEWORK

The water industry regulator, Ofwat, introduced a 'company monitoring framework' as a tool to oversee that customers and other stakeholders have confidence in the information that water companies report. The framework covers both data assurance activities and wider assurance that companies perform to demonstrate they are listening to customers and other stakeholders and delivering services customers want and can afford.

Companies are assessed in one of three categories, 'self assurance,' 'targeted assurance' or 'prescribed assurance,' which determine additional requirements that are required by companies to ensure trust and confidence is maintained for customers and other stakeholders.

In January 2019, following Ofwat's assessment of the 2018/19 reporting cycle, South West Water was classified within the 'targeted assurance' category as it had been at the previous assessment.

South West Water South West Water will work to ensure continual improvement in its presentation of information which we report. Further information on improvements we are making in respect of the Company Monitoring Framework will be published in July within the Company's Annual Performance Report (www.southwestwater.co.uk/report2019).

SOUTH WEST WATER'S 2018/19 SUMMARY ASSURANCE REPORT

In July 2019, South West Water will publish its third 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/report2019.

THE SUSTAINABILITY COMMITTEE

We are pleased to report on the Sustainability Committee's activities during the year, and would particularly like to thank Gill Rider, who stood down as Sustainability Chair, for her work in the role up until December 2018. We are delighted to have retained Gill's experience and expertise on the committee.

Our refreshed Sustainability Strategy ensures alignment and integration with the business, people and health and safety strategies. With clear objectives, targets and implementation plans identified throughout the organisation, we are confident that we will be able to ensure that our services bring resources to life, responsibly, for customers and communities now and in the long-term.

The role of the Sustainability Committee is to oversee the delivery of strategic sustainability objectives and to ensure robust scrutiny of key aspects of environmental, social and governance performance. This year we have reviewed and approved refreshed strategic objectives, within an ESG framework, to add value and resilience to our business. These are set out on page 6.

In the development of our new strategy we tested thoroughly the materiality of our areas of focus and consulted a cross-section of our key stakeholders. Group-wide three-year sustainability targets aligned with the new strategy have also been established as an effective way of monitoring performance against our objectives in the focus areas most materially relevant to the business and our stakeholders. Progress and performance will be clearly reported on going forward.

We have also assessed and aligned our objectives and targets against the most relevant of the United Nations Sustainable Development Goals (SDGs) and will increasingly monitor our performance using the SDGs.

A strong performance against these SDGs and our own sustainability objectives, ensures high standards of corporate responsibility for the benefit of all our stakeholders – our customers and communities, our people, suppliers and regulators, and our investors.

This annual report provides an integrated assessment to show how a responsible approach to sustainability helps us to balance the immediate and longer-term needs of society with the delivery of sustained commercial success.

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(1)	Chairman	3/3
Gill Rider	Non-Executive Director	4/4
Stephen Bird	Managing Director	4/4
Lord Matthew Taylor	Non-Executive Director	4/4
Jon Butterworth	Non-Executive Director	4/4
Chris Loughlin	Non-Executive Director	4/4
Martin Angle(2)	Non-Executive Director	3/3

(1) Iain Evans resigned from the South West Water Board on 27 March 2019. In order to ensure consistency with the Pennon Group Sustainability Committee, it was agreed that Iain Evans, formerly a director of the Company, would remain as Chairman of the SWW Sustainability Committee from 1 January 2019

(2) Stepped down from the Board on 31 December 2018

The Sustainability Committee assesses South West Water's performance against its approved sustainability targets that are set as part of the business planning process. Progress is reported to the Committee throughout the year. These targets are key to the successful delivery of South West Water's K6 Business Plan 2015-20.

The Committee ensures challenging targets are set and approved. As at 31 March 2019 South West Water had achieved 7 of its 12 targets for the year. Full details of the sustainability performance against these targets is shown on page 84.

During the year the Committee continued to work closely within the best practice framework developed by Business in the Community (BITC), a leading business-led charity promoting responsible business. South West Water was pleased to be part of the Pennon Group-wide participation as a pioneer company in trialling BITC's new Responsible Business Tracker during 2018 and will use the results to further inform its own community benefit programmes contributing to social capital gain.

The Sustainability Committee aims to ensure a transparent approach to conducting business in a responsible manner, within a business focussed on delivering robust financial performance and sustainable value for 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, well-being 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 2018/19, 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 and safety performance and the effectiveness of health and safety policies and procedures, including the continued rollout of the HomeSafe programme
- environmental strategy and performance
- performance in respect of customer service, satisfaction and engagement
- the Company's approach to community relations, community benefit and investment
- performance against our workplace policy, within the Group-wide People Strategy, including South West Water's results in the latest Group-wide employee engagement survey
- sustainable supply chain procurement and practices, including a new Supplier Code of Practice
- sustainability reporting and disclosures for 2018/19 and the associated verifier's reports and recommendations
- progress against the sustainability targets for 2018/19 and sustainability targets for 2020-23
- materiality and refreshed sustainability strategy

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 southwestwater.co.uk/report2019).

BENCHMARKING

The Pennon Group (including South West Water) is a constituent of the FTSE4Good Index and a number of other leading external ESG assessments. FTSE4Good is an equity index series that is designed to facilitate investment in companies that meet globally recognised corporate responsibility standards. Companies in the FTSE4Good Index Series have met stringent environmental, social and governance criteria, and are positioned 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 7)
- Business model (page 12)
- Strategic priorities (page 6)
- Our people (pages 15 to 18)
- Our operations (pages 19 to 23)
- Sustainability targets (pages 84 and 85)

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/report2019, published in July.

SUSTAINABILITY TARGETS

A summary of South West Water's performance against sustainability targets for 2018/19 is outlined in the following report. South West Water is making good progress against its targets and it aims to meet all targets by the end of the regulatory reporting period (2015-20).

ENVIRONMENTAL SUSTAINABILITY

The protection of the environment is an essential aspect of ensuring that we have high quality resources available now and in the future. By working alongside partner organisations and agencies and identifying how new technology and innovation can reduce our impact we aim to deliver water and wastewater services in harmony with the ecosystems and habitats of our region.

Target	Status
To ensure the average time taken to fix significant customer reported leaks is less than 2.0 days	NOT MET(1)
To achieve zero Category 1 and 2 pollution incidents which are our responsibility from waste water assets	NOT MET(2)
To increase the number of farms that have an agreed plan to benefit the environment and the acres of farmland under revised management plans and delivering environmental outcomes in line with our Business Plans	MET

(1) The average time taken to fix significant leaks can be significantly impacted by weather conditions and this measure has risen in the year as a result of the extreme cold weather in March 2018 and the long dry Summer. We believe with the continued implementation of new technology, especially with a focus on leak detection in urban areas, South West Water remains on track to meet its 2020 target.

(2) Regrettably South West Water failed to meet its target for zero Category 1 or 2 pollutions from wastewater assets, although the number reduced year on year. South West Water has implemented a targeted strategy to reduce the number of pollutions from wastewater assets such as using additional vehicles and equipment for sewer monitoring and cleaning. We remain committed to reaching our 2020 targets in respect of pollution incidents.

COMMUNITY SUSTAINABILITY

As the providers of an essential service we have a responsibility and vested interest in understanding and meeting the needs of the various communities across the area we serve. It is our aim to be a 'good neighbour', having a positive effect on our local communities and the quality of life that they enjoy.

Target	Status
To minimise our supply interruptions to customers and ensure that they do not exceed 0.214 hours per property	MET
To increase the number of customers assisted through our water affordability initiatives in line with our Business Plans (to over 29,000)	MET
To invest at least £80,000 in the local community through sponsorship and charitable donations during the year and measure benefits this investment has delivered	MET

WORKPLACE SUSTAINABILITY

Engaged staff are critical to the success of the Company. Colleagues who are more engaged feel safer, are involved in fewer accidents at work, take fewer days off sick and receive more positive feedback from customers. Put simply, working to improve engagement is a key part of working to improve overall performance and sustainability.

Target	**Status**
To achieve employee satisfaction of 79% as measured in our annual survey	NOT MET(1)
Our desire is to have no accidents at work and to achieve a reducing lost time accident frequency rate	MET
To have extended the recruitment of apprentices on our programme by the end of 2018/19 to over 110	MET

(1) Employee satisfaction, as measured by our annual employee survey rose slightly in the year to 77%, but did not reach the target of 79%. The survey however identified clear strengths in communication and involvement, trust, diversity and empowerment and accountability as well as strong health and safety results. It also revealed areas requiring further work. These include continuing to ensure our people understand our strategy and direction, as well as maintaining focus on embedding our values into everything we do, while recognising the contribution made by our employees.

MARKETPLACE / CUSTOMER SUSTAINABILITY

Our ultimate goal is to provide our customers with the highest standards of service, ensuring that their requests, problems and queries are dealt with first time and that the service they receive represents value for money. In turn, this helps South West Water to build a solid reputation for high quality customer service, which contributes to the creation of shareholder value.

Target	**Status**
To achieve an average of 90% of our customers being satisfied or very satisfied with our overall services	MET
To achieve an average of 80% of our customers being satisfied with the value for money of our services	NOT MET(1)
To ensure our water and wastewater activities are emitting a reduced level of greenhouse gas compared to 2014/15 in line with our business plan	NOT MET(2)

(1) Although customer satisfaction with value for money improved in the year to 62% (our highest ever level), it did not meet our challenging target of 80%. We continue to pledge to ensure that any rise in average household bills will remain less than inflation (as measured by the Retail Prices Index) over the 2015-20 period.

(2) Although we did not meet our target in respect of greenhouse gases produced in water activities, we met our target for wastewater activities and met the targets on a combined basis. We remain committed to our 2020 targets in respect of greenhouse gas emissions.

SOUTH WEST WATER'S ANNUAL PERFORMANCE REPORT AND REGULATORY REPORTING

Each of the above benchmarks chosen as our sustainability targets are also reported within our Annual Performance Report and Regulatory Reporting as either 'performance commitments' in respect of 'outcomes' specified in our 2015-20 regulatory business plan or as separate internal Key Performance Indicators.

South West Water's Annual Performance Report and Regulatory Reporting will be published in July 2019 and available at www.southwestwater.co.uk/report2019.

THE NOMINATION COMMITTEE

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

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 resulting in the following changes:
    - The extension of Sir John Parker's appointment as Chairman of South West Water from 1 August 2018 into his second term
    - The extension of Gill Rider's appointment as a Non-Executive Director of South West Water from 1 September 2018 into her third term. Gill was also appointed to the role of Remuneration Committee Chair from 1 January 2019
    - 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 Group's gender pay disclosure for 2018 and ongoing action plan

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. Hendrick & Struggles has no other connection to the Company.

NOMINATION COMMITTEE COMPOSITION AND MEETINGS

Director	**Role**	**Attendance**
Sir John Parker(1)	Chairman	2/3
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
Martin Angle(2)	Non-Executive Director	2/2
Iain Evans(3)	Non-Executive Director	2/2

(1) Sir John Parker unfortunately missed the May 2018 meeting due to medical treatment. Gill Rider chaired the May Committee meeting in Sir John's absence

(2) Stepped down from the Board on 31 December 2018

(3) Includes only meetings since his appointment on 1 September 2018 and prior to his resignation on 27 March 2019.

The Pennon Group Chief Executive (a member of the South West Water Board) also attends meetings when invited alongside the Group General Counsel & Company Secretary and the Pennon Group HR Director.

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 content of the 2018 UK Corporate Code and 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.

As disclosed on page 17, the percentage of female representation within the Board and the Company's senior management team is below the target set. 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 17.

In support of this aim, our Chairman is a member 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.

The Committee and the Board will continue to monitor and promote diversity across the Group with the aim of ensuring a diverse pipeline for succession to Board and senior management positions in accordance with our Diversity, Respect and Inclusion Policy, which encourages the growth of a diverse workforce where individuals from different backgrounds can fulfil their potential.

Our 2018 employee survey told us that 89% of our employees believe that people within the Company are treated fairly regardless of race or ethnic origin. While we recognise this as good progress, we plan to further increase our focus on ethnic diversity in the coming year. We continue to strive to ensure people with disabilities are given all the encouragement and support necessary and that South West Water is seen as a welcoming and inclusive place to work in all respects.

Information regarding the gender breakdown of the workforce is provided on page 17.

THE REMUNERATION COMMITTEE

Gill Ryder was appointed as Chairman of the Committee on 1 January 2019.

The Committee met four 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

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 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:

- Completing the annual executive salary review and the annual review of the Chairman's fee
- Ensuring executive pay in South West Water is aligned to Ofwat's principles and responding to their request to ensure we set the appropriate stretch targets to meet customer delivery requirements as part of achieving fast-track status
- Reviewing drafts of the Directors' remuneration report and recommending it to the Board for approval for inclusion in the 2019 annual report
- Determining performance targets in respect of the Annual Incentive Bonus Plan for 2018/19
- Determining bonuses and deferred bonus awards pursuant to the Company's Annual Incentive Bonus Plan in respect of the year 2017/18
- Approving the long-term incentive plan (LTIP) awards for the year
- Approving the release of the 2015 deferred bonus share awards
- Reviewing the outcome of the 2015 Performance and Co-Investment Plan awards
- Reviewing the results of the Committee's performance evaluation and considering any appropriate changes

A comprehensive re-tendering process was also taken for the appointment of Remuneration consultants for the Pennon Remuneration Committee and South West Water Remuneration Committee, resulting in the re-appointment of Deloitte, with a refreshed advisory team.

THE COMMITTEE'S FOCUS FOR 2019/20

- 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 and to create long-term value for shareholders
- Monitor on an ongoing basis the alignment of executive pay and benefits with the strategic direction of the Company to ensure these support the long-term success of the Company and promote its values
- Review workforce remuneration, incentives and 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.

- Reviewing and redrafting the remuneration policy in line with the three year cycle for approval at the Pennon Group AGM in 2020.

REMUNERATION COMMITTEE COMPOSITION AND MEETINGS

There were four 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)	1 April 2016	Chairman	4/4
Neil Cooper	1 April 2016	Non-Executive Director	4/4
Martin Hagen	1 September 2013	Non-Executive Director	4/4
Martin Angle(2)	1 April 2016	Non-Executive Director	3/3
Iain Evans(3)	1 September 2018	Non-Executive Director	3/3

(1) Appointed as Committee Chairman on 1 January 2019
(2) Stepped down from the Board, and as Chairman of the Committee, on 31 December 2018
(3) Includes only meetings since his appointment on 1 September 2018 and prior to his resignation on 27 March 2019

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

LINK BETWEEN STRATEGY, 2019 PERFORMANCE AND REMUNERATION

1	**Leadership in UK water and waste**	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**	focused on driving down overheads and operating in the most efficient way to minimise costs.
3	**Driving sustainable growth**	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.

Group KPIs		Link to strategy			Link to variable remuneration	
		Leadership in UK water and waste	Leadership in cost base efficiency	Driving sustainable growth	Annual bonus	LTIP
Long-term	Earnings per share	✓	✓	✓		✓
	Dividend per share	✓	✓	✓		✓
	Return on capital employed		✓	✓		✓
Annual operation	Profit before tax	✓	✓	✓	✓	
	Return on regulated equity	✓	✓	✓	✓	
	ODI net rewards	✓		✓	✓ Reflected in bonus operational and individual metrics	
Sustainable business	Customer satisfaction with overall service	✓		✓		
	Employee engagement	✓		✓		
	Health and safety	✓		✓		
	Carbon emissions	✓		✓		

LINK TO CUSTOMERS

Pay linked to underlying performance **Performance pay – appropriately aligned with customer interests** **Bonus and LTIs – substantial link to stretching performance delivery for customers**	➢ Significant portion of executive remuneration linked to performance of the business ➢ Annual bonus includes customer and operational measures linked to metrics assessed by our regulator, customers, communities and wider stakeholders ➢ Stretching targets – motivate management to deliver sustainable performance ➢ Safeguard mechanisms in place to ensure outcomes reflect underlying performance	**Transparency** **Clear disclosure of reasons for changes to policy** **Explanation of how changes take into account customer interests**	➢ Principles followed for 2017 policy review: - Ensure a transparent, simple and equitable approach to pay - Incentivise the delivery of sustainable long-term value to shareholders - Support the underlying strategic priorities of operating safely, with an engaged workforce and focus on customer service ➢ Next policy review in 2020 – maintain commitment to transparent pay structures and clear disclosure of any changes

ANNUAL STATEMENT FROM THE CHAIRMAN OF THE REMUNERATION COMMITTEE

Gill Rider succeeded Martin Angle as Chair of the Committee in January 2019. On behalf of the Board, we would like to thank Martin for his significant contribution.

INTRODUCTION

At the Pennon Group plc 2017 AGM, shareholders approved the revised remuneration policy with 98% of votes cast in favour of the resolution and this applies to South West Water Directors. The policy is available in full at www.pennon-group.co.uk/about-us/governance-and-remuneration and a summary of the policy is provided on pages 93 to 94.

The Committee intends to conduct a comprehensive review of the remuneration policy during 2019/20. This will help us determine if the policy remains ‘fit for purpose’ and continues to align executives with the Company’s strategic direction and long-term sustainable success. Our review will also focus on the recent changes to the UK Corporate Governance Code and on Ofwat’s vision for water companies and regulatory framework going forward.

PERFORMANCE IN 2018/19

A significant proportion of remuneration for the Executive Directors is delivered as variable pay that rewards for the achievement of sustainable strong performance. As illustrated on page 90, the metrics used for the bonus and long-term incentives are directly aligned with South West Water’s strategy. The incentives reward for performance against financial, operating and customer based metrics that are important to our customers, the water industry regulator and wider stakeholders. Key achievements in the year included:

- The South West Water 2020-25 Business Plan receiving a fast track green light from Ofwat, the water industry regulator – the only company to have achieved fast-track status for two successive price reviews
- Strong performance in the water business, demonstrating service resilience through extreme weather conditions. Our focus on customers was demonstrated by delivery of our lowest ever supply interruptions and a record customer service score. South West Water is now ranked second in the industry for quality and service

INCENTIVE OUTCOMES

The bonus outturns for the Executive Directors for 2018/19 reflect the Company’s strong achievements against financial, operational, customer and individual targets set at the start of the year.

The Committee considered the formulaic outcome and concluded that the bonus was a fair reflection of the strong performance achieved in the year. Further details of bonus targets, measures and performance are set out on pages 97 to 99.

For the 2018/19 bonus, Executives were also asked to evidence how they demonstrated our new Values (Trusted, Collaborative, Responsible, Progressive), in delivering individual objectives. This is in order to ensure that the values become a part of the leadership culture, with the intention of introducing this performance element to further levels of the organisation.

Half of the bonus earned is deferred into shares in Pennon Group plc which affirms the Executives’ commitment to creating a long-term sustainable business.

Legacy awards granted under the Performance and Co-Investment Plan in 2016 will be eligible for vesting in 2019. This award was based on relative TSR performance against sector peers and the wider FTSE250 (excluding investment trusts). Although the performance assessment for this award will only be concluded after the finalisation of this report, the current expectation is that there will be partial vesting, currently estimated at c.44% for this award due to outperformance against sector peers.

KEY REMUNERATION DECISIONS

For 2019/20, salaries for Executive Directors were increased by 2.0%, which is slightly lower than the pay increase awarded to the wider employee population. No other changes are being made at this time to the pay arrangements for Executive Directors.

LOOKING FORWARD

In this year's report we have provided detail as to how we comply with the remuneration provisions within the new UK Corporate Governance Code which takes effect for 2019/20 and are well-placed for the adoption of the provisions.

Under the normal three-year renewal cycle, the Remuneration Policy will be presented to shareholders for approval at the Pennon Group plc 2020 AGM as will continue to apply to South West Water Directors. During the year we will therefore be undertaking a review of our current arrangements in light of our strategic priorities, as well as evolving market and best practice. As part of this review we intend to consider our approach to pensions and post-employment shareholding guidelines in response to the new Code.

The Remuneration Committee has sought to take a measured and responsible approach to executive pay, with a close focus on the strategic priorities of the business and the interests of wider stakeholders. We hope that this approach is clear in our Remuneration Report.

DIRECTORS’ REMUNERATION POLICY

INTRODUCTION

The current Directors’ remuneration policy was approved in July 2017.

The Committee’s intention is to seek approval for the Company’s remuneration policy at the end of the usual three-year cycle, in accordance with section 439A of the Companies Act 2006. Unless the Directors wish to amend the remuneration policy in the meantime, it will be submitted for approval in 2020, following a review to be carried out by the Committee in 2019/20.

The remuneration policy tables for Executive and Non-Executive Directors are set out below for information. The policy is displayed in its entirety on the South West Water website and is also available upon request from the Group Company Secretary.

SUMMARY OF DIRECTOR’S REMUNERATION POLICY AND IMPLEMENTATION IN 2019/20

Element	Operation	Implementation in 2019/20
Base salary Set at a competitive level to attract and retain high calibre people to meet the Company’s strategic objectives in an increasingly complex business environment.	Salaries are generally reviewed annually and any changes are normally effective from 1 April each year. In normal circumstances, salary increases will not be materially different to general employee pay increases.	Salaries for 2019/20 were increased by 2%, which was lower than increases for all employees: Louise Rowe: £166,464
Benefits Benefits provided are consistent with the market and level of seniority to aid retention of key skills to assist in meeting strategic objectives.	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.	No changes.
Annual Bonus Incentivises the achievement of key performance objectives aligned to the strategy of the Company.	The maximum bonus potential for each Director is 75% of base salary. A portion of any bonus is deferred into shares in the Company which are normally released after three years. Normally 50% is deferred. Malus and clawback provisions apply.	No changes. Maximum opportunity of 75% of salary, with deferral of 50% of any bonus into shares for three years.
Long-term incentive plan (LTIP) Provides alignment to the achievement of the Company’s strategic objectives and the delivery of sustainable long-term value to shareholders.	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. In addition a two year holding period will apply in respect of any shares which vest at the end of the three year performance period. The maximum annual award is 80% of base salary. An ‘underpin’ applies which allows the Committee to reduce or withhold vesting if the Committee is not satisfied with the underlying operational and economic performance of the Company. Malus and clawback provisions apply.	No changes. Maximum award of 80% of salary.
Shareholding requirements Create alignment between executives and shareholders and promote long-term stewardship.	100% of salary.	No change.

Element	Operation	Implementation in 2019/20
Pension		
Provides funding for retirement and aids retention of key skills to assist in meeting the Company's strategic objectives.	The maximum annual pension contribution or cash allowance is 15% of salary.	No changes. Current benefit levels as agreed in prior years are: £16,000 for Louise Rowe. In light of the updated UK Corporate Governance Code, the Remuneration Committee will be expecting to reduce the pension benefits for any future Board appointment to reflect pensions across the wider employee population.
All employee share plans		
Align the interests of all employees with Pennon Group plc share performance.	Executive Directors may participate in HMRC approved all-employee plans on the same basis as employees. The maximum is as prescribed under the relevant HMRC legislation governing the plans.	No changes.
Non-Executive Director fee policy		
Set at a market level to attract Non-Executive Directors who have appropriate experience and skills to assist in determining the Group's strategy.	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. 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.	2019/20 fee policy is based on the attendance and responsibility of each Non-Executive Director

IMPLEMENTATION OF THE REMUNERATION POLICY FOR 2019/20 – FURTHER DETAILS ON PERFORMANCE METRICS

A summary of the specific remuneration arrangements for Executive Directors in 2019/20 is described below:

<table>
<tr><td>Base salary</td><td>2019/20 salary is:
Louise Rowe: £166,464

Salaries were increased by 2% which is lower than the increase for all employees</td></tr>
<tr><td>Pension and benefits</td><td>No changes. Salary supplement cash allowance of 15% for Louise Rowe from which is deducted the employer’s contribution to the defined contribution pension scheme for the Directors.</td></tr>
<tr><td>Variable remuneration</td><td>Maximum opportunity of 75% of salary for Louise Rowe. No change to operation of deferral with 50% of the bonus to be deferred into shares for three years.

For 2019/20, the annual bonus will be based on the following performance measures:

<u>L Rowe</u>
45% based on Pennon Group financial measures (37.5% profit before taxation (PBT), 7.5% Return on Regulatory Equity (RoRE)).

15% based on operational measures. These will be quantitative and measurable and are key to meeting the needs of our customers, our regulator, and wider stakeholders:
• Water metrics:
○ Customer Service Score
○ Bathing water failures
○ Leakage
○ Wastewater pollution incidents
○ Interruptions to supply
○ Water and wastewater asset reliability

15% Individual objectives include goals relating to:
○ Health and safety
○ Employee engagement
○ Execution of the PR19 Business Plan
○ Development of strategy
Executives will be asked to evidence how they demonstrated our values (trusted, collaborative, responsible, progressive), in delivering individual objectives. This is in order to ensure that the values become part of the leadership culture, with the intention of introducing this performance element to further levels of the organisation.</td></tr>
<tr><td></td><td>For bonuses from 2014/15, both malus and clawback apply as described in the remuneration policy.</td></tr>
</table>

IMPLEMENTATION OF THE REMUNERATION POLICY FOR 2019/20 – FURTHER DETAILS ON PERFORMANCE METRICS CONTINUED

Long-term incentive plan

There is a maximum award of 80% of salary for the Finance Director.

For 2019/20, performance measure will continue to be EPS growth, a sustainable dividend measure and RoCE, with targets set in the table below. The LTIP award will be subject to an 'underpin' relating to overall Group performance including consideration of environmental, social and governance factors and safety performance, as well as financial performance.

	Threshold (25% of element)	Maximum (100% of element)
Pennon Group EPS growth (40%)	6% p.a.	10% p.a.
Sustainable dividends (40%)	2.6x	3.6x
RoCE* (20%)	8%	10%
	Straight line vesting between threshold and maximum	
Shareholding guidance	100% of salary for the Finance Director (subject to building over five years for new appointments).	

**RoCE is defined as: (underlying operating profit + JV profit after tax + interest receivable) divided by capital employed (debt + equity including hybrid).*

The sustainable dividend is based on EBITDA cover. This element is subject to two underpins:

- Achievement of a gateway dividend growth target of RPI+4% per annum; and
- The Board must also be satisfied with the level of EPS dividend cover. EBITDA dividend cover will be based on adjusted EBITDA calculated as (underlying EBITDA +share of JV dividends & interest receivable + IFRIC12 interest receivable).

For the purpose of the calculation, dividend cover would be based on the policy of 4% p.a. above RPI.

For awards from 2015/16, both malus and clawback apply and a two year holding period applies in respect of any shares which vest at the end of the three year performance period, as described in the remuneration policy report.

Non-Executive Director fees

Non-Executive Director fees for 2019/20 are set out below. They include a 2% increase for the Non-Executive Directors.

Director	Fees £000
Chairman, Sir John Parker	138
Lord Matthew Taylor	61
Jon Butterworth	57
Martin Hagen	57
Neil Cooper	35
Gill Rider	39
Chris Loughlin	269

The Chairman, Sir John Parker, Neil Cooper and Gill Rider's fees and Chris Loughlin's salary 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/salary charges for 2019/20.

ANNUAL REPORT ON REMUNERATION

INTRODUCTION

This section sets out how the Company has applied its remuneration policy in the year.

SINGLE TOTAL FIGURE OF REMUNERATION TABLES (AUDITED INFORMATION)

	Base salary /fees (£000)		Benefits[1] (including sharesave) (£000)		Annual bonus (cash bonus and deferred shares) (£000)		Performance and co-investment plan[6] (£000)		Pension[7] (£000)		Total remuneration (£000)	
	2018/19	2017/18	**2018/19**	2017/18	**2018/19**	2017/18	**2018/19**	2017/18	**2018/19**	2017/18	**2018/19**	2017/18
Executive Directors												
Stephen Bird	**248**	244	**26**	21	**236**	155	**109**	-	**44**	44	**663**	493
Louise Rowe	**163**	160	**16**	15	**119**	104	**57**	-	**24**	24	**379**	303
Non-Executive Directors												
Sir John Parker, Chairman[2]	**135**	135	**-**	-	**-**	-	**-**	-	**-**	-	**135**	135
Lord Matthew Taylor, Senior Independent Director	**60**	55	**-**	-	**-**	-	**-**	-	**-**	-	**60**	55
Jon Butterworth[3]	**56**	28	**-**	-	**-**	-	**-**	-	**-**	-	**56**	28
Martin Hagen	**56**	55	**-**	-	**-**	-	**-**	-	**-**	-	**56**	55
Martin Angle[2][4]	**26**	34	**-**	-	**-**	-	**-**	-	**-**	-	**26**	34
Neil Cooper[2]	**35**	33	**-**	-	**-**	-	**-**	-	**-**	-	**35**	33
Gill Rider[2]	**39**	37	**-**	-	**-**	-	**-**	-	**-**	-	**39**	37
Iain Evans[5]	**20**	-	**-**	-	**-**	-	**-**	-	**-**	-	**20**	-
Chris Loughlin[2]	**264**	259	**17**	15	**240**	225	**104**	-	**79**	78	**704**	577

(1) Benefits comprise a car allowance and medical insurance

(2) 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 show on page 98 of the Pennon Group plc Annual Report and Accounts 2019

(3) Jon Butterworth joined the South West Water Board on 28 September 2018

(4) Retired from the Board on 31 December 2018

(5) Iain Evans was appointed to the Board on 1 September 2018 and resigned on 27 March 2019

(6) Based on an estimated 44% vesting as referred to on page 99

(7) See page 100 for further information.

ANNUAL BONUS OUTTURN FOR 2018/19 (AUDITED INFORMATION)

The performance targets set and the performance achieved in respect of the annual bonus for 2018/19 in respect of each Executive Director is set out below.

Stephen Bird

Group financial measures – 60% weighting

Measure	Threshold	Target	Maximum	Actual outturn	Bonus outturn
Underlying profit before tax (50% weighting)	£262.1m	£267.4m	£280.8m	£280.2m	49%
RoRE (10% weighting)	8%	9%	11%	11.6%	10%

Customer and operational measures – 20% weighting

<table>
<tr><th>Measures</th><th>Target</th><th>Actual outturn</th><th>Target achieved</th><th>Bonus outturn</th></tr>
<tr><td colspan="5">Water metrics</td></tr>
<tr><td>Service incentive mechanism (SIM)</td><td>85/87</td><td>88/88</td><td>Yes</td><td rowspan="9">14%</td></tr>
<tr><td>Bathing water quality</td><td><5 beaches failing</td><td>0</td><td>Yes</td></tr>
<tr><td>Leakage</td><td>81</td><td>84</td><td>No</td></tr>
<tr><td colspan="4">Wastewater pollution incidents</td></tr>
<tr><td>Category 1-2</td><td>2</td><td>2</td><td rowspan="2">No</td></tr>
<tr><td>Category 3-4</td><td>180</td><td>248</td></tr>
<tr><td>Average duration of interruptions to supply</td><td>0.214 hours per property</td><td>0.161 hours per property</td><td>Yes</td></tr>
<tr><td>Water and wastewater reliability</td><td>Stable</td><td>Stable</td><td>Yes</td></tr>
<tr><td colspan="4"></td></tr>
<tr><td colspan="4">Personal objectives for 2018/19 were aligned to the delivery of strategic objectives, including:
• the personal leadership and embedding of the Group’s health and safety programme HomeSafe
• continued momentum around a number of Board priorities including the PR19 programme</td><td>17%</td></tr>
</table>

Louise Rowe

Group financial measures – 45% weighting

Measure	Threshold	Target	Maximum	Actual outturn	Bonus outturn
Underlying profit before tax (37.5% weighting)	£262.1m	£267.4m	£280.8m	£280.2m	36.75%
RoRE (7.5% weighting)	8%	9%	11%	11.6%	7.5%

Customer and operational measures – 15% weighting

<table>
<tr><th>Measures</th><th>Target</th><th>Actual outturn</th><th>Target achieved</th><th>Bonus outturn</th></tr>
<tr><td colspan="5">Water metrics</td></tr>
<tr><td>Service incentive mechanism (SIM)</td><td>85/87</td><td>88/88</td><td>Yes</td><td rowspan="8">10.5%</td></tr>
<tr><td>Bathing water quality</td><td><5 beaches failing</td><td>0</td><td>Yes</td></tr>
<tr><td>Leakage</td><td>81</td><td>84</td><td>No</td></tr>
<tr><td colspan="4">Wastewater pollution incidents</td></tr>
<tr><td>Category 1-2</td><td>2</td><td>2</td><td rowspan="2">No</td></tr>
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<tr><td>Average duration of interruptions to supply</td><td>0.214 hours per property</td><td>0.161 hours per property</td><td>Yes</td></tr>
<tr><td>Water and wastewater reliability</td><td>Stable</td><td>Stable</td><td>Yes</td></tr>
<tr><td colspan="4">Personal objectives for 2018/19 were aligned to the delivery of strategic objectives, including:
• the personal leadership and embedding of the Group’s health and safety programme HomeSafe
• continued momentum around a number of Board priorities including the PR19 programme</td><td>13%</td></tr>
</table>

Summary of bonus outcome

	Weighting	Bonus outturn	
		Managing Director	Finance Director
Group financial measures	60% / 45%	59%	44.25%
Customer and operational measures	20% /15%	14%	10.5%
Individual objectives	20% / 15%	17%	13%
Total outturn	**100% / 75%**	**90%**	**67.75%**

A discretionary amount of 5% of salary was also awarded for the successful outcome of the PR19 Business Plan assessment.

PERFORMANCE & CO-INVESTMENT PLAN OUTTURN FOR 2018/19

The awards in the single figure table relate to share awards granted on 1 July 2016, which are due to vest on 1 July 2019. These awards were granted under the legacy incentive plan which operated prior to 2017.

The 2016 share awards were subject to the satisfaction of the TSR based performance conditions. These conditions were set at the time that the awards were granted. The calculation for this award requires averaging TSR performance over the first three months of the performance period and comparing it to the average over the three months following the end of the performance period (1 April 2019 to 30 June 2019). In light of this timeframe, the outturn described in this report is based on an estimate based on TSR up to 20 May 2019. The final vesting outcome will be confirmed in next year's Remuneration Report.

	Threshold (30% of maximum vests)	Maximum (100% of maximum vests)	Forecasted Achievement	Forecasted Vesting
Comparator Index (50% of award)	Equal to index	15% above the index	Out-performance of index: 12.4%	44%
FTSE 250 (excluding investment trusts) (50% of award)	Above 50th percentile	At or above 75th percentile	Below median	0%
Total				**44%**

Straight line vesting between points
For below threshold performance for either performance condition, 0% vests in respect of that performance condition
Comparator index comprises: National Grid plc, Séché Environnement, Severn Trent, Shanks Group, Suez Environnement, and Veolia Environnement

The calculation of TSR performance was undertaken by Deloitte LLP for the Committee. Vesting of an award is also subject to the 'underpin' described in the remuneration policy, which the Committee has determined to the date of this report would be satisfied, if any award was to vest.

If awards were to vest, they would be subject to a two-year holding period during which clawback may be applied where the Committee considers it appropriate in certain circumstances. The holding period ends on 30 June 2021.

RETIREMENT BENEFITS AND ENTITLEMENTS (AUDITED INFORMATION)

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

	Value of defined benefit pension(i) (£000)	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)	Accrued pension at 31 March 2019 (£000)[1]
Stephen Bird	(5)	6	43	44	60 (14 May 2018)	83
Louise Rowe[2]	-	15	10	25	65 (15 January 2047)	-

[1] The value of the defined benefit pension accrued over the period comprises the total pension input amount (which has been calculated in line with regulatory requirements) less the pension contributions paid by the Director

[2] 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.

No additional benefits will become receivable by a Director in the event that the Director retires early.

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	Expiry date of service contract
Louise Rowe*	1 February 2015	At age 65 (15 January 2047)

* 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 August 2019
Neil Cooper	1 April 2016	31 August 2020
Gill Rider	1 April 2016	31 August 2021
Chris Loughlin	1 January 2006	12 months' notice period

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 and for the Chairman's letter of appointment to contain a 12 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.

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. Currently, no Executive Directors hold outside company appointments other than with industry bodies or governmental or quasi-governmental agencies.

Non-Executive Director fees and benefits

Non-Executive Directors' fees increased by 2% in 2018/19 and by 11% for Lord Matthew Taylor, reflecting increased responsibility in the year following his appointment as Senior Non-Executive Director, approved by the Board. The Chairman declined to accept an increase in 2018/19.

The Chairman's benefits comprise provision of a driver and vehicle, when appropriate for the efficient carrying out of his duties. He is entitled to expenses on the same basis as for the other Non-Executive Directors.

ALL EMPLOYEE, PERFORMANCE AND OTHER CONTEXTUAL INFORMATION

Remuneration of the Managing Director

	2014/15	2015/16	2016/17	2017/18	2018/19
Managing Director single figure remuneration (£000)	378	461	553	493	663
Annual Bonus payout (% of maximum)	89.6%	78.3%	65.8%	85%	90%
LTIP (PCP) vesting (% of maximum)	0.0%	34.5%	43.7%	0%	44%[1]

[1]The LTIP vesting percentage is an estimate as at 20 May 2019.

COMPARISON OF MANAGING DIRECTOR REMUNERATION TO EMPLOYEE REMUNERATION

The table below shows the percentage change between 2017/18 and 2018/19 in base salary, benefits and annual bonus for the average of the Managing Director and all employees.

The percentage increase in salary for employees reflects the annual award for staff in 2018/19 of 2.3%, analysed into the three components in the table below, with no change in the benefits or bonuses for staff.

	Percentage change in salary	Percentage change in benefits[2]	Percentage change in annual bonus
Managing Director remuneration	2.0%	8%	6%[1]
All employees	2.3%	-	-

[1]For 2018/19, the annual bonus potential increased from 75% to 100%. Figure reflects the percentage of potential bonus

[2]Includes pension

RELATIVE IMPORTANCE OF SPEND ON PAY

	2018/19 £m	2017/18 £m	Percentage change (%)
Overall expenditure on pay[1]	57.9	52.8	9.7%
Distributions to Parent Company	123.1	120.3	2.3%
Net interest charges	70.5	67.3	4.8%
Purchase of property, plant and equipment (cash flow)	140.7	197.8	40.6%

[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.

SHARE AWARD AND SHAREHOLDING DISCLOSURES (AUDITED INFORMATION)

Share awards granted during 2018/19

The table below sets out details of share awards made in the year to Executive Directors.

Executive Director	Type of interest	Basis of Award	Face value £000	Percentage vesting at threshold performance	Performance period end date
Stephen Bird	LTIP	100% of salary	248	25% of maximum	1 July 2021
Louise Rowe		80% of salary	130		
Stephen Bird	Deferred bonus	50% of bonus awarded	76	N/A	24 July 2021
Louise Rowe			52		

LTIP awards were calculated using the Pennon Group plc share price of 790.12p (being the average closing price over the five dealing days preceding the date of grant, which was 2 July 2018). Deferred bonus awards were calculated using the share price at which shares were purchased on the market on 25 July 2018 in order to satisfy the award, which was 761.36p.

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 2018/19, this guideline was 100% of salary for Executive Directors. 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 Directors in the ordinary shares (40.7p each) of Pennon Group plc as at 31 March 2019 (or date of cessation, if earlier) and 31 March 2019 together with their shareholding guideline obligation (based on the 2018/19 guideline of 100% of salary) and interest are shown in the table below:

					Unvested awards		
	Share interests (including connected parties) at 31 March 2019	Share interests (including connected parties) at 31 March 2018	Share-holding guideline (100% to be accrued over five years)	Share-holding guideline met?	Performance shares (subject to performance conditions)	SAYE	Deferred Bonus shares
Stephen Bird	34,793	29,528	100%	Yes	82,664	888	26,552
Louise Rowe	19,541	9,604	80%	No	44,643	2,834	16,726

Since 31 March 2019, 42 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 2019	Shares held at 31 March 2018
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
Chris Loughlin	359,265	324,935

Since 31 March 2019 Chris Loughlin has acquired 7,588 additional ordinary shares as part of the Pennon Group's Dividend Reinvestment Plan and Pennon Group's Share Incentive Plan. There is no formal shareholding guideline for the Non-Executive Directors; however they are encouraged to purchase shares in Pennon Group plc. A shareholding guideline applies to Chris Loughlin in his capacity as Pennon Group Chief Executive Officer.

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	Conditional awards held at 1 April 2018	Conditional awards made in year	Market price upon award in year	Lapsed in year(i)	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2019	Date of end of period for qualifying conditions to be fulfilled	Expected date of release(ii)
Stephen Bird								
01/07/15	18,260	-	810.50p	(18,260)	-	-	-	-
01/07/16	20,869	-	920.00p	-	-	20,869	30/06/19	30/06/21
25/08/17	30,348	-	802.70p	-	-	30,348	24/08/20	24/08/22
02/07/18	-	31,447	790.12p	-	-	31,447	01/07/21	01/07/23
Louise Rowe								
01/07/15	11,351	-	810.50p	(11,351)	-	-	-	-
01/07/16	12,173	-	920.00p	-	-	12,173	30/06/19	30/06/21
25/08/17	15,946	-	802.70p	-	-	15,946	24/03/20	24/08/22
02/07/18	-	16,524	790.12p	-	-	16,524	01/07/21	01/07/23

(i) All of the 2015 share awards lapsed in 2018 as a consequence of not meeting the performance criteria
(ii) Awards granted from 2015 onwards are subject to a two-year holding period following vesting.

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 qualifying period:

Director and date of award	Conditional awards held at 1 April 2018	Conditional awards made in year	Market price of each share upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2019	Date of end of period for qualifying conditions to be fulfilled
Stephen Bird							
27/07/15	7,318	-	791.00p	7,318	54	-	26/07/18
04/07/16	6,589	-	950.14p	-	-	6,589	03/07/19
30/08/17	9,765	-	808.69p	-	-	9,765	29/08/20
25/07/18	-	10,198	683.00p	-	-	10,198	24/07/21
Louise Rowe							
27/07/15	1,553	-	791.00p	1,553	11	-	26/07/18
04/07/16	3,994	-	950.14p	-	-	3,994	03/07/19
30/08/17	5,929	-	808.69p	-	-	5,929	29/08/20
25/07/18	-	6,803	683.00p	-	-	6,803	24/07/21

During the year the Directors received dividends on the above shares in accordance with the conditions of the bonus plan as follows: Stephen Bird £9,135; Louise Rowe £4,429.

(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 2018	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 2019	Options held at 31 March 2019	Exercise period/ maturity date
S. Bird								
24/06/15	1,317	-	1,317	683.00p	739.80p	-	-	01/09/18-28/02/19
29/06/16	888	-	-	709.00p	-	743.60p	888	01/09/19 – 02/02/20
L. Rowe								
03/07/18	-	2,834	-	635.00p	-	743.60p	2,834	01/09/21-28/02/22

BOARD OF DIRECTORS AND COMPANY INFORMATION

CHAIRMAN	Sir John Parker
MANAGING DIRECTOR (INTERIM)	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
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 51 to 89 and 106 to 110 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 31 to 34 of the strategic report)
- likely future developments of the Company (page 5 of the strategic report)
- certain employee matters (pages 15 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 24 to 30 of the strategic report and notes 21 and 19 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 105. In addition, Martin Angle, an Independent Non- Executive Director, served during the year until he stepped down from the Board on 31 December 2018. Iain Evans, an Independent Non-Executive Director, served from 1 September 2018 until he stepped down from the Board on 27 March 2019. 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 £123.1 million was paid during the year (2017/18: £120.3 million). The Report of the Finance Director on pages 24 to 30 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 Group has policies in place covering health and 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 86. Information regarding the diversity of the workforce is provided on page 17.

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 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 15 to 18 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 2019 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.

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 £0.2 million during the year (2017/18: £0.1 million)

OVERSEAS BRANCHES

The Company has no overseas branches.

DONATIONS

During 2018/19 the Company provided a total of £210,000 in charitable donations (2017/18: £97,000).

No political donations were made or political expenditure incurred and no contributions were made to a non-EU political party (2017/18: nil).

GOING CONCERN

Having considered the Company's funding position and financial projections the Directors have a reasonable expectation that the Company has adequate resources to continue its operational existence for the foreseeable future and considers the business model, strategy and operations are sustainable. They therefore have continued to adopt the going concern basis in preparing the financial statements.

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.

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 European Union have been followed, subject to any material departures disclosed and explained in the financial statements. The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the 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 105, confirms that, to the best of his or her knowledge:

i) The financial statements, which have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Company.

ii) The Strategic report (pages 3 to 61) and the Directors' report (62 to 89 and 106 to 110) 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 51 to 87 and 105 to 110 was approved by the Board on 4 June 2019.

By Order of the Board

SIMON A F PUGSLEY
Group General Counsel and Company Secretary

4 June 2019

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 2019 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 38, 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 2019 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 31 to 48 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 109 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 108 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 pages 49 to 50 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	• Revenue recognition • Valuation of the provision for doubtful debts • Valuation of plant, property and equipment
Materiality	• Overall materiality of £9.0m 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**
Revenue recognition (£582.4 million, PY comparative £572.8 million) *Refer to the Audit Committee Report (page 75); Accounting policies (page 124); and Note 4 of the Financial Statements (page 132)* 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 areas, where there is opportunity to overstate revenue: 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,		Our procedures include: • 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 adjustments to reflect the accrual or deferral of revenue • We tested key controls linked to system generated information and around the estimation process for measured revenue • We compared the accrued income to bills raised post year end for a sample of customers, and compared management's history of estimating the accrued income balance to bills raised in the subsequent year to assess the accuracy of the accrued income balance • 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	We concluded that the estimation process undertaken by management to calculate the measured income accrual reflects latest operational factors in the key assumptions and results in an accrued income within an acceptable range (£80.7 million to £95.0 million).

together with management judgements as to the likely impact on usage of factors such as recent weather patterns. The accrued income balance at 31 March 2019 is £89.8 million (2018: £70.3 million).		customers, such as weather patterns and leaks in infrastructure network, together with information on 'water into supply' • For a sample of contracts, we tested whether contract terms and conditions were met and revenue recognised at the correct time in accordance with IFRS 15 • We performed analytical procedures by comparing revenue balances for the year against expectation and obtaining support for significant variances • We tested a sample of transactions to underlying bills • In performing our journal testing, we paid increased attention to entries impacting revenue focusing on non-system postings and those raised in the last two weeks of the year.	
Valuation of the provision for doubtful debts (South West Water) (£86.8 million, PY comparative £89.7 million) *Refer to the Audit Committee Report (page 75); Accounting policies (page 128); and included within Note 19 of the Financial Statements (page 141)* 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. Under the new revenue recognition criteria, revenue should be recognised only when it is probable that the company will collect the consideration to which it will be entitled in exchange for the services that will be transferred to the customer. 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.		Our procedures include: • We performed a walkthrough of the process for calculating the bad debt provision and assessed the design effectiveness of 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 obtained an understanding of management's consideration of the new standard (IFRS 9 Financial Instruments) and its impact on the bad debt allowance calculation • We obtained an understanding of management's consideration of the new revenue standard (IFRS 15) and its impact on revenue recognition and the bad debt allowance. • We corroborated the assumptions used by management in determining the amounts provided against the different categories and age of debt, by comparing	We concluded that the doubtful debt provision is within an acceptable range (£84.3 million to £92.6 million) and reflects recent history of collection of outstanding debts.

		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 the appropriateness of journal entries and adjustments impacting the doubtful debt provision, particularly those raised close to the balance sheet date.	
Valuation of property, plant and equipment *Refer to the Audit Committee Report (page 75); Accounting policies (pages 126 to 127) and Note 4 of the Financial Statements (page 133)* As shown in note 15, the carrying value of the Company's property, plant and equipment totals £3,013.3 million (2018: £2,970.5 million). Given targets associated to financial performance and also pressures to meet market expectations, there is a risk that expenditure might be improperly recognised as capital, rather than operating and that the depreciation charge may be understated if inappropriate useful economic lives are used.	•	• We tested the classification of expenditure between capital and operating, considering whether the expenditure recorded as property, plant and equipment meets the definitions set out in IAS 16 'Property, Plant and Equipment'. • We tested the asset lives utilised based on latest third party benchmarking. • We re-performed the calculation of depreciation. • We read the disclosures in the Annual Report and Financial Statements in respect of the change in asset lives and evaluated the adequacy of these.	We concluded that fixed assets have been correctly accounted for in the financial statements.

The key audit matters for the current year are consistent with matters included in our prior year auditor's report.

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 £9.0 million (2018: £8.9 million), which is 5% (2018: 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.

Starting basis	• Reported profit before taxation £178.6m (2018: £179.8m)
Adjustments	• Non-underlying items - increase basis by £1.9m (2018: £nil)
Materiality	• Totals £180.5m (£179.8m) profit before taxation before non-underlying items • Materiality of £9.0m (5% of profit before taxation before non-underlying items)

PERFORMANCE MATERIALITY

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 75% (2018: 75%) of our planning materiality, namely £6.7m (2018: £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 (2018: £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 110, 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 109** – 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 72 to 80 –** 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 71** – 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 109, 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.

Debbie O'Hanlon (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Reading
4 June 2019

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 2019

	Notes	Before non-underlying items 2019 £m	Non-underlying items (note 6) 2019 £m	Total 2019 £m	Before non-underlying items 2018 £m	Non-underlying items (note 6) 2018 £m	Total 2018 £m
Revenue	5	582.4	-	582.4	572.8	-	572.8
Operating costs	7						
Employment costs		(48.6)	-	(48.6)	(45.3)	-	(45.3)
Raw materials and consumables used		(14.9)	-	(14.9)	(16.6)	-	(16.6)
Other operating expenses		(151.9)	-	(151.9)	(150.4)	-	(150.4)
Earnings before interest, tax, depreciation and amortisation		**367.0**	**-**	**367.0**	**360.5**	**-**	**360.5**
Depreciation and amortisation	7	(116.0)	-	(116.0)	(113.4)	-	(113.4)
Operating profit before exceptional items		**251.0**	**-**	**251.0**	**247.1**	**-**	**247.1**
Exceptional items		-	(1.9)	(1.9)	-	-	-
Operating profit		**251.0**	**(1.9)**	**249.1**	**247.1**	**-**	**247.1**
Finance income	8	2.3	-	2.3	1.2	-	1.2
Finance costs	8	(72.8)	-	(72.8)	(68.5)	-	(68.5)
Net finance costs		**(70.5)**	**-**	**(70.5)**	**(67.3)**	**-**	**(67.3)**
Profit before tax		**180.5**	**(1.9)**	**178.6**	**179.8**	**-**	**179.8**
Taxation (charge)/credit	9	**(29.5)**	**0.3**	**(29.2)**	**(31.4)**	**-**	**(31.4)**
Profit for the year		**151.0**	**(1.6)**	**149.4**	**148.4**	**-**	**148.4**

The notes on pages 124 to 155 form part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 MARCH 2019

	Notes	Before non-underlying items 2019 £m	Non-underlying items (note 6) 2019 £m	Total 2019 £m	Before non-underlying items 2018 £m	Non-underlying items (note 6) 2018 £m	Total 2018 £m
Profit for the year		**151.0**	**(1.6)**	**149.4**	**148.4**	**-**	**148.4**
Other comprehensive (loss)/income							
Items which will not be reclassified to profit or loss							
Re-measurement of defined benefit obligations	25	(6.2)	-	(6.2)	12.2	-	12.2
Income tax on items that will not be reclassified	9, 27	1.1	-	1.1	(2.0)	-	(2.0)
Total items that will not be reclassified to profit or loss		**(5.1)**	**-**	**(5.1)**	**10.2**	**-**	**10.2**
Items that may be reclassified subsequently to profit or loss							
Cash flow hedges		(3.9)	-	(3.9)	20.6	-	20.6
Income tax charge/(credit) on items that may be reclassified	9, 27	0.3	-	0.3	(3.5)	-	(3.5)
Total items that may be reclassified subsequently to profit or loss		**(3.6)**	**-**	**(3.6)**	**17.1**	**-**	**17.1**
Other comprehensive (loss)/income for the year net of tax		**(8.7)**	**-**	**(8.7)**	**27.3**	**-**	**27.3**
Total comprehensive income for the year		**142.3**	**(1.6)**	**140.7**	**175.7**	**-**	**175.7**

The notes on pages 124 to 155 form part of these financial statements.

BALANCE SHEET
AS AT 31 MARCH 2019

	Notes	2019 £m	2018 £m
Assets			
Non–current assets			
Goodwill	13	51.3	51.3
Other intangible assets	14	0.5	1.0
Property, plant and equipment	15	3,013.3	2,970.5
Investment in subsidiary undertakings	17	3.3	3.3
		3,068.4	**3,026.1**
Current assets			
Inventories	18	4.9	4.9
Trade and other receivables	19	144.2	117.6
Current tax asset	26	-	0.7
Cash and cash deposits	21	329.4	226.9
		478.5	**350.1**
Liabilities			
Current liabilities			
Borrowings	23	(87.9)	(48.1)
Derivative financial instruments	20	(10.9)	(8.4)
Trade and other payables	22	(109.6)	(77.9)
Current tax liabilities	26	(15.3)	-
Provisions	28	(1.1)	(2.7)
		(224.8)	**(137.1)**
Net current assets		**253.7**	**213.0**
Non–current liabilities			
Borrowings	23	(2,304.1)	(2,246.9)
Other non–current liabilities	24	(116.1)	(108.7)
Derivative financial instruments	20	(9.1)	(8.2)
Retirement benefit obligations	25	(21.9)	(22.6)
Deferred tax liabilities	27	(230.8)	(231.3)
		(2,682.0)	**(2,617.7)**
Net assets		**640.1**	**621.4**
Equity			
Called up share capital	29	250.9	250.9
Retained earnings and other reserves	31	389.2	370.5
Total Equity		**640.1**	**621.4**

The notes on pages 124 to 155 form part of these financial statements.

The financial statements on pages 119 to 155 were approved and authorised for issue by the Board of Directors on 4 June 2019 and were signed on its behalf by:

C Loughlin
Managing Director (Interim)

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 2019

	Called up share capital (note 29) £m	Retained earnings and other reserves (note 31) £m	Total Equity £m
At 31 March 2017	**250.9**	**314.3**	**565.2**
Profit for the year	-	148.4	148.4
Other comprehensive income for the year	-	27.3	27.3
Total comprehensive income for the year	-	175.7	175.7
Transactions with owners			
Dividends paid	-	(120.3)	(120.3)
Share based payments (net of tax)	-	0.8	0.8
Total transactions with owners	-	(119.5)	(119.5)
At 31 March 2018	**250.9**	**370.5**	**621.4**
Profit for the year	-	149.4	149.4
Other comprehensive loss for the year	-	(8.7)	(8.7)
Total comprehensive income for the year	-	140.7	140.7
Transactions with owners			
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**

The notes on pages 124 to 155 form part of these financial statements.

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 MARCH 2019

	Notes	2019 £m	2018 £m
Cash flows from operating activities			
Cash generated from operations	32	346.7	353.3
Interest paid		(53.0)	(47.4)
Tax paid		(12.2)	(38.7)
Net cash generated from operating activities		**281.5**	**267.2**
Cash flows from investing activities			
Interest received		0.7	0.2
Purchase of property, plant and equipment		(140.7)	(197.8)
Receipt of grants and contributions		3.6	2.3
Disposal of business assets to fellow subsidiary		-	31.9
Proceeds from sale of property, plant and equipment		1.9	2.8
Net cash used in investing activities		**(134.5)**	**(160.6)**
Cash flows from financing activities			
(Deposit)/withdrawal of restricted funds	21	(20.6)	42.4
Proceeds from new borrowing		50.0	50.0
Repayment of borrowings		(32.0)	(41.1)
Repayments of intercompany borrowings		-	(100.0)
Finance lease sale and lease back		74.9	100.1
Finance lease principal repayments		(15.9)	(16.9)
Dividends paid	10	(123.1)	(120.3)
Net cash used in financing activities		**(66.7)**	**(85.8)**
Net increase in cash and cash equivalents		**80.3**	**20.8**
Cash and cash equivalents at beginning of the year		**46.5**	**25.7**
Cash and cash equivalents at end of the year	21	**126.8**	**46.5**

The notes on pages 124 to 155 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 105.

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 (IFRIC) 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 108.

The new standards or interpretations which were mandatory for the first time in the year beginning 1 April 2018 did not have a material impact on the net assets or results of the Company.

Initial adoption of IFRS 15 'Revenue from Contracts with Customers'

The Company adopted the standard with effect from 1 April 2018 using the full retrospective approach to transition. As the impact of the new standard has not had a material effect on the Company's reported revenues, net assets or any specific financial statement line, there has been no restatement of prior year figures. The revised accounting policy on revenue following implementation of IFRS 15 is set out below in paragraph (c). The disaggregation of revenue information required by IFRS 15 is given below within note 5 for the current and prior years.

Initial adoption of IFRS 9 'Financial Instruments'

IFRS 9 replaces IAS 39 with effect from 1 April 2018 bringing together all three aspects of the accounting for financial instruments: classification and measurement, impairment and hedge accounting. The Company applied IFRS 9 prospectively from 1 April 2018. The first-time application of this standard in the specific areas is detailed below but has not resulted in any adjustment or reclassification of amounts previously reported. The classification and measurement requirements of IFRS 9 require that financial assets are classified in the statements of financial position according to their nature, the characteristics of their contractual cash flows and the business model adopted for their management. Following assessment of the Company's business model as of the date of initial application, 1 April 2018, these requirements did not have a significant impact on the Company. The Company continued measuring at fair value all financial assets previously held at fair value under IAS 39.

The impairment aspects of IFRS 9 require the Company to evaluate and recognise expected credit losses (ECLs) on financial assets and to ensure changes in credit risk are assessed at regular intervals, and to make suitable adjustments for ECLs where applicable. The disclosure below within note 4 Critical accounting judgements and estimates on provision for doubtful debts has been expanded to clarify the Company's evaluation approach, which now includes the forward-looking assessment of ECLs and changes in credit risk.

The Company has a policy of hedging currency risk and interest rate risks as detailed in note 3. The Company adopted hedge accounting in accordance with IFRS 9 from 1 April 2018.

Adoption of IFRS 16 'Leases'

The adoption of IFRS 16 on 1 April 2019 will affect primarily the accounting for those leases currently classified as operating leases. IFRS 16 no longer distinguishes between an on the balance sheet finance lease and an off the balance sheet operating lease. The Company has made the following elections on adopting IFRS 16 to apply from 1 April 2019:

- 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.
- Using the exemptions available in respect of contracts with a lease term ending within 12 months of 1 April 2019 and in respect of the low value of underlying assets. These exemptions allow accounting similar to that for an operating lease under IAS 17.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED
(a) Basis of preparation continued

Carrying amounts for assets and liabilities under leases accounted for as finance leases prior to adoption of IFRS 16 will not be impacted.

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 business.

Applying IFRS 16 at 1 April 2019 results in the Company recognising an asset in use of £31.9 million, an additional lease liability of £36.4 million, the release of prepayments of £0.5 million and the reversal of accruals of £2.9 million. The overall reduction in net assets of £2.1 million is deducted from retained profits at 1 April 2019 in accordance with the modified retrospective approach.

Differences between the values of the disclosed operating lease commitment at 31 March 2019 and the additional lease liability recognised at 1 April 2019 under IFRS 16 result from future cash outflows being discounted under IFRS rather than shown gross, the availability of exemptions available on transition and different rules defining the appropriate length of lease to use between the two methods.

Based on the additional lease liability and associated assets recognised at 1 April 2019 it is estimated that the impact on profit for the year ended 31 March 2020 would be a reduction in profit after tax of £0.4 million, resulting from an increase in EBITDA of £2.0 million, depreciation of £1.3 million, finance costs of £1.2 million and a reduction in corporation tax of £0.1 million.

Other new standards or interpretations in issue but not yet effective are not expected to have a material impact on the Company's net assets or results.

(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.

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.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

(c) Revenue recognition continued

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) as appropriate. 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 unamortised 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.

(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.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED
(g) Property, plant and equipment 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
Assets held under finance leases are included as property, plant and equipment at the lower of their fair value at commencement or the present value of the minimum lease payments and are depreciated over their estimated economic lives or the finance lease period, whichever is the shorter. The corresponding liability is recorded as borrowings. The interest element of the rental costs is charged against profits using the actuarial method over the period of the lease. Rental costs arising under operating leases are charged against profits on a straight basis over the life of the lease.

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

(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.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

(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 IAS 39 until 31 March 2018 and in accordance with IFRS 9 from 1 April 2018. 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.

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, since 1 April 2018, 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) Trade payables

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

iv) Derivative financial instruments and hedging activities

The 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.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

(o) Taxation including deferred tax

The tax charge for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in the statement of comprehensive income or directly in equity. In this case 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 from other Group companies. 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 if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be realised. Deferred tax is determined using the tax rates enacted or substantively enacted at the balance sheet date and expected to apply when the deferred tax liability is settled or the deferred tax asset is realised.

(p) Provisions

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

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.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

(s) Employee benefits continued

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.

(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, 68% (31 March 2018: 60%) of net borrowings were at fixed rates and 25% (31 March 2018: 25%) were index-linked. 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 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.

3. FINANCIAL RISK MANAGEMENT CONTINUED

(a) Financial risk factors continued

For 2019 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 £1.2 million (2018: £0.8 million), for the equity sensitivity fair value, derivative impacts are excluded.

For 2019 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 (2018: £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.

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

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	989.7
Interest payments on borrowings	26.9	26.7	78.4	599.5	731.5
Finance 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

31 March 2018	**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	32.0	35.0	115.8	776.8	959.6
Interest payments on borrowings	26.1	26.3	78.1	612.3	742.8
Finance lease liabilities including interest	36.8	73.4	188.5	1,954.9	2,253.6
Trade and other payables	77.9	-	-	-	77.9
Derivative financial liabilities					
Derivative contracts – net payments	7.9	6.9	1.2	0.4	16.4

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 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 2019 the Company had cash and committed facilities excluding restricted funds of almost £525 million (31 March 2018: £590 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	2019 £m	2018 £m
Net Borrowings	33	2,062.6	2,068.1
Total equity		640.1	621.4
Total capital		**2,702.7**	**2,689.5**
Gearing Ratio		**76.3%**	**76.9%**

Consistent with the industry peer group, the Company is also monitored on the basis of the ratio of its Debt to Regulated Capital Value (RCV). South West Water's net debt to RCV has decreased to 58.9%, which compares to Ofwat's K6 target for efficient gearing of 62.5%.

	Note	2019 £m	2018 £m
Regulatory Capital Value		3,504.7	3,431.2
Net borrowings	33	2,062.6	2,068.1
Net borrowings / Regulatory Capital Value		**58.9%**	**60.3%**

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.

(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:

(a) 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 £89.8 million (31 March 2018: £70.3 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.

4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES CONTINUED

(b) Provision for doubtful debts

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.

The actual level of debt collected may differ from the estimated levels of recovery. As at 31 March 2019 the Company's current trade receivables were £199.7 million (2018: £184.3 million), against which £86.8 million (2018: £89.7 million) had been provided for impairment (note 19).

(c) 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 2019 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 2015 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.

(d) Taxation

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

(e) 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 2019 was £3,013.3 million. In the year ended 31 March 2019 additions to property, plant and equipment totalled £154.0 million and the depreciation charge was £119.0 million. Estimated useful economic lives of property, plant and equipment are based on management's judgement and experience.

Asset lives and residual values are reviewed annually and historically changes to remaining estimates of useful lives have not been material.

(f) 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.

	2019 £m	2018 £m
Water	261.7	257.1
Wastewater	284.4	280.5
Other services	36.3	35.2
Total	**582.4**	**572.8**

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	2019 £m	2018 £m
Pensions past service cost	25	1.9	-
Net operating costs		**1.9**	**-**
Tax credit arising on non-underlying items	9	(0.3)	-
Net non-underlying charge		**1.6**	**-**

On 28 October 2018 the High Court of Justice of England and Wales issued a judgement in a claim regarding the rights of female members of certain pension schemes to equality of treatment in relation to pension benefits (Guaranteed Minimum Pension equalisation). The Company estimates, with advice from the Pennon Group's corporate actuary, that the scheme liabilities will increase by an estimated £1.9 million as a result of this judgement. This cost has been recognised as a past service cost in the current year income statement. The charge is considered non-underlying due to its size and non-recurring nature.

7. OPERATING COSTS BEFORE NON-UNDERLYING ITEMS

	Note	2019 £m	2018 £m
Employment costs before non-underlying items	11	48.6	45.3
Raw materials and consumables		14.9	16.6
Other operating expenses include			
Profit on disposal of property, plant and equipment		(1.7)	(2.4)
Operating lease rentals payable:			
Plant and machinery		1.3	1.2
Property		1.7	1.7
Research and development expenditure		0.2	0.1
Trade receivables impairment	19	2.3	5.1
Depreciation of property, plant and equipment:			
Owned assets		75.9	77.8
Under finance leases		39.6	35.1
		115.5	112.9
Amortisation of other intangible assets	14	0.5	0.5
Total Depreciation		116.0	113.4

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

	2019 £000	2018 £000
Fees payable to the Company's auditors and its associates for the audit of the financial statements	174	237
Fees payable to the Company's auditors and its associates for other services:		
All other services	102	41
Total fees	**276**	**278**

Expenses reimbursed to the auditors in relation to the audit of the Company were £16,000 (2017/18: £16,000).

A description of the work of the Audit Committee is set out in its report on page 72 to 80 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

	2019			2018		
	Finance cost £m	Finance income £m	Total £m	Finance cost £m	Finance income £m	Total £m
Cost of servicing debt						
Bank borrowings and overdrafts	(15.8)	-	(15.8)	(14.3)	-	(14.3)
Interest element of finance lease rentals	(35.5)	-	(35.5)	(31.0)	-	(31.0)
Other finance costs	(2.4)	-	(2.4)	(2.8)	-	(2.8)
Interest receivable	-	2.3	2.3	-	1.2	1.2
Intercompany interest to subsidiaries	(18.3)	-	(18.3)	(19.6)	-	(19.6)
Working capital adjustment	**(72.0)**	**2.3**	**(69.7)**	**(67.7)**	**1.2**	**(66.5)**
Notional interest						
Retirement benefit obligations (note 25)	(0.8)	-	(0.8)	(0.8)	-	(0.8)
Finance (costs) /income	**(72.8)**	**2.3**	**(70.5)**	**(68.5)**	**1.2**	**(67.3)**

In addition to the above, finance costs of £2.9 million (2017/18: £4.0 million) have been capitalised on qualifying assets included in property, plant and equipment.

9. TAXATION

	Before non-underlying items 2019 £m	Non-underlying items (note 6) 2019 £m	Total 2019 £m	Before non-underlying items 2018 £m	Non-underlying items (note 6) 2018 £m	Total 2018 £m
Analysis of charge in year						
Current year tax charge	28.2	-	28.2	25.8	-	25.8
Deferred tax charge/(credit)	1.3	(0.3)	1.0	5.6	-	5.6
Tax charge/(credit) for year	**29.5**	**(0.3)**	**29.2**	**31.4**	**-**	**31.4**

UK Corporation tax is calculated at 19% (2017/18: 19%) of the estimated assessable profit for the year.

UK corporation tax is stated after a credit relating to prior year current tax of £3.9 million (2018: credit of £4.5 million) and a prior year deferred tax credit of £2.9 million (2018: charge of £0.7 million).

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% (2017/18: 19%). The differences are explained below:

Reconciliation of total tax charge	2019 £m	2018 £m
Profit before tax	178.6	179.8
Profit before tax multiplied by the standard rate of corporation tax in the UK of 19% (2017/18: 19%)	34.0	34.2
Effects of:		
Expenses not deductible for tax purposes	0.4	0.1
Profit on the disposal of non-qualifying assets	(0.3)	(0.5)
Adjustments to tax charge in respect of prior years	(6.8)	(3.8)
Depreciation charged on non-qualifying assets	1.9	1.1
Other	-	0.3
Tax charge for year	**29.2**	**31.4**

The average effective tax rate excluding non-underlying items for the year was 16% (2017/18: 17%).

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% (2017/18: 19%). The differences are explained below:

Reconciliation of current tax charge	2019 £m	2018 £m
Profit before tax	178.6	179.8
Profit before tax multiplied by the standard rate of corporation tax in the UK of 19% (2017/18: 19%)	34.0	34.2
Effects of:		
Relief for capital allowances in place of depreciation	(22.0)	(22.0)
Disallowance of depreciation charged in the accounts	18.6	17.6
Expenses not deductible for tax purposes	0.1	0.1
Adjustments to tax charge in respect of prior years	(3.9)	(4.5)
Depreciation charged on non-qualifying assets	1.9	1.1
Relief for capitalised interest	(0.5)	(0.7)
Tax charge for year	**28.2**	**25.8**

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 customer bills, as corporation tax relief is given against the investments made. As noted in the deferred tax note (note 26), the rate of UK corporation tax will reduce to 17% from April 2020.

Adjustments to the tax charge in prior periods results from having submitted tax computations to HMRC, as a result ensuring the tax charge in the accounts reconciles with those submitted computations.

Open enquiries were settled during the year, these resulted in a current tax credit of £3.2m.

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

	2019 £m	2018 £m
Amounts recognised directly in other comprehensive income		
Deferred tax (credit)/charge on defined benefit pension schemes	(1.1)	2.0
Deferred tax (credit)/charge on cash flow hedges	(0.3)	3.5
Amounts recognised directly in equity		
Deferred tax (credit)/charge on share based payments	(0.1)	0.2

10. DIVIDENDS

	2019 £m	2018 £m
Amounts recognised as distributions to equity holders in the year:		
Base dividend of 22.0p per ordinary share in respect of 2016/17 and 2017/18 paid 29 September 2017	-	55.2
Special dividend of 25.9p per ordinary share paid 29 March 2018	-	65.1
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	-
	123.1	**120.3**

11. EMPLOYMENT COSTS

The average number of persons (including Executive Directors) employed by the Company was 1,389 (2018: 1,433).

	Note	2019 £m	2018 £m
Wages and salaries		49.6	44.3
Social security costs		5.0	4.7
Pension costs	25	7.3	7.5
Share-based payments		1.0	0.9
Total employment costs		**62.9**	**57.4**
Charged as follows:			
Employee costs		48.6	45.3
Capital schemes		14.2	12.1
Research and development		0.1	-
Total employment costs		**62.9**	**57.4**

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

	2019 £000	2018 £000
Executive Directors:		
Salary	412	404
Performance-related bonus paid or payable	171	129
Share-based payments	311	209
Other emoluments, including payments in lieu of pension provision	116	133
Non-Executive Directors (including Chairman)	1,027	953
Total emoluments	**2,037**	**1,828**

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 97 to 104. 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 (2018: £80,000). Total gains made by Directors on the exercise of share options were £nil (2018: £855).

At 31 March 2019 there was one Director accruing retirement benefits under defined benefit pension schemes (2018: one Director) At 31 March 2019 there was one Director accruing benefits under defined contribution pension schemes with contributions of £14,835 made during the year (2017/18: £14,183).

13. GOODWILL

	2019 £m	2018 £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

	2019 £m	2018 £m
Cost:		
At 1 April	2.0	2.0
At 31 March	**2.0**	**2.0**
Accumulated amortisation		
At 1 April	1.0	0.5
Charge for period	0.5	0.5
At 31 March	**1.5**	**1.0**
Net book value		
At 1 April	**1.0**	**1.5**
At 31 March	**0.5**	**1.0**

Other acquired intangible assets relate to computer software and arose on the acquisition of Bournemouth Water. The weighted average useful life at 31 March 2019 was 5 years (31 March 2018: 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 2017	**45.8**	**1,795.1**	**713.5**	**1,616.6**	**162.4**	**4,333.4**
Additions	2.0	13.2	1.9	44.3	122.6	184.0
Assets adopted at fair value	-	8.1	-	-	-	8.1
Grants & contributions	-	(2.1)	-	-	-	(2.1)
Disposals	(0.2)	(1.2)	-	(2.1)	-	(3.5)
Disposal of business assets to fellow subsidiary	-	-		(2.6)	-	(2.6)
Transfers/reclassifications	3.7	21.9	11.1	73.4	(110.1)	-
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**
Accumulated depreciation:						
At 31 March 2017	**9.6**	**232.2**	**244.6**	**947.2**	**-**	**1,433.6**
Charge for year	1.7	22.4	13.7	78.5	-	116.3
Disposals	-	(1.2)	-	(1.9)	-	(3.1)
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**
Net book value:						
At 31 March 2017	**36.2**	**1,562.9**	**468.9**	**669.4**	**162.4**	**2,899.8**
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**

15. PROPERTY, PLANT AND EQUIPMENT CONTINUED

Out of the total depreciation charge for the Company of £119.0 million (2017/18: £116.3 million), the sum of £1.5 million (2017/18: £1.5 million) has been charged to capital projects, £1.5 million (2017/18: £1.9 million) has been offset by deferred income and £116.0 million (2017/18: £112.9 million) against profits.

Asset lives and residual values are reviewed annually.

During the year borrowing costs of £2.9 million (2017/18: £4.0 million) have been capitalised on qualifying assets, at an average borrowing rate of 3.7% (2017/18: 3.7%).

On 1 April 2017, £2.6 million of assets relating to the non-household retail business were acquired by Pennon Water Services Limited, a fellow Pennon Group plc subsidiary.

Assets held under finance leases 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 2018	**2.5**	**416.9**	**461.2**	**487.6**	**0.2**	**1,368.4**
At 31 March 2019	**3.3**	**428.4**	**471.1**	**490.2**	**5.2**	**1,398.2**
Accumulated depreciation:						
At 31 March 2018	**-**	**63.3**	**119.4**	**246.6**	**-**	**429.3**
At 31 March 2019	**0.1**	**68.2**	**126.7**	**255.0**	**-**	**450.0**
Net book value:						
At 31 March 2018	**2.5**	**353.6**	**341.8**	**241.0**	**0.2**	**939.1**
At 31 March 2019	**3.2**	**360.3**	**344.4**	**235.2**	**5.2**	**948.2**

16. FINANCIAL INSTRUMENTS BY CATEGORY

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

	Note	Fair value	Amortised cost		
		Derivatives used for cash flow hedging £m	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)**

	Note	Fair value	Amortised cost		
		Derivatives used for cash flow hedging £m	Loans and receivables £m	Trade receivables and trade payables £m	Total £m
31 March 2018					
Financial assets					
Trade and other receivables	19	-	16.4	94.6	111.0
Cash and cash deposits	21	-	226.9	-	226.9
		-	**243.3**	**94.6**	**337.9**
Financial liabilities					
Borrowings	23	-	(2,295.0)	-	(2,295.0)
Derivative financial instruments	20	(16.6)	-	-	(16.6)
Trade and other payables	22	-	(3.9)	(38.0)	(41.9)
		(16.6)	**(2,298.9)**	**(38.0)**	**(2,353.5)**

17. INVESTMENTS

	2019 £m	2018 £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

	2019 £m	2018 £m
Raw materials and consumables	4.9	4.9

19. TRADE AND OTHER RECEIVABLES – CURRENT

	2019 £m	2018 £m
Amounts receivable from customers	199.7	184.3
Less: provision for impairment of receivables	(86.8)	(89.7)
Net trade receivables	**112.9**	**94.6**
Amounts owed by fellow subsidiary companies	19.0	13.3
Other receivables	4.4	3.2
Prepayments and accrued income	7.9	6.5
Trade and other receivables – current	**144.2**	**117.6**

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:

	2019 £m	2018 £m
Not due	37.2	8.8
Past due 1 - 30 days	7.6	21.5
Past due 31 - 120 days	9.8	10.4
More than 120 days	145.1	143.6
Total trade receivables	**199.7**	**184.3**

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(o). 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 subsidiary undertakings.

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

	2019 £m	2018 £m
At 1 April	**89.7**	**91.4**
Provision for expected credit losses	2.3	5.1
Disposal of business asset to fellow subsidiary company	-	(3.4)
Net Receivables written-off during the year as uncollectable	(5.2)	(3.4)
At 31 March	**86.8**	**89.7**

On 1 April 2017, following the opening of the market, South West Water's non-household retail net customer book and related assets together totalling £31.9 million were acquired by Pennon Water Services (a fellow Pennon Group plc subsidiary) for consideration of £31.9 million, being the consideration following finalised assessments of asset values. As a result, trade receivables from 2017/18 onwards now represent household retail receivables due from consumers and non-household wholesale receivables due from retailers of water and wastewater services.

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

	2019 £m	2018 £m
Derivatives used for cash flow hedging:		
Current liabilities	10.9	8.4
Non-current liabilities	9.1	8.2

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

The ineffective portion recognised in the income statement arising from cash flow hedges was £nil (2017/18: £nil).

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50%, after the effect of interest rate swaps, of net borrowings is at fixed rate. At 31 March 2019, 68% (31 March 2018: 60%) of net borrowings was at fixed rate.

At 31 March 2019 interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £1,459.5 million existed, with a weighted average maturity of 3.1 years (31 March 2018: £878.0 million, with 2.3 years). The weighted average interest rate of the swaps was 1.74% (31 March 2018: 1.96%).

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 2019					
Liabilities	10.9	2.1	5.4	1.6	20.0
31 March 2018					
Liabilities	8.4	7.1	0.8	0.3	16.6

Valuation hierarchy

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

	2019 £m	2018 £m
Level 2 inputs		
Liabilities		
Derivatives used for cash flow hedging	20.0	16.6

The amounts above are the fair value of financial instruments using level 2 inputs that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The fair value of swaps is based on the market value of equivalent instruments at the balance sheet date.

21. CASH AND CASH DEPOSITS

	2019 £m	2018 £m
Cash at bank and in hand	46.8	46.5
Other deposits	282.6	180.4
Cash and cash deposits	**329.4**	**226.9**

Overnight deposits have an average maturity of one working day. Other short-term bank deposits have an average maturity of 64 days.

Other deposits include £202.6 million (31 March 2018: £180.4 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:

	2019 £m	2018 £m
Cash and cash deposits as above	329.4	226.9
Less: deposits with a maturity of three months or more (restricted funds)	(202.6)	(180.4)
Cash and cash equivalents	**126.8**	**46.5**

22. TRADE AND OTHER PAYABLES – CURRENT

	2019 £m	2018 £m
Trade payables	68.5	38.0
Amounts owed to subsidiary companies	5.0	3.9
Amounts owed to parent undertaking	4.3	-
Other tax and social security	1.6	3.5
Other payables	10.2	8.0
Accruals	18.0	22.6
Contract liabilities	2.0	1.9
	109.6	**77.9**

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

Prior year comparatives have been re-analysed to separately recognised contract liabilities in accordance with IFRS 15. Contract liabilities are recognised when consideration is received in advance of the Company performing its obligations to customers.

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

	2019 £m	2018 £m
At 1 April	110.6	104.5
Revenue recognised in the year	(2.6)	(2.0)
Consideration received in advance of completion of performance obligations	10.1	8.1
At 31 March	**118.1**	**110.6**

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

	2019 £m	2018 £m
Current	2.0	1.9
Non-current (note 24)	116.1	108.7
	118.1	**110.6**

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 2020.

23. BORROWINGS

	2019 £m	2018 £m
Current		
European Investment Bank	27.0	32.0
Other external loans	8.0	-
	35.0	**32.0**
Obligations under finance leases	52.9	16.1
Total current borrowings	**87.9**	**48.1**
Non-current		
European Investment Bank	264.4	291.4
Other external loans	270.0	224.9
Loan from subsidiary company (note 36)	420.3	411.3
	954.7	**927.6**
Obligations under finance leases	1,349.4	1,319.3
	2,304.1	**2,246.9**
Total borrowings	**2,392.0**	**2,295.0**

23. BORROWINGS CONTINUED

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 borrowings raised are lent to the Company on 'back-to-back' terms.
The fair value of the non-current borrowings were:

	2019 Book value £m	2019 Fair value £m	2018 Book value £m	2018 Fair value £m
European Investment Bank	264.4	235.7	291.4	251.5
Other external loans	270.0	320.5	224.9	270.2
Loan from subsidiary company	420.3	575.4	411.3	552.9
	954.7	**1,131.6**	**927.6**	**1,074.6**
Obligations under finance leases	1,349.4	1,288.1	1,319.3	1,207.7
	2,304.1	**2,419.7**	**2,246.9**	**2,282.3**

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

The maturity of non-current borrowings was:

	2019 £m	2018 £m
Between 1 and 2 years	53.2	85.5
Over 2 and less than 5 years	257.2	232.2
Over 5 years	1,993.7	1,929.2
	2,304.1	**2,246.9**

The weighted average maturity of non-current borrowings was 21.9 years (31 March 2018: 23.1 years).

Finance lease liabilities – minimum lease payments:

	2019 £m	2018 £m
Within 1 year	78.0	36.8
Over 1 year and less than 5 years	249.5	262.0
Over 5 years	1,994.7	1,954.8
	2,322.2	**2,253.6**
Less: future finance charges	(919.9)	(918.2)
Present value of finance lease liabilities	**1,402.3**	**1,335.4**

The maturity of finance lease liabilities was:

	2019 £m	2018 £m
Within 1 year	52.8	16.1
Over 1 year and less than 5 years	154.3	171.8
Over 5 years	1,195.2	1,147.5
	1,402.3	**1,335.4**

Included above are accrued finance charges arising on obligations under finance leases totalling £160.7 million (2017/18: £152.9 million), of which £0.7 million (2017/18: £0.6 million) is repayable within one year.

Included above is £0.2 million (31 March 2018: £0.5 million) due to Peninsula Leasing Limited (a fellow Pennon Group subsidiary), under finance lease agreements of which £0.2 million (31 March 2018: £0.3 million) is repayable within one year.

The period for repayment of these leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits of £97.5 million at 31 March 2019 (31 March 2018: £87.9 million) are being held to settle the lease liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

The period for repayment of certain existing leases includes an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposit at 31 March 2019 of £105.1 million (31 March 2018: £92.5 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.

23. BORROWINGS CONTINUED

Undrawn committed borrowing facilities at the balance sheet date were:

	2019 £m	2018 £m
Floating rate:		
Expiring within one year	-	80.0
Expiring after one year	195.0	279.9
	195.0	**359.9**

In addition, the Company has undrawn uncommitted short-term bank facilities of £nil (31 March 2018: £nil).

24. OTHER NON-CURRENT LIABILITIES

	2019 £m	2018 £m
Contract liabilities	116.1	108.7

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 £1.6 million (2017/18: £1.5 million).

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

	2019 %	2018 %	2017 %
Rate of increase in pensionable pay	3.3	3.2	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	2.4	2.7	2.6
Inflation	3.3	3.2	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:

	2019	2018	2017
Male	23.9	24.9	24.8
Female	26.3	27.3	27.2

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

	2019	2018	2017
Male	25.0	26.3	26.2
Female	28.1	29.6	29.5

25. RETIREMENT BENEFIT OBLIGATIONS CONTINUED

The sensitivities regarding the principal assumptions used to measure the schemes' liabilities are:

	Change in assumption	Impact on schemes' liabilities
Rate of increase in pensionable pay	+/- 0.5%	+/- 0.6%
Rate of increase in current and future pensions	+/- 0.5%	+/- 6.5%
Rate used to discount schemes' liabilities	+/- 0.5%	+/- 9.7%
Inflation	+/- 0.5%	+/- 6.7%
Life expectancy	+/- 1 year	+/- 4.8%

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:

	2019 £m	2018 £m
Present value of financial obligations	(659.4)	(639.7)
Fair value of plan assets	637.5	617.1
Net liability recognised in the balance sheet	**(21.9)**	**(22.6)**

The movement in the net defined benefit obligation over the accounting period is as follows:

			2019			**2018**
	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	**(639.7)**	**617.1**	**(22.6)**	**(658.6)**	**626.3**	**(32.3)**
Current service cost	(5.6)	-	(5.6)	(6.0)	-	(6.0)
Interest (expense)/income	(17.0)	16.2	(0.8)	(16.6)	15.8	(0.8)
Past service cost and gains and losses on settlements	(1.9)	-	(1.9)	(0.7)	-	(0.7)
	(24.5)	**16.2**	**(8.3)**	**(23.3)**	**15.8**	**(7.5)**
Remeasurements:						
Return/(loss) on plan assets excluding amounts included in interest expense	-	13.9	13.9	-	(5.3)	(5.3)
Gain from change in demographic assumptions	28.9	-	28.9	-	-	-
(Loss)/gain from change in financial assumptions	(48.9)	-	(48.9)	17.5	-	17.5
Experience losses	(0.1)	-	(0.1)	-	-	-
	(20.1)	**13.9**	**(6.2)**	**17.5**	**(5.3)**	**12.2**
Contributions:						
Employers	-	15.2	15.2	-	5.0	5.0
Payments from plans:						
Benefit payments	24.9	(24.9)	-	24.7	(24.7)	-
	24.9	**(9.7)**	**15.2**	**24.7**	**(19.7)**	**5.0**
At 31 March	**(659.4)**	**637.5**	**(21.9)**	**(639.7)**	**617.1**	**(22.6)**

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).

25. RETIREMENT BENEFIT OBLIGATIONS CONTINUED

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

	2019			2018		
	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	121.6	-	19	121.2	-	20
Property	55.5	-	9	45.3	7.6	9
Bonds	303.5	-	48	305.7	-	50
Diversified Growth Fund	101.1	-	16	101.7	-	16
Insurance linked securities	41.5	-	6	33.0	-	5
Other	14.3	-	2	2.6	-	-
	637.5	**-**	**100**	**609.5**	**7.6**	**100**

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

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 last triennial actuarial valuation of the principal defined benefit scheme was at 31 March 2016. The 31 March 2019 valuation is in progress. The Company made a deficit recovery contribution of £11.4 million to the main scheme during the year (2017/18: £nil). Pennon Group plc monitors funding levels on an annual basis and expects to pay total contributions of around £11 million during the year ended 31 March 2020. This is in line with our K6 commitments.

26. CURRENT TAX (LIABILITIES)/ASSET

	2019 £m	2018 £m
Current year creditor	(16.4)	(14.8)
Prior year tax items	1.1	15.5
At 31 March	**(15.3)**	**0.7**

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:

	2019 £m	2018 £m
At 1 April	**231.3**	**220.0**
Charged to the income statement	1.0	5.6
Charged/(credited) to other comprehensive income / equity	(1.5)	5.7
At 31 March	**230.8**	**231.3**

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 liability 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 2017	**234.6**
Charged to the income statement	5.9
At 31 March 2018	**240.5**
Charged to the income statement	0.2
At 31 March 2019	**240.7**

Deferred tax assets

	Provisions £m	Retirement benefit obligations £m	Derivatives £m	Share based payments £m	Total £m
At 31 March 2017	**(2.0)**	**(5.3)**	**(6.5)**	**(0.8)**	**(14.6)**
(Credit)/charge to income statement	-	(0.5)	-	0.2	(0.3)
Charge to other comprehensive income/equity	-	2.0	3.5	0.2	5.7
At 31 March 2018	**(2.0)**	**(3.8)**	**(3.0)**	**(0.4)**	**(9.2)**
(Credit)/charge to income statement	1.0	(0.2)	-	-	0.8
Charge 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)**

The deferred tax credited/(charged) to other comprehensive income/equity during the year was:

	2019 £m	2018 £m
Actuarial gains on defined benefit schemes	1.1	(2.0)
Share-based payments	0.1	(0.2)
Cash-flow hedges	0.3	(3.5)
	1.5	**(5.7)**

27. DEFERRED TAX LIABILITIES CONTINUED

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 8% up to 100% in certain instances, with most items qualifying at either 8% or 18% per annum. The 8% rate reduces to 6% from April 2019.

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 environmental provisions and retirement benefit obligations 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.

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

	2019 £m	2018 £m
Restructuring		
At 1 April	**2.7**	**4.9**
Utilised during year	(1.6)	(2.2)
At 31 March	**1.1**	**2.7**

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

29. CALLED UP SHARE CAPITAL

	2019 £m	2018 £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	
			2019	2018
29 June 2011	536p	2014 – 2018	-	15
29 June 2012	588p	2015 – 2017	-	1
03 July 2013	538p	2016 – 2018	-	54
14 July 2014	611p	2017 – 2019	79	83
24 June 2015	683p	2018 – 2020	106	476
29 June 2016	709p	2019 – 2021	212	271
28 June 2017	767p	2020 – 2022	191	279
03 July 2018	635p	2021 – 2023	702	-
			1,290	**1,179**

30. EMPLOYEE SHARE SCHEMES CONTINUED

i) Sharesave Scheme (continued)

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

	2019 Number of Ordinary shares (thousands)	2019 Weighted average exercise price per share (p)	2018 Number of Ordinary shares (thousands)	2018 Weighted average exercise price per share (p)
At 1 April	1,179	695	1,294	658
Granted	726	635	316	767
Exercised	(406)	658	(258)	590
Expired	(209)	719	(173)	703
At 31 March	**1,290**	**669**	**1,179**	**695**

The weighted average share price at the date of exercise of Sharesave options during the year was 750p (2017/18: 798p). The options outstanding at 31 March 2019 had a weighted average exercise price of 669p (31 March 2018: 695p) and a weighted average remaining contractual life of 2.1 years (31 March 2018: 1.5 years).

The aggregate fair value of Sharesave options granted during the year was £0.4 million (2017/18: £0.9 million), determined using the Black-Scholes valuation model. The significant inputs into the valuation model, at the date of issue of the options, were:

	2019	2018
Weighted average share price	801p	848p
Weighted average exercise price	635p	767p
Expected volatility	20.0%	19.0%
Expected life	3.4 years	3.4 years
Risk free rate	0.5%	0.3%
Expected dividend yield	5.2%	4.5%

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

ii) Performance and Co-investment Plan

Executive Directors and Senior Management receive a conditional award of Ordinary shares in 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:

	2019 Number of Ordinary shares (thousands)	2019 Weighted average exercise price per share (p)	2018 Number of Ordinary shares (thousands)	2018 Weighted average exercise price per share (p)
At 1 April	127	869	183	847
Vested	-	-	(8)	799
Lapsed	(59)	810	(48)	799
At 31 March	**68**	**920**	**127**	**869**

The awards outstanding at 31 March 2019 had a weighted average exercise price of 920p (31 March 2018: 869p) and a weighted average remaining contractual life of 0.3 years (31 March 2018: 0.8 years).

No awards were granted during the year.

30. EMPLOYEE SHARE SCHEMES CONTINUED

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:

		2019		2018
	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	86	803	-	-
Granted	66	790	86	803
Lapsed	(12)	803	-	-
At 31 March	**140**	**797**	**86**	**803**

The awards outstanding at 31 March 2019 had a weighted average exercise price of 797p (31 March 2018: 803p) and a weighted average remaining contractual life of 1.8 years (31 March 2018: 2.4 years).

The aggregate fair value of awards granted during the year was £0.2 million (2017/18: £0.4 million), determined from market value. No option pricing methodology is applied since the vesting of the shares depend on non-market performance vesting conditions.

iv) Annual Incentive Bonus Plan – Deferred Shares

Awards under the plan to Executive Directors and Senior Management involve the release of Ordinary shares in 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:

		2019		2018
	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	130	845	143	845
Granted	51	761	57	809
Vested	(34)	790	(17)	821
Transferred to Pennon	-	-	(52)	-
Lapsed	(7)	808	(1)	843
At 31 March	**140**	**830**	**130**	**845**

The awards outstanding at 31 March 2019 had a weighted average price of 830p (31 March 2018: 845p) and a weighted average remaining contractual life of 1.5 years (31 March 2018: 1.6 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 £0.4 million (2017/18: £0.5 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 2017	**(29.6)**	**343.9**	**314.3**
Profit for the year	-	148.4	148.4
Other comprehensive income for the year	17.1	10.2	27.3
Dividends paid	-	(120.3)	(120.3)
Share-based payments (net of tax)	-	0.8	0.8
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**

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:

	2019 £m	2018 £m
Continuing operations		
Profit for the year	149.4	148.4
Adjustments for:		
Share based payments	1.0	1.0
Deferred income released to profits	-	(0.3)
Profit on disposal of property, plant and equipment	(1.7)	(2.4)
Depreciation charge	115.5	112.9
Amortisation of intangible fixed assets	0.5	0.5
Finance income	(2.3)	(1.2)
Finance costs	72.8	68.5
Taxation	29.2	31.4
Non-underlying provision charge	1.9	-
Changes in working capital:		
Decrease in inventories	-	0.4
Increase in trade and other receivables	(26.5)	(12.4)
Increase in trade and other payables	18.1	6.9
(Decrease)/increase in retirement benefit obligations	(9.6)	1.7
Decrease in provisions	(1.6)	(2.1)
Cash generated from operations	**346.7**	**353.3**

33. NET BORROWINGS

	2019 £m	2018 £m
Cash and cash deposits	**329.4**	**226.9**
Borrowings – current		
Other current borrowings	(35.0)	(32.0)
Finance lease obligations	(52.9)	(16.1)
Total current borrowings	**(87.9)**	**(48.1)**
Borrowings – non-current		
Other non-current borrowings	(954.7)	(927.6)
Finance lease obligations	(1349.4)	(1,319.3)
Total non-current borrowings	**(2,304.1)**	**(2,246.9)**
Total net borrowings	**(2,062.6)**	**(2,068.1)**

34. OPERATING LEASE COMMITMENTS

The future aggregate minimum lease payments under non-cancellable operating leases are:

	2019 £m	2018 £m
Within 1 year	2.0	1.9
Over 1 year and less than 5 years	7.5	7.1
Over 5 years	46.3	46.8
	55.8	**55.8**

35. CONTINGENT LIABILITIES

	2019 £m	2018 £m
Guarantee of borrowings of subsidiary undertaking	410.5	401.7

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.

36. CAPITAL COMMITMENTS

	2019 £m	2018 £m
Contracted but not provided	68.1	80.4

37. RELATED PARTY TRANSACTIONS

	2019 £m	2018 £m
Parent company		
Purchase of goods and services		
– Group expenses	1.1	5.6
Payment for provision of finance		
- Loan interest	-	0.1
Sale of goods and services		
– Administrative services	8.0	0.5
Dividends paid	123.1	120.3

	2019 £m	2018 £m
Subsidiaries of the Company		
Purchase of goods and services		
– Property consultancy	0.2	0.4
– Billing and collection services	9.8	9.7
Payment for provision of finance		
– Loan interest	18.2	19.4
Sale of goods and services (administrative services)	1.3	1.5

	2019 £m	2018 £m
Fellow subsidiaries of the Pennon Group		
Purchase of goods and services		
– Management charges	2.1	2.6
– Waste disposal	0.3	0.2
Sale of goods and services		
– Non-household services	119.5	126.0
– Tankered waste and trade effluent charges	4.6	0.3

	2019 £m	2018 £m
Year end balances		
Borrowings		
– Loan from subsidiary	420.3	411.3
– Finance lease balances with fellow subsidiary	0.2	0.5
Receivables		
– Subsidiaries	-	0.1
– Fellow subsidiaries	19.0	13.2
Payables		
– Parent company	4.3	-
– Subsidiaries	3.4	3.8
– Fellow subsidiaries	1.6	0.1

38. 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.